Magna International Inc.: Firing on All Cylinders

Description

Magna International Inc. (TSX:MG)(NYSE:MGA) is a leading global automotive supplier with over 320 manufacturing operations, approximately 100 product development centres, and sales offices in over 30 countries. Despite recent weakness in the automotive sector, last week Magna reported impressive fourth-quarter results. The company's revenues and earnings topped analysts' expectations, growing by 12% and 19%, respectively, over last year's fourth quarter.

Magna generated free cash flow (FCF) of $585 million in the quarter and $1.2 billion FCF in 2017. These are blowout numbers, and it's impressive that FCF is the main reason for the company's massive return of capital to the shareholder program. Along with fourth-quarter earnings, the company announced a hefty 20% dividend increase. Income investors should be salivating at Magna's dividend-growth potential. Since its nine-year dividend-growth streak began, it has consistently grown dividends by double digits.

Investors can expect this trend to continue, as its payout ratio is still only 15%, which is below the company's targeted earnings-payout ratio of 20%. If you prefer share buybacks, Magna has you covered. In 2017, the company repurchased a total of 26.3 million shares for $1.3 billion. The end result of its 2017 share-repurchase program was a 6% decrease in the weighted average number of diluted shares outstanding.

The sizable dividend increase and the earnings beat sent the stock soaring to 52-week highs. Despite touching new highs, Magna is still significantly undervalued. The company's current price-to-earnings (P/E) ratio of 9.4 is below its normal P/E ratio 10.8 and well below the industry average of 20.51. Its forward P/E is a low 8.39, and its P/E-to-growth (PEG) ratio is 0.69. A PEG below one signifies that the company's share price is not keeping up with expected earnings and is considered undervalued.

Despite an outlook for relatively flat auto sales, Magna has guided to above-market growth through 2020. At the mid-point of 2020's sales guidance, sales are expected to reach $44.2 billion for a compound annual growth rate of approximately 5%.

Bottom line

At its current share price, Magna provides great value and is an attractive income play. The company is a cash machine and has a very shareholder-friendly capital-return program. Dividends are increasing at double digits, and an investor's yield on cost can potentially double within five years. The company has an excellent track record of growing organically through the launch of new product segments. Earnings growth is also fueled by its significant share-buyback program. Magna continues to deliver, and at such cheap forward valuations, it's a solid investment.

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