Bombardier, Inc.: Be Prepared for This Company to Go to Zero

Description

The demise of **Bombardier, Inc.** (TSX:BBD.B) has been one of Canada's biggest business news stories.

By now, just about every Canadian investor has a pretty good idea of what's gone wrong with the maker of planes and trains. Cost overruns in its ambitious new CSeries line of regional jets has stretched the company's already overleveraged balance sheet to its limit. Bombardier is now is serious danger of running out of cash, even after getting a bailout worth US$1 billion from the Quebec government.

This could have been avoided, of course. Bombardier's management consistently did what every business owner knows is deadly–overpromising and underdelivering. It told customers CSeries jets would originally be ready sometime in 2014. Several delays later, suddenly we're close to 2016 without a single delivery to customers who have been very patient considering the circumstances.

These customers reacted the same way any logical human would. If Bombardier can't be counted on to deliver jets on time, then they'd simply take their business elsewhere. Both **Boeing** and **Airbus** have regional jets airlines are already familiar with, and they actually deliver the goods when promised.

If Bombardier can find a way to raise the capital needed to see the CSeries to market–I estimate it'll need at least US$2 billion in additional capital, maybe more–then it still has to deal with getting orders in a competitive market. It's not going to be easy.

In short, there's still a lot of work for the company to do to just avoid bankruptcy. A recovery past that could just be wishful thinking.

The opportunity

It might sound completely insane after you've read the first part of this article, but I still think there's a potential opportunity in Bombardier shares.

Look at it this way. Yes, there's a chance the company goes bankrupt. You could even say it's a good chance, and I wouldn't disagree with you. But if the company avoids bankruptcy, you could be looking at a huge gain.

Say Bombardier has a 33% chance of recovering to $5 per share. This seems like a very ambitious price target for a company trading barely above $1, but keep in mind it traded above $5 as recently as 2013. Thus, you'd have a 33% chance of making 400% on your money, and a 66% chance of the stock going to zero. If you did this three times with companies with equal risk-to-reward ratios, you'd lose your entire investment twice.

But the third time would more than make up for it. You'd take your initial investment and increase it by 400%. Your whole portfolio would still increase 66% even after the other two investments went to zero.

This is why you have to keep any exposure to Bombardier (or companies like it) as a small percentage of your overall portfolio because there's a very real possibility the investment could go to zero.

If you take a basket approach and buy Bombardier as well as other companies with similar risk/reward profiles, you can create an interesting lottery ticket type of investment for a small part of your portfolio. You'll undoubtedly buy some duds that go to zero, with the potential that Bombardier could end up being one of them. But as an overall basket approach, it could be an interesting way to generate market-beating returns.

CATEGORY

1. Investing

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1. Editor's Choice

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1. TSX:BBD.B (Bombardier)

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