Bombardier (TSX:BBD.B) Stock: Don’t Catch This Falling Knife

Description

Bombardier (TSX:BBD.B) stock is witnessing immense selling pressure ever since it announced the sale of its Transportation division to Alstom. Meanwhile, a market sell-off amid fears of coronavirus spreading beyond China isn’t helping Bombardier’s case either. Bombardier stock has fallen by 57% so far this year. Meanwhile, it is down about 72% from its 52-week high of $2.93.

Why the market hates Bombardier stock

To give a background, cash-strapped Bombardier is finding ways to deleverage its balance sheet by divesting businesses. Notably, the company has a mountain of debt to be paid in the coming years. Bombardier’s adjusted-debt-to-adjusted-EBITDA ratio stood at 10.9 times at the end of 2019. However, the company is not generating enough cash. Divestiture of the Transportation division will enable Bombardier to pay off a significant portion of its debt and focus on the core Aviation segment. The company expects that the deal will provide it with enough ammo to drive profitable growth in the future.

In the first instance, the idea seems fair to divest assets and underperforming businesses to reduce debt. However, this is where the problem is. Bombardier generates more than half of its revenues from the Transportation division. In 2019, Bombardier posted revenues of $15.8 billion, out of which the Transportation segment contributed $8.3 billion. Meanwhile, the Aviation segment added $7.5 billion. In terms of backlog, the Transportation segment had an order backlog of $35.8 billion, while the Aviation segment had an order backlog of $16.3 billion.

Divestiture of the Transportation segment means Bombardier is exposing itself to a lot of risks. Investors are worried about how the company will fare with only one division, which is highly cyclical. The risk associated with the business aviation sector cannot be neglected, as an economic downturn could pose severe challenges.

Is the market overreacting?

The fundamental objective of Bombardier’s turnaround plan is to lower the debt load and infuse enough liquidity in the business to meet all contingencies. The company has successfully done that in the past. Bombardier sold its CRJ program and Aerostructures business, the proceeds from which helped in reducing net liabilities by $1 billion. The company's decision to exit from the loss-making commercial aircraft business and the commercial aerospace business turned out to be prudent for all stakeholders.

However, the question remains whether the divestiture of the Transportation segment makes sense for Bombardier's shareholders. The Transportation segment is facing production ramp-up challenges. Moreover, any delay in achieving technical milestones and software certifications results in additional costs for the company, which negatively impacts its cash flows.

If we look at the recent financial performance, the Aviation segment stands out on all fronts. The Aviation segment's revenues increased 2% in 2019, as compared to a 7% decline in the Transportation segment's revenues. Meanwhile, the Aviation segment's adjusted EBITDA increased 26% year over year, while adjusted EBITDA margin expanded by 200 basis points. In comparison, the Transportation segment's adjusted EBITDA plunged 75% year over year, while the adjusted EBITDA margin contracted by 690 basis points. The numbers indicate that the Transportation division is a drag on Bombardier's financial performance.

The bottom line

Whether Bombardier's decision to sell the Transportation division will have a positive impact on its financials remains a wait-and-watch story. Meanwhile, investors should pause before rushing to buy the Bombardier stock until the business shows some meaningful growth and liquidity improves.

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