



Bombardier, Inc.: Why Is Air Canada Interested in the CSeries?

Description

Bombardier, Inc. ([TSX:BBD.B](#)) shares got a big boost when **Air Canada** ([TSX:AC](#))(TSX:AC.B) signed a letter of intent for 45 CS300 jets with an option for 30 more. Assuming this gets converted into a firm order, it would be worth up to US\$3.8 billion at list prices and would give the CSeries some much-needed credibility with North American airlines.

But not all of this optimism may be warranted.

A significant discount

After Bombardier launched the CSeries program in 2008, the company's larger competitors reacted fiercely. Airbus and **Boeing Co.** put new engines on their flagship single-aisle planes and began offering them at heavy discounts.

Bombardier refused to offer the same kind of discounts on the CSeries, arguing that the premium plane deserved a premium price tag. When fuel prices plunged in 2014 and 2015, this approach became a serious problem for Bombardier, because it diminished the fuel-efficiency advantage that came with the CSeries. This is a big reason why Bombardier hasn't been able to secure any firm CSeries orders since September 2014.

Late last year though, it looked like Bombardier was willing to offer discounts on the CSeries. And according to *The Globe and Mail*, Air Canada is paying only about US\$30 million for each aircraft, a discount of almost 60%.

This may look like a smart move on Bombardier's part, but it comes with other problems. Chairman Pierre Beaudoin has pointed out that once you offer discounts on a plane, it becomes difficult to ever charge a premium price again. And worse still, Bombardier has admitted the CSeries won't generate positive cash flow until 2020. This makes one wonder just how much profit the company can generate when giving such discounts.

Some government incentives

As part of the deal, the government of Quebec will drop a lawsuit it filed against Air Canada for not honouring a commitment to keep some heavy aircraft maintenance work in Montreal. The lawsuit alleged that Air Canada had breached the 1988 Air Canada Public Participation Act, which stipulates that the airline is required to perform maintenance in certain parts of Quebec. Air Canada has also agreed to perform heavy maintenance on its CSeries planes in Quebec for at least 20 years.

Furthermore, the government of Canada agreed to modify the Act, something that Air Canada had been clamouring for. Canadian transport minister Marc Garneau insisted that other than this promise, Air Canada was not pressured into purchasing the CSeries.

But this also presents a problem for Bombardier, since its competitors will label these government actions as protectionism. In other words, Boeing and Airbus will surely claim that Air Canada only bought these planes because of government interference. This could prevent the CSeries from gaining serious credibility in the United States.

All in all, the deal looks like a very good one for Air Canada. Whether or not Bombardier's shareholders win is another matter.

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