Why Magna International Stock Is Worth the Risk

Description

Magna International (TSX:MG) stock just reported its fourth-quarter (Q4) and full-year 2022 earnings results last Friday. The stock reacted by falling 17% on Friday. This is the kind of volatility, which is one type of risk, that investors must be able to stomach. In addition to reporting its earnings results, Magna also provided its 2023 outlook, which likely contributed to the stock volatility.

If anything, Magna's dividend increase of 2% this month should boost investors' confidence. It has maintained a dividend-growth streak of about 13 years with a three-year dividend-growth rate of 7.2%. The recent quotation leads to a dividend yield of about 3.3%.

Let's take a look at the auto parts company's 2022 results (instead of its Q4 results) to get a better understanding of the bigger picture.

Magna International stock's 2022 results

Magna's chief executive officer, Swamy Kotagiri, listed challenges that the cyclical company experienced in 2022, including high inflation, geopolitical issues contributing to unprecedented European energy prices, and original equipment manufacturer (OEM) production schedule volatility.

For the year, Magna increased sales by 4% to US$37,840 million. Income from operations before income taxes declined by 55% to US$878 million. As a result, net income dropped 61% to US$592 million, and diluted earnings per share (EPS) fell 59% to US$2.03. As quoted from the press release, the income was pressured from "net losses on the revaluation of certain public and private company warrants and equity investments, a loss on the sale of a business operation, and restructuring and impairment costs." So, this measure of income doesn't illustrate its business earnings power well.

Perhaps a better measure of its business performance is the adjusted earnings before interest and taxes (EBIT), which came in 19% lower at US$1,662 million, and the adjusted EPS, which was 20% lower at US$4.10. These measures were weighed by higher production input costs, such as energy, commodity, labour, and freight costs, inefficiencies and other costs at certain underperforming facilities, higher engineering costs related to its electrification and Advanced Driver-Assistance Systems (ADAS) businesses, among other factors.

Its outlook for 2023 and beyond

Magna management provided its 2023 outlook, including sales of US$39.6 to US$41.2 billion and adjusted EBIT margin of 4.1% to 5.1%. Based on the midpoint of its guidance, its fair price is approximately US$52 per share assuming a target price-to-earnings ratio of 11, which is roughly the normal long-term multiple of the cyclical stock.

Based on data today, management also shared its best guess on where the company might be in 2025. It expects sales to be at US$44.7 to US$47.2 billion and adjusted EBIT margin to improve to 6.7% to 7.8%. Based on the low end of this guidance, its 2025 target price is about US$90 per share, which implies total returns potential of about 20% per year over the next three years or so.

Why Magna International stock may be worth the risk?

Investors absolutely must have a big appetite for risk if they take a position in Magna International stock, given the downside it displayed last Friday. However, the consumer discretionary stock could also display strong upside during an economic expansion.

Given where we're at in the economic cycle — potentially running into a recession this year in Canada and the United States — 2023 could be a good year to accumulate shares in the dividend stock on dips. You should have an investment horizon of three to five years to allow the turnaround thesis to potentially play out, though.

Does Magna stock sound too risky to you? Then consider the best Canadian stocks to buy.

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kayng