



## This Massive 9.6% Yield Comes From an Incredibly Unlikely Source

### Description

It's no secret I'm [not a fan](#) of **Bombardier** ([TSX:BBD.B](#)).

Although demand continues to be strong for the company's products — especially the transportation division — management can't seem to convert this steady revenue into profits. It seems like every few months, guidance is further cut, and the company announces its plan to achieve positive free cash flow has been pushed back ... yet again.

There's no doubt demand for rail cars will continue to be high, as more cities invest in greener transportation alternatives. But it's a tough business with several smart competitors. This all but ensures margins will be tight in the contracts Bombardier does win.

And then there's the aerospace division. Bombardier's management has done the smart thing and sold off many assets in the space, keeping a lot of the best assets, including the Learjet program. It seems to have a bit of an advantage in that specialty part of the aviation market, which is a positive. But I'm still not convinced the company has what it takes to be one of the finest in the industry, even as it focuses on what it does best.

The cash raised from the aviation asset sales will be plunked directly on the company's massive debt pile, which is further good news. Bombardier's balance sheet continues to be a mess, with the company's net debt still well over US\$6 billion. It desperately needs to repay some of those borrowings.

After all that, it might seem like I'd encourage investors to stay far away from Bombardier stock. That's only partially true. While I wouldn't touch common shares with a 10-foot pole — it's just too volatile for me, although more risk-adverse investors might want to bet on the turnaround — I think the preferred shares might be interesting.

### Why I prefer the preferreds

There are two main reasons why I think Bombardier's [preferred shares](#) are an interesting opportunity today.

Firstly, I firmly believe there's no way Bombardier will ever go bankrupt. Any subsequent financial issues will be a repeat of 2015-16, when the company hit up both the federal and Quebec governments for a bailout. People were mad — especially folks out west — but it didn't change anything. Federal politicians knew the company's importance in Quebec and cut a cheque.

Secondly, Bombardier is on the cusp of improving its balance sheet pretty significantly, thanks to the aforementioned asset sales in the aviation part of the business. If the company can generate any significant cash flow from the transportation business, that'll help too. Yet the preferred shares aren't giving the company any credit for these improvements. In fact, yields on the preferred shares have actually increased since it announced the sale of its commercial aircraft division to Mitsubishi back in June.

The preferred shares that I think are the most interesting are the company's Series 3 preferred shares, which trade under the ticker symbol BBD.PR.D. These shares pay a quarterly dividend of just under \$0.25 each, which works out to an annualized yield of 9.6%.

Bombardier pays out a mere US\$20 million per year in preferred share dividends. It generated enough free cash flow to easily afford this in 2018. The company also has more than US\$3 billion worth of cash on its balance sheet. This all translates into one of the safer +9% yields you'll find.

Things would have to get pretty dire for Bombardier to interrupt preferred share dividends, too. That sends a very dire message to the market, one top management wants to avoid at all costs.

And finally, investors should remember that these preferred shares are taxed as dividends. This means they're equivalent to a 10-15% yield in interest, depending on your tax bracket. That makes these preferred shares a very interesting choice.

## The bottom line

Bombardier's common stock is a little too risky for me, even after it sold off some non-core parts. I just don't really like the remaining assets enough to buy the common stock.

But the preferred shares are much more enticing. They offer succulent yields, good security, and potential upside, as the company turns around. Combine the yield and potential capital gains, and these preferred shares have the possibility of turning out to be a lucrative opportunity.

### CATEGORY

1. Dividend Stocks
2. Investing

### TICKERS GLOBAL

1. TSX:BBD.B (Bombardier)

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### **Date**

2025/07/03

### **Date Created**

2019/11/24

### **Author**

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