Recommendation: Hold
MGA

Price: $77.17
Price Target: $68
Downside: -11.9%

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Valuation Highlights

Industry	Consumer Discretionary
Market Cap	$23.094B
52 Week Range	22.75 - 77.59
AVG Volume	863,957
Dividend (yield)	$1.60
P/E (ttm)	50.70
P/E (fwd 1yr)	12.64
P/Sales (ttm)	0.74
P/B (mrq)	2.20
EV	$26.98B

Financial Highlights

Revenue (ttm) Gross	$31.474B
Profit (ttm)	$3.935B
Gross Margin	12.50%
EBITDA (ttm)	$2.595B
EBITDA Margin	8.24%
Net Income (ttm)	$0.459B
Net Margin	1.46%
Diluted EPS (ttm)	$1.57
Total Cash (mrq)	$1.498B
Total Debt (mrq)	$3.832B
Debt / Equity (mrq)	0.37
Current Ratio (mrq)	1.29
BV per/share (mrq)	$34.13
ROE (ttm)	4.37%
ROA (ttm)	1.80%

Operating Revenues ($ Millions)

	Q1	Q2	Q3	Q4	FY
2017	8,900	9,140	8,864	9,684	36,588
y/y	–	–	–	–	–
2018	10,792	10,280	9,618	10,137	40,827
y/y	*17.5%*	*11.1%*	*7.8%*	*4.5%*	*10.4%*
2019	10,591	10,126	9,319	9,395	39,431
y/y	*-1.9%*	*-1.5%*	*-3.2%*	*-7.9%*	*-3.5%*
2020	8,657	4,293	9,129	10,120	32,199
y/y	*-22.3%*	*-135.9%*	*-2.1%*	*7.2%*	*-22.5%*
2021	9,176	9,445	9,312	10,727	38,660
y/y	*6.0%*	*120.0%*	*2.0%*	*6.0%*	*16.7%*
2022	9,589	9,870	9,731	11,210	40,399
y/y	*4.5%*	*4.5%*	*4.5%*	*4.5%*	*4.3%*

Note: values in red represent analyst estimates

Diluted EPS

	Q1	Q2	Q3	Q4	FY
2017	$ 1.51	$ 1.44	$ 1.38	$ 1.54	$ 5.87
y/y	–	–	–	–	–
2018	$ 1.83	$ 1.77	$ 1.62	$ 1.39	$ 6.61
y/y	*17.5%*	*18.6%*	*14.8%*	*-10.8%*	*11.2%*
2019	$ 3.39	$ 1.42	$ (0.75)	$ 1.53	$ 4.06
y/y	*99.9%*	*47.8%*	*-14.1%*	*285.3%*	*-62.8%*
2020	$ 0.86	$ (2.17)	$ 1.35	$ 1.40	$ 1.44
y/y	*-294.2%*	*165.4%*	*155.6%*	*-9.3%*	*-181.9%*
2021	$ 0.96	$ 1.95	$ 1.40	$ 1.46	$ 5.78
y/y	*12.0%*	*-190.0%*	*4.0%*	*4.0%*	*75.1%*
2022	$ 1.01	$ 2.04	$ 1.47	$ 1.52	$ 6.05
y/y	*4.5%*	*4.5%*	*4.5%*	*4.5%*	*4.5%*

Note: values in red represent analyst estimates

Sources: Bloomberg, Yahoo Finance, Macrotrends

Magna International (MGA)

Recommending a HOLD Rating for MGA

Market Power: Magna is a leading provider of auto parts for a number of large automotive companies, and their contracts with these firms results in financial stability and success.

Technology Expansion: Magna is pivoting their business to provide more autonomous vehicle (AV) technology, which is a rapidly growing sector of the automotive market.

Joint Ventures: Through strategic partnerships with technology companies, MGA is able to provide a more sophisticated suite of product offerings, particularly in the AV market.

Short-term Overvaluation: MGA remains 13.4% overvalued in spite of improving cash flows, which is to be expected in the current overconfident market; however, this could lead to an eventual price decline.

New Management: MGA's former CTO is taking over as CEO, with intentions to leverage his technological background to usher Magna into a more tech-focused firm.

Management Confidence: Management has undergone $1.3 billion in share repurchases over 3 years and consistently increased their yearly dividend.

Debt Increases: Magna has been increasing their amount of long term debt recently, despite their CapEx and R&D expenses remaining stable. This could indicate decreasing ability to manage costs.

Figure 1: Competitor Breakdown

Vendor	Sales	% Sales in NA
Robert Bosch GmbH	$49.52B	17%
Denso Corp.	$42.79B	23%
Magna International Inc.	$40.82B	50%
Continental AG	$37.80B	28%

Figure 2: Revenue Breakdown by Business Segment

Segment	Sales	% Sales
Body Exteriors/Structures	$16.45B	41%
Power & Vision	$11.31B	28%
Seating Systems	$5.58B	14%
Complete Vehicles	$6.71B	17%
	$40.05B*	

*Revenue discrepancy with Fig 1 due to Corporate & Investment sales

Figure 3: Demand for new vehicles during 2008 recession

Source: St. Louis FRED

Company Overview

Magna International (MGA) is a Canadian mobility technology and auto parts manufacturer that provides automotive materials to most major auto manufacturers such as GM, Toyota, and Ford. The firm produces car bodies and supporting structures, power trains and movement technology, and seating systems, as well as recent forays into self-driving technology systems. Founded in 1957 and headquartered in Aurora, Canada, MGA employs 169,000 workers globally.

Magna operates primarily in 2 markets, North America and Europe, and is looking to expand its business in Asia. Their largest segment is North America, with their sales of $19.3B representing 49% of the total, with European sales lagging slightly behind at 44% ($17.3B). Across their 4 sales segments, body exteriors drives their core revenue, but is trailed closely by their ‘power and vision’ segment, as demand for such products has grown by 4% over the past 3 years (*Fig 2*).

Magna’s management team recently underwent some changes, as their CEO of 15 years retired at the end of 2020 and was replaced by a 21-year company veteran: Swamy Kotagiri. Kotagiri, who once headed the R&D department before becoming CTO, is expected to help the firm usher in an era of new automotive technology that aligns with market trends. He is joined by Vincent Galifi, CFO, and Tommy Skudutis, COO, both of whom have been at the firm for over 10 years. There have been no major insider transactions since 2018.

Revenues have been slowly increasing over the past 10 years, up until early 2020 where the COVID pandemic caused a huge decrease in demand for vehicles. They have maintained a gross margin of around 13% for the past 10+ years, as the auto part manufacturing industry has a high price elasticity of demand due to large competitors. Additionally, production costs are highly optimized in the industry, which has led to a stable, if low, operating margin of around 5.5%.

Industry Overview

Magna operates in the consumer discretionary sector, though more closely aligns with trends in the auto parts manufacturing sub-industry. The industry is made up of several large firms, which leverage economies of scale to mass-produce parts that are generally sold at just above manufacturing cost, as the automakers hold most of the bargaining power. Magna competes largely against other multinational producers, such as Bosch, Denso, and Continental, where these major producers contend for high-value contracts with the major automakers to produce specific parts or entire proprietary systems for auto lines. Minor producers usually are not able to match the cost leadership of larger firms, so instead they compete to sell specialized or innovative products to the major players.

On of the major threats to the industry is extremely high revenue volatility. Demand for auto parts is intrinsically tied to demand for automobiles, which falls by as much as 45% during major recessionary periods (*Fig 3*). This can have a massive impact on the income streams of auto parts manufacturers. Additionally, purchases of raw materials or key inputs makes up over 60% of their costs, which adds further volatility through increased costs based on metal prices. Minimum wage increases due to the Biden administration may result in higher costs, as well as increased unionization of labor workers

Industry Overview (cont.)

that could increase wages further. Generally, however, costs are not expected to increase substantially, though R&D spend may increase to keep pace with industry trends. All growth will likely come from top-line increases through new product offerings or items with greater profit margins, such as self-driving technology or luxury seating systems.

The sector overall is expected to grow by 5.9% annually between 2020-2025. Revenues have been slowly declining over the past 5 years, accelerated by the extremely weak demand for new vehicles brought on by the pandemic and associated economic stagnation. However, the end of the pandemic is expected to result in increased consumer confidence and disposable income, which will increase personal spending and drive auto sales (and thus auto parts sales) higher.

Financial Analysis

It has been a difficult year for Magna, as COVID has resulted a sizable decrease in EPS (projected to be -180% year-over-year). This was accompanied by a steep revenue drop for the same quarter, down 58.7%, as auto manufacturers waited to renew contracts or halted production altogether. 2021 sales estimates hover around $38.5B, which still represents a decline of 2% from pre-pandemic 2019, as uncertainty surrounding the end of the pandemic will result in slightly lower sales. EPS is expected to return to pre-COVID levels of $6.51.

Throughout the past 5 years, MGA has been increasing their levels of long term debt, up 86% to $6.1B since 2015 (*Fig 4*). This is usually an indicator that a firm is either struggling to generate cash (and thus relies on debt) or that they are reinvesting in the firm. As CapEx has not risen proportional to the debt amount, this is a negative sign for the firm's financial health. However, MGA's net debt is only 0.69 times EBITDA, and as their EBIT (28.2x net debt) can easily cover interest expense, they aren't in any short-term financial danger. It will be important to monitor how MGA manages their debt over the next 3-5 years.

Interestingly, despite overall industry decline and relatively flat gross profit, free cash flows have been rising substantially over the past 5 years (252% since 2015). This indicator is contrary to the previous, as growing FCFs are generally an excellent signal of the company's growth. This largely comes from non-operational activities, as net income has remained relatively stable as depreciation has been growing at a rapid rate, leading us to the increase in FCF. Thus, recently improvements in MGA's financial health are largely due to enhancements in financial management rather than operational excellence.

Future Growth Opportunities

Autonomous Section Growth: With the advent of Tesla as the pioneer of self-driving technology, many other companies have realized the immense profit opportunity through the production of autonomous vehicles. However, starting an autonomous vehicle (AV) division is a massive R&D undertaking for most companies, and many are opting to either outsource production to other firms or acquire autonomous technology companies. This represents a sizeable opportunity for Magna, as the increase in autonomous vehicle demand (12.8% CAGR expected

Earnings Surprise

QTR	Est.	Actual	% Surp
Q4 20	$1.35	$1.95	30.8%
Q3 20	($2.03)	($1.71)	18.7%
Q2 20	$0.74	$0.86	14.0%
Q1 20	$1.32	$1.41	6.4%
Q4 19	$1.38	$1.41	2.1%
Q3 19	$1.54	$1.59	3.1%
Q2 19	$1.73	$1.63	-6.1%
Q1 19	$1.60	$1.63	1.8%
Q4 18	$1.49	$1.56	4.5%
Q3 18	$1.74	$1.67	-4.2%
Q2 18	$1.66	$1.84	9.8%
Q1 18	$1.58	$1.57	-0.6%
Q4 17	$1.31	$1.36	3.7%
Q3 17	$1.47	$1.48	0.7%
Q2 17	$1.34	$1.53	12.4%
Q1 17	$1.38	$1.24	-11.3%

Figure 4: Balance Sheet Debt Analysis

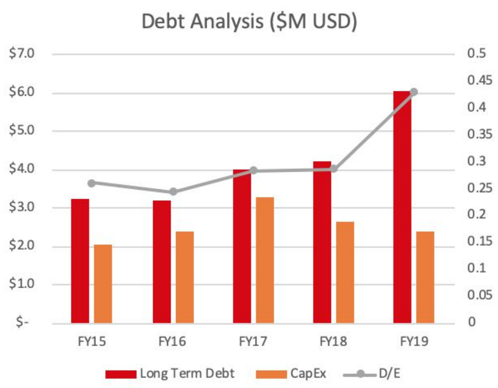
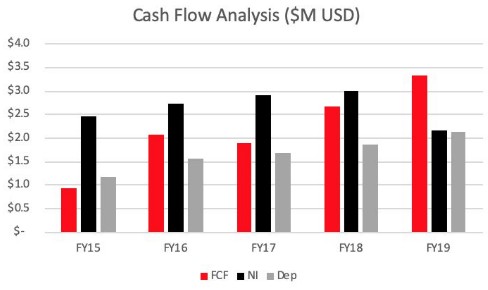


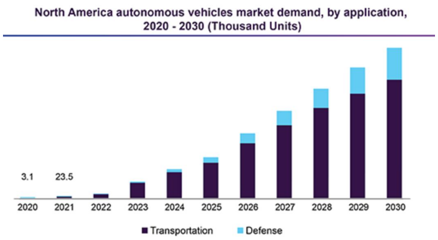
Figure 5: Free Cash Flow



Future Growth Opportunities (cont.)

over 2 years, 17.8% 2023+) will result in a corresponding demand in this profitable new segment of business (*Fig 6*). Their MAX4 technology already has been implemented in cars such as the Chevy Volt, Mazda 6, and Cadillac ATS, and is expected to be added a range of vehicles throughout the next 3 years.

Figure 6: AV Demand



Source: Grandview Research

Joint Ventures: Magna International has a history of partnerships with a number of high-growth technology firms. Previously, they have worked with Lyft to develop autonomous technology, a partnership that ended late 2020 due to lagging Lyft sales. They recently announced a new partnership with LG electronics to co-create new electric powertrains, representing yet another foray into electric car manufacturing. Magna's ability to partner with industry-leading firms is a great driver of growth, and their LG partnership may result in improved product offerings and increased sales.

Sustainability Efforts: As knowledge of climate change has become more widespread over the past few decades, public opinion has swayed away from non-renewables and towards more environmentally-friendly methods of power generation. As consumers continue to demand sustainable goods and services, manufacturers must respond by revamping their operations to match customer sentiment. Major motor companies like GM, Toyota, and Ford have pledged to go carbon neutral within 20 years, which will require a corresponding ESG effort for all their suppliers. With Magna's industry-leading sustainability efforts through solar and microgrid technology, they are well positioned to capture a greater market share from firms adapting to the changing times.

Valuation Analysis

MGA is currently trading 5% below their 52-week high, which is in line with comparables. They trade at a discount on EBITDA and revenue multiples relative to peers, with earnings multiples at a slight premium. Their forward P/E of 12.56x is well below subsector average of 35.0x*, while their PEG of 4.89x is much higher than the subsector average of 1.32x. They also have slightly smaller EBITDA margins of 8.74%, compared to 10.68% for industry.

Additionally, MGA dividends have been rising consistently for the past 11 years. They average an 12% yearly increase in dividends, which currently results in a 3.5% dividend yield. This consistent dividend growth represents an opportunity for the investor, as it not only results in improved returns over time but also indicates management's confidence in company performance (further supported by $1.3B in management share repurchases over 3 yrs).

Determining the fair value of MGA using 2020 FCF proved difficult, as their FCF is currently negative (despite FCF of $2.70B in 2019) due to the massive sales slump brought on by the pandemic. Our price target was derived using a 3-stage FCF method. This model was utilized to account for the moderate revenue recovery throughout 2021 (-18% from 2019, +480% from 2020) and accelerated revenue growth in post-pandemic 2022 (9.3%), with a 4.5% CAGR from 2023 on. Discounted using the 9.2% WACC, we arrived at a fair valuation of $68. This represents a potential 11.9% downside; however, given the consistent overvaluation across the market (77% using Mkt Cap/GDP), we don't believe this downside warrants a sell. Instead, we rate MGA Hold, and will continue to monitor their financials in relation to the market.

*Yardeni Research Inc. https://www.yardeni.com/pub/mktbriefsppesecind.pdf

Recommendation Risks

This hold recommendation brings with it both upside and downside risk. Magna International, as a company that is heavily reliant on economic health and the purchasing power of consumers, is subject to strong market risk. With a beta of 1.52, an economic downturn could cause a sizeable slide in the stock price to the aforementioned fair value. However, the stock has been trending upward in the months following the initial lockdown, and coronavirus recovery efforts are slowly restoring consumer confidence and purchasing power. These are likely to drive increase vehicle sales and thus improve the demand for Magna's goods and services, which represents a substantial upside over the next 1-2 years.