Why You Should Forget About Bombardier, Inc. and Buy its Largest CSeries Customer Instead

Description

Bombardier, Inc. (TSX:BBD) has no shortage of bad news for its investors recently. The company recently posted a US$5.3 billion loss for 2015 and also announced the layoff of 7,000 employees. This is why the recent good news that **Air Canada** (TSX:AC)(TSX:AC.B) placed a fairly large CSeries order sent shares soaring over 40% in the days after the announcement.

The news is positive for Bombardier; after almost year and a half with no firm CSeries orders, Air Canada provided a letter of intent for a firm order of 45 C300 aircraft with the option to purchase up to 30 more and deliveries expected in 2019.

While a large order from a major airline may give investors confidence in the CSeries program, it does little to improve the overall fundamentals of Bombardier or reduce the risk of it as an investment. For investors, the real opportunity lies in Air Canada stock itself.

Like Bombardier, Air Canada is in the middle of a transformation, but unlike Bombardier, this transformation has been extremely successful so far and has very good odds of continuing, which could send shares up significantly.

Bombardier is a very high-risk turnaround opportunity

One of the main reasons investors buy Bombardier is for its potential as a turnaround play. Bombardier has found some recent success in this effort. The company's recent layoffs and cuts to business jet production emphasized management's right-sizing of the organization and focus on cost cutting.

In addition, concerns about the balance sheet are improving. Investments by the Quebec Pension Board and Quebec government will give Bombardier about $6.5 billion of liquidity to work with. Despite this, the real concerns about Bombardier still remain—mainly whether or not the CSeries can actually compete with peers like Airbus, Boeing, or Embraer.

Boeing and Airbus have quickly moved into the market created by the CSeries; Airbus came out with the competing A320Neo family of aircraft, and Boeing came out with the 737 MAX aircraft. These companies not only provide aircraft that airlines are already familiar with, but also a product that easily competes with Bombardiers CSeries aircraft on nearly every level.

Bombardier’s turnaround depends on its ability to book more firm orders for CSeries aircraft. Currently, Bombardier is short of the goal it set for 300 CSeries firm orders by the time the C100 aircraft enters into service in the next few months. Since nobody is sure how popular the CSeries will be, Bombardier is very high risk.

Air Canada is a lower-risk turnaround opportunity

Like Bombardier, Air Canada is also midway through a transformation, and it has so far been extremely successful. Over the past 10 years, Air Canada has gone to bankruptcy court (in 2003) and almost went bankrupt again only a few years ago.

The company had a massive $4 billion pension shortfall, fuel costs were rising, and it was in the middle of intense labour struggles. As a result, Air Canada shares fell into penny-stock territory. Since then, Air Canada has eliminated its pension shortfall, reduced its debt (from 3.4 times equity in 2010-2012 to 2.5 times at the end of 2015), and improved its margins from 11.5% in 2010-2012 to 18.3% at the end of 2015.

Air Canada has been successful in reaching the targets it set out, and going forward it has even more ambitious targets. The main target is that Air Canada is aiming to reduce its CASM (costs per available seat mile) by 21% by 2018 from 2012 levels.

If Air Canada can achieve these cost-reduction targets, shares can increase substantially. Air Canada has shown significant progress in reaching targets so far, and Air Canada recently reached new flexible labour agreements, which will support it in reaching its cost-reduction targets.

Air Canada is currently undervalued compared with its peers, and reaching these goals could close the valuation gap. Air Canada represents a low-risk turnaround opportunity compared with Bombardier, and investors should consider Air Canada shares as an alternative in the aerospace sector.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:AC (Air Canada)
2. TSX:BBD.B (Bombardier)

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/08/25
Date Created
2016/02/26
Author
amancini