



Can the Bombardier-Alstom Deal Survive the Pandemic?

Description

Bombardier ([TSX:BBD.B](#)) has been one of the worst-hit companies, as the COVID-19 pandemic came at a crucial time when the company was about to stabilize its financial position. For the last six years, it has been accumulating debt to run its business, as delays in the CSeries aircraft pushed the company into huge losses. The Quebec government offered a \$1.3 billion bailout package to Bombardier in 2016, but the situation didn't improve. The company started off-loading its loss-making business to stabilize its finances. Its latest deal is to [sell Bombardier Transportation](#) to French train maker **Alstom** for €5.8-€6.2 billion. The agreement was signed in February, but the COVID-19 outbreak in March has put the deal in jeopardy.

Bombardier-Alstom deal is vital to both the parties

The Bombardier-Alstom deal is essential for both parties. It will double Alstom's revenue from €8 billion to €15.5 billion and make it the world's second-largest train manufacturer after China's CRRC. For Bombardier, the deal will inject up to US\$4.5 billion in cash, which it will use to deleverage its balance sheet.

Alstom signed the deal to benefit from the growth in the rail industry in European countries. Alstom is eyeing Bombardier Transportation's €32 billion order backlog. However, the pandemic has shifted the focus of world governments to health and safety, thereby delaying new orders. The pandemic-driven lockdown has disrupted production of both Alstom and Bombardier as well as their suppliers, causing delays in project execution. The disruption in production has also delayed cash payments from customers that are based on project milestones. Delays and production slowdown prove to be expensive in a capital-intensive business like trains.

The regulatory challenge

Setting aside the economic situation, the first major challenge for the Bombardier-Alstom deal is securing the European Union's approval. Last year, the regulator had blocked the Alstom-Siemens

merger over competition concerns in the mainline signalling and high-speed train markets. The Bombardier-Alstom deal will not increase the combined company's market share in a particular segment, but it will broaden its offerings with complementary products. The regulator's verdict will come in mid-July. It might either approve the deal or launch a four-month investigation. Any delays will only add to uncertainty and increase the cost of the transaction.

The pandemic has raised doubts around the Bombardier-Alstom deal

If Alstom secures the regulatory approval, the transaction is expected to complete by the first half of 2021. Had the economy been stable with no fears of recession looming, the deal could be completed smoothly. However, one year has now become a long time amid the uncertainty around the pandemic's magnitude, duration, and impact on the economy.

Bombardier's market capitalization has declined to \$1.3 billion in the last three months, thereby reducing its enterprise value. The current market environment has created uncertainty around new orders, forcing many capital-intensive companies to downsize. Business expansion will not generate profits unless the economy recovers and order volumes normalize. Moreover, companies are preserving cash and reducing costs to meet their working capital requirements amid demand weakness.

Alstom is currently net cash positive and has positive cash flows. It plans to raise capital through a rights issue and debt to fund the acquisition of Bombardier Transportation. But if the economy enters a period of recession, it will be difficult for Alstom to raise capital.

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So far, the two companies have stated that the deal is intact. But if the economic conditions worsen, Alstom might suspend or cancel the deal as the very reason, which is growth in train orders, will vanish.

Bombardier is already burning cash and is [on the verge of bankruptcy](#). It already has a non-investment grade credit rating, which makes it difficult for the company to restructure its debt. It needs the net proceeds from the Alstom deal to pay its US\$1.5 billion debt maturing next year. If Bombardier's bankruptcy is confirmed, Alstom could renegotiate the transaction price.

As the deal is crucial for both the parties, any update could see significant movements in their stock prices. Investors should stay away from Bombardier stock, as it is a rocky road with many bumps and troughs.

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