What Is Bombardier, Inc.'s Future as a Penny Stock?

Description

Last Wednesday, for the first time in 25 years, **Bombardier, Inc.** (TSX:BBD.B) shares closed below $1 as shareholders grew more frustrated about the lack of CSeries orders. Then the next day the company's stock sank once again as worries grew about Bombardier's status in the **S&P/TSX Composite** index.

We take a closer look below.

The significance of $1

In order for a security to be added to the TSX Composite, it "must have a minimum [volume-weighted average price] of CAD$1 over the past three months and over the last three trading days of the month-end prior to the quarterly review." Once the security is already added, the "three trading days" requirement is no longer needed for the security to remain.

So in plain English, Bombardier's shares must average at least $1 over each three-month period (the current one expires in February), otherwise it will no longer qualify for the index's inclusion.

If Bombardier's share price stays at $0.90 throughout February, then its average price over the current three-month period will be roughly $1.08. Thus the shares would need to depreciate further for index expulsion in March. But, of course, the shares would then have to recover in the following quarter.

And this has significant implications for the share price. If Bombardier is no longer a part of the TSX Composite, then index-oriented investors (including some big institutions) will be forced to sell their Bombardier holdings. That would drive the stock price further down.

Normally, we wouldn't get so concerned about short-term share-price movements. But Bombardier is trying to raise money from the federal government, and if its share price sinks much lower, the company would probably have to accept worse terms.

Just to illustrate, the Quebec government received 200 million Bombardier stock options when it invested $1 billion in the CSeries program (at a strike price of $2.21). If Canada asks for similar options, then Bombardier’s current share price will make a big difference in those negotiations.

Another option for Bombardier

There is a way for Bombardier to avoid this mess: a reverse stock split. For instance, if the company underwent a 1-10 split, then the number of shares would decline by 90%, and each share would trade for 10 times as much.

Companies usually like to avoid this tactic, since it can be a sign of desperation. But Bombardier is already in such a precarious state anyways; bad optics are the least of its worries.

Stay focused on the long term

Unlike Bombardier’s other share-price declines, this latest one seems unjustified. Even if Bombardier were in danger of being ejected, there are ways for the company to avoid this fate.

So if you’re a shareholder of Bombardier, then the company’s long-term strategy is what’s most important. If it succeeds, then you’ll still make a lot of money, no matter what happens with the TSX index. I wish you good luck.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BBD.B (Bombardier)

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