Bombardier, Inc. Has a New Cost-Cutting Plan: Outsourcing

Description

If current conditions persist, **Bombardier, Inc.** (TSX:BBD.B) won't be able to survive much longer. That's why this week the company's unionized workforce agreed to outsource some production to lower-cost countries.

According to *The Star*, "Bombardier has made it clear to workers that it is struggling to be competitive with rival ATR, a joint French-Italian venture, whose turboprops are cheaper than the Q400. The company has landed few orders for the Q400 in recent months, so it wants to send work on the cockpit to China and the wing to Mexico, to cut costs."

The deal approval is a testament to Bombardier's rapidly deteriorating financial position. Just last October the union voted down the proposal with 72% of workers voting against it.

In all, Bombardier expects to outsource roughly 200 jobs. How important is this step in ensuring the company's long-term survival?

Trying its best

This year Bombardier management received a slew of good news–a big reason why shares have nearly doubled since the year began.

In April **Chorus Aviation Inc.** announced that it signed a firm purchase agreement to acquire five CRJ900 regional jets from Bombardier with purchase rights for five additional aircraft. Another $184 million deal was made with Trident Jet Ltd. for four CRJ900 aircraft. Its biggest deals, however, came from major airline carriers. This year, it received an order for 45 CSeries jets from **Air Canada** in addition to a deal with **Delta Air Lines** for 125 CSeries jets (75 initial orders and an option for 50 more).

This month, the orders continued to roll in. On June 1 **WestJet Airlines Ltd.** signed a firm order for nine Bombardier Q400 turboprops. Just this week the company announced that it signed a firm purchase agreement for 10 CRJ900 aircraft with an unidentified customer. The deal is worth about $472 million based on list prices, but planes are often discounted.

Apart from aviation, the company also recently announced that it won a contract to supply 43 trains to European rail operator Abellio Rail Südwest for US$244 million.

Not so fast

Sure, Bombardier is selling more aircraft than expected this year, but that doesn’t necessarily mean a return to profitability. Industry sources estimate that the company’s biggest deal yet, Delta’s 75 plane order, included discounts as high as 75%. The heavy discounts were necessary given equally aggressive pricing from other manufacturers such as **Airbus Group SE**, **Boeing Co**, and **Embraer SA**.

Looking at industry trends, these larger and more profitable competitors aren’t going to let Bombardier compete very easily.

Earlier this year Boeing gave **United Continental Holdings Inc.** a 75% discount on its 737NG jet. If Boeing is willing to give similar discounts, it’s difficult to see how Bombardier can compete. For example, Boeing’s deal with United blocks smaller rivals like Bombardier from contributing to the airline’s fleet. Basically, Boeing used its bargaining power to create an exclusivity agreement. In December **Southwest Airlines Co** struck a similar deal with Boeing and ordered 33 aircraft.

For United, Southwest, and other airlines, this type of deal makes sense. Boeing has one of the widest offerings of jets and can offer incredibly attractive prices given its economies of scale. In the end, Bombardier’s cost-cutting moves will only help if it can continue to sell planes. However, if it’s forced to sell at incredibly discounted prices–a distinct possibility–a return to profitability will be nearly impossible.

CATEGORY

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1. TSX:BBD.B (Bombardier)

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