Income Investors: How to Get Double-Digit Yields From Bombardier Inc.

Description

There haven't been many investments worse than **Bombardier Inc.** (TSX:BBD.B) over the last few months.

Since shares of the beleaguered maker of planes and trains peaked at close to $4.40 each back in late 2014, they've been absolutely decimated, falling more than 60% to the current price of just $1.63 per share. Needless to say, that's not a move any shareholder wants to see.

Although much of the company's weakness has stemmed from the debacle that is the CSeries program, these days investors are more worried about something else, namely the company's upcoming cash crunch. To put it bluntly, investors are concerned Bombardier's management has wasted so much money that bankruptcy is only the natural conclusion.

At the beginning of the year Bombardier told investors it had about $3 billion in cash. After the first two quarters, it had $3.6 billion in cash, which is a marked improvement. Except the company raised more than $3 billion during the first quarter by issuing massive amounts of new debt and nearly 500 million new shares. Net it all out, and Bombardier burned through approximately $2.4 billion in cash during the first six months of the year.

At this pace, the company looks to run out of cash sometime in the first half of 2016, which is right around when the CSeries is scheduled to begin deliveries to customers. Obviously, the market is a little concerned with the timing of this.

If this is the case, why would anyone want to buy Bombardier? Well, it turns out it's not quite as bad as it first seems.

Upcoming IPO

Bombardier's management knows the company needs more cash. They've found a solution, which is to spin off a portion of the more stable transportation division that makes subway cars and locomotives.

The company plans to list approximately 20% of the transportation business later this year, most likely on the Frankfurt Stock Exchange. Nobody knows just how much the transportation division will fetch from the market, but estimates have pegged the whole division as being worth $10 billion. So, we'll assume the transaction will net the company $2 billion.

That, combined with the reigning in of some of its spending in the second half of the year, should be enough for Bombardier to survive until it finally starts generating some cash from CSeries sales. And if not, the Quebec provincial government looks ready to provide the company with emergency financing.

Income investors, take note

This weakness has created an opportunity for income investors who are comfortable taking on some risk.

Investors have been fleeing Bombardier bonds and preferred shares en masse, worried about the bankruptcy risk. This has pushed up the yields on these securities to eye-popping levels, especially in today's low interest rate world.

Take the Bombardier Series 4 preferred shares, trading under the ticker symbol BBD.PR.C. These shares are currently trading at about half of the issue price of $25, which is pushed the yield up to 12.7%. Or, to put it another way, that's more than 15 times higher than the yield for the five-year Government of Canada bond.

Yes, there's definitely risk involved in buying Bombardier preferred shares; that much is obvious. There's a very real possibility that the company could stop paying the dividend, since it already cut the dividend to common shares earlier this year. But for a 12.7% yield, many investors might be willing to bet that Bombardier won't have to go the bankruptcy route.

Management knows that if the company stops paying its preferred share dividends, spurned investors would be unlikely to give it anywhere close to attractive yields on the preferred share market ever again. Plus, such an event would cause investors to lose confidence in the company's ability to stave off bankruptcy. In short, suspending preferred share dividends is something the company wants very much to avoid doing.

Bombardier's preferred shares are hardly safe, but the yield is enough to entice some investors. The preferred shares could be an interesting opportunity for someone who's looking to speculate a little. If the company manages a way to get out of its current troubles, these shares could go much higher. That potential, combined with the succulent yield, makes the preferred shares look pretty interesting.

CATEGORY

1. Dividend Stocks
2. Investing

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1. TSX:BBD.B (Bombardier)

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