Is Bombardier Doomed?

Description

Many Canadian investors are attracted to **Bombardier Inc.** (TSX:BBD.B) shares for a few different reasons.

Perhaps the biggest bull signal is the company's status as a protected asset. When it was facing a potential bankruptcy a couple of years ago, you might remember both the Quebec and federal governments stepped in and offered assistance.

There are very few other Canadian companies that could get a bailout if they were close to bankruptcy. Bombardier is one of them. This helps protect equity investors on the downside.

And then there's the cheap price and total return appreciation potential. It seems like Canadian investors love cheap stocks, as even a retail investor can control a few thousand shares without a huge capital commitment. And although Bombardier trades at just $2 per share, investors with long memories might remember shares trading above $7 each in 2011 or the days of the 1998-2000 tech bubble when shares spiked at over $20 each.

I'm not quite so sure, however. Here's why I'd be very wary buying Bombardier shares today.

Too much debt

Every now and again I succumb to temptation and take a look at Bombardier's preferred shares, issues that yield more than 9%. But I quickly change my mind after taking just a cursory glance at the balance sheet.

After its most recently concluded quarter, Bombardier's total debt stands at more than US$10 billion. Investors should note this figure doesn't include all the preferred shares outstanding. It also ignores Bombardier's pension shortfall, which currently sits at approximately US$2.6 billion.

Put all these numbers together and it paints a bleak picture for the company.

Management is doing the right thing in trying to get the debt down. The company recently sold its aircraft flight training subsidiary for a nice gain and is reportedly pursuing a sale of its regional jet business to Mitsubishi. And you likely remember the CSeries program, an asset that was sold to Airbus and renamed the A220. At least Bombardier retained a minority stake.

It's smart for management to exit the poor parts of the aviation business and put the cash generated back towards debt. I've long asserted that the transportation part of Bombardier was the crown jewel of the company. But there's so much debt I see it being a big problem for years — if not decades — to come.

What remains

While making subway cars and signing contracts to maintain subway fleets is a much better business than a persistently under-performing aviation division, investors are making a dire mistake if they think it's a good business.

Sure, there are things to like about the transportation division. It has a massive backlog, something that should persist as cities invest in public transport, which translates into plenty of steady revenue. And there is competition, but high costs to entry assure there won't ever be a sudden flood of new competitors to hit the market.

In its most recent quarter, the transportation division did US$2.1 billion in revenue and only made US$83 million in earnings before interest and taxes (EBIT). This gave it an unimpressive EBIT margin of just over 3%. Note that this was a bad quarter and EBIT margins for the division are generally in the 5-8% range.

I pay a lot of attention to profit margins, which I believe is an underrated piece of analysis. A company with pricing power can maintain high margins for a long period. A company with low margins doesn't have much room for error. Bombardier's transportation division is in the latter category.

The bottom line

Bombardier could work hard over the next decade and get its balance sheet back into decent shape. If this happens, the current shareholders would probably be pretty happy with how their investment did.

But remember, Bombardier has been pledging to get its balance sheet under control for the better part of a decade now. It just doesn't ever seem to happen, which is why I'm not optimistic about the future.

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