1 Leading Stock to Steer Clear of in This Trade War

Description

Magna (TSX:MG)(NYSE:MGA) has fared better than its peers in the automotive parts and equipment industry in the past year. However, the rising trade tensions between North America and China pose a risk to its bottom line.

In the last quarter, Magna, which is the largest automotive supplier in North America and fourth-largest in the world, reported net income of $554 million. Revenue totaled $9.62 billion, up from $8.86 billion in the same quarter last year. The company designs and manufactures automotive systems and components primarily for sale to OEMs of cars and light trucks.

While sales remain healthy, trade tensions continue to jeopardize the company's performance. Earlier in 2018, concerns over a new NAFTA deal and the announcement by **General Motors** (GM) that it intends to shutter five North American plants weighed heavily on all Canadian suppliers.

The effect of the new NAFTA

The United States-Mexico-Canada Agreement (USMCA) was officially signed as a replacement to NAFTA in late November. Declared in Canada as the new NAFTA, Canadian auto parts manufacturers gave a collective sigh of relief when the terms of the revised deal were made public. Earlier drafts of the agreement were reported to include crippling demands on automotive suppliers dealing with American auto makers.

Reported previous versions of the deal included tariffs up to 25% on any auto part entering the United States. Other drafts proposed that 50% of all parts going into American vehicles must be made in the country.

The final document, which eased the restrictions reported in previous versions of the deal, was welcome news to all suppliers in Canada. Under the guidelines of the new NAFTA, 75 % of a vehicle's parts must originate in North America. In addition, 70% of the steel and aluminum used in the parts must originate in North America and at least 40% of the parts must be made at plants paying workers a minimum of $16 per hour.

Under the less-restrictive terms of the finalized deal, Magna should see little to no effect on its business.

GM plans to idle plants in North America

The decision by GM to cease production at five North American plants, including one in Oshawa, Ontario, will affect all North American auto parts manufacturers. In the past few days, a notice filed with the Ohio Department of Job and Family Services states that Magna's Lordstown Seating Systems will be closed due to GM's decision to shutter the nearby Chevrolet Cruze facility.

While the full impact of GM's announcement on its vendors will take time to gauge, the consequences are likely to be limited to those facilities closest in proximity to the plants scheduled for closure.

The ongoing threat of tariffs

The on-again, off-again talk of a trade war between China and the United States is of major concern to all players in the auto industry.

On the latest earnings call, Magna's CEO Donald J. Walter admitted that the tariffs could impose more pressure to the supply chain and "lots of moving pieces make the situation quite complicated."

Vincent J. Galifi, executive vice-president and CFO of Magna, added, "As we look at it, it all depends on what happens to the rate of tariffs coming in from China. Try to fast-forward to 2019, that impact could be above $15 million a quarter. But what happens if this goes to 25%, if the U.S. tariffs go away, retaliatory tariffs go away? A bunch of open questions at this point."

Although most analysts remain bullish on the stock and the risks from the NAFTA deal and the GM closures have been curtailed, I would urge caution until the ongoing threat of a trade war is alleviated.

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