



This Auto Parts Company Is One of the Best Bargains on the TSX

Description

Auto suppliers have all seen their stocks decline recently for a number of reasons. First, the dispute between the U.S and China has investors worried that there may be a continued slowdown in global growth if the two biggest economies can't make a trade deal. Second, Q1 2019 was a poor performing quarter for light vehicle sales; each month was down year over year from 2018, and the sector was down 1.8% for the quarter.

Despite this, there are still some attractive auto suppliers trading at bargain prices. Last week I wrote about how **Linamar** was trading at just [five times forward earnings](#). Additionally, another auto supplier that looks like it could be a steal is **Martinrea International Inc** ([TSX:MRE](#)).

Martinrea is a leading tier one auto supplier focusing on lightweight structures and propulsion systems. The company's main products include powertrain, chassis components and fluid management systems.

In North America, about 75% of Martinrea's production is SUVs and trucks. Going forward, management expects this portion of business to increase, bringing its exposure to larger vehicles up to 85%-90%.

How Martinrea has performed

The adjusted operating income margin has been growing consistently for Martinrea; currently it's at 7.8%. Management believes they can continue to increase the margin by implementing operational improvements as well as evolving the manufacturing process. The company is also making itself more flexible in order to improve efficiencies regardless of the demand the assembly plants are dealing with.

The new and more efficient process will require about 20% less workers and 20% less floor space and will also reduce the waste the company generates. In addition, the company estimates that it will save about 40% of the capital currently being used in the old process. Martinrea believes that these changes will lead to a big improvement in efficiency and it's aiming to grow operating margins to over 9% by 2020.

Financial performance

In addition to the growing margins, Martinrea's operating cash flow has also been increasing and now sits at \$475 million. This is a major improvement, up 100% from 2013. Net earnings and adjusted earnings per share have also been growing at an impressive rate, more than doubling since 2014.

In addition to its operational and financial improvements, the company has also been reducing its debt on an earnings before interest, taxes, depreciation and amortization (EBITDA) basis. The net debt to adjusted EBITDA ratio from the trailing 12 months has been steadily decreasing, especially as EBITDA has been increasing. Net debt to adjusted EBITDA is currently just under 1.6 times earnings.

The company pays a small dividend that currently yields 1.7%. Additionally, it has begun to repurchase some of its shares. This is a solid strategy, as the outlook for global demand looks bleak in the short-term. Instead of investing money into additional capex, the company is using its excess cash to buy the stock back at a discount.

Economics and risks

The economics surrounding the industry still remain mostly positive. Lower oil prices translate to lower fuel prices and have been incentivizing consumers to buy larger vehicles.

The main risks to the company include a downturn in the credit market or continued negative demand. The credit market is paramount to auto sales, as most consumers need to finance their purchases. Although the credit market has remained strong until now, if it was impacted negatively and began to dry up, auto sales would see a huge impact.

Additionally, demand could fall off naturally, especially if there is a revision from the ultra-low unemployment rates, or the decline in global demand is bigger and happens faster than the market is expecting. Demand could also be impacted as ride sharing programs gain more popularity, leading to reduced demand for future vehicle purchases.

Bottom line

All in all, Martinrea is a well-run company trading at rock bottom prices, just 4.2 times forward earnings and 3.2 times cash flow. If you believe in continued growth in the auto sector for the long term, then it's one of the best opportunities available to investors.

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