Should You Buy Bombardier, Inc. Ahead of Earnings?

Description

Bombardier, Inc. (TSX:BBD.B) cruised through the first half of 2016 rather smoothly much to everyone's relief. And as of Q2 2016, Bombardier's rebound seems to be on track. The company reported fresh liquidity on a pro forma basis of $4.9 billion in cash and equivalents and initiated tough job cuts to bolster its margins, while reaffirming 2016 revenue guidance, albeit to the softer side of its $16.5-17.5 billion range.

There is also the CSeries order the company inked with **Delta Airlines**; the Global 7000 is on schedule, and a refinancing deal has pushed debt maturities out to 2018.

So the worst might be over for Canada's largest aerospace/transportation company, but before you buy the shares, take note of the following risks.

Business jet segment continues to face prolonged weakness

While the company should be lauded for its 11th hour CSeries contract with Delta, it doesn't mean that it's going to be clear skies ahead. For example, in Q2 Bombardier warned of continued softness in the business jet space, citing prolonged weakness across the global economy.

Business jet headwinds have also led to questions about the future of Learjet, which continues to struggle, by Bombardier's own admission, in a "highly competitive" and "oversupplied" market. For example, in Q1 of this year, the company delivered six Learjets compared to 15 the year before. To be honest, it wouldn't surprise me if Bombardier unloaded Learjet to a willing buyer (such as Cessna-maker Textron Inc.) at a loss to generate much-needed cash flow.

Competitive headwinds expected to pressure prices/margins

I'm a bit skeptical of the CSeries's prospects in the face of such low jet fuel prices, which diminish the incentives for airlines to upgrade to more fuel-efficient models. Moreover, Bombardier faces aggressive levels of competition from Airbus and **Boeing**, which have largely cornered the narrow-body market for the past two decades through their size and economies of scale.

As a newcomer, Bombardier will no doubt feel pricing pressure as it looks to retain its spot in this very competitive space. Therefore, you can expect significant concessions and pressure on its margins going forward. In the aggressive price war that awaits Bombardier, any supply-chain setback will be viewed as a weakness, and each missed delivery will merely incentivize clients to stick to the incumbents. This brings me to the last point.

Potential of dilution from further government injections

Bombardier is heavily dependent on government liquidity. Perhaps so much so that the company could not have competed for the CSeries contracts without a government lifeline. Although the Feds have voiced their support of further investments by stating, “it’s not a matter of if, but when,” talks are still on going for a $1 billion injection, perhaps by way of additional BBD warrants. If that’s the case, then expect further dilution for current shareholders.

The bottom line

Right now, Bombardier is in a wait-and-see mode. Yes, the CSeries has emerged as a viable competitor to Boeing’s 737 and Airbus’s A320, but can Bombardier actually win more contracts and make its deliveries while derisking itself? Currently, the company is expected to be cash flow neutral in 2018; I say wait until then.

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