1 Discounted Stock Is About to Become Even More So

Description

Acquisitions are an important part of market transformation. It varies a lot from industry to industry and for market conditions. When the industry is thriving, a lot of new businesses enter the marketplace, and institutional investors and associated businesses try to divest into the thriving industry. But once an industry is in trouble, the long-term players tend to acquire troubled businesses for pennies on the dollar and wait for the dust to settle.

It's not always so mercenary, and a lot of acquisitions are partial — i.e., one company acquires part of another company, usually one complete business division. That's what happened in January when France-based manufacturing company and train maker **Alstom SA** bought **Bombardier's** (TSX:BBD.B) transportation business for $3.6 billion — $600 million of which is in Alstom shares.

The deal has been great for Bombardier stock so far, and it has risen over 36% in 2021 so far. But Alstom stock took a dive. And while the deal allowed Bombardier to reach its "repositioning" goal and focus solely on its jet business (in addition to helping it pay off debt), the positivity might not be reflected in Bombardier stock in the next few years.

Struggling commercial aviation industry

The commercial aviation industry suffered a lot in 2020, and while the scars may last for decades, the recovery is in sight — 2024 to be precise. An annual review for the global commercial aircraft market predicts that the industry will fully recover and reach pre-COVID levels by 2024.

But that's not all. The aviation industry is going through another transformation — i.e., planes are becoming greener and more environmentally friendly. Some market leaders are looking at a complete transformation by the early 2030s, which includes hydrogen-propelled jets and, hopefully, electric planes as well (though it might seem like a long shot at the moment).

The combined scope of two problems the commercial jet industry is facing places Bombardier in a less-than-ideal position.

A company heavily in debt

Bombardier has an imbalanced balance sheet. It has a total debt of about $12 billion, total liabilities of about $18 billion, and total assets of about $14.9 billion that includes the funds it got from selling one of its business segments to Alstom. The company isn't investing nearly enough in R&D to keep up with the changes the industry is going through.

For the first quarter of 2021, about 80% of its revenues came from aircraft sales and 20% from aftermarket services. The sales might not pick up pace in the next three years, and if the company uses the funds, it got from the sale to Alstom and become cash poor again, the financial statements of the coming quarters might become even more discouraging.

Foolish takeaway

The company is currently trading at a 9.8% premium from its pre-crash valuation and the price-to-earnings ratio of 4.8, making it an undervalued stock (in a way). It's difficult to predict where its valuation will go from here, but the stock might become discounted from its current (or future peak) if it starts tumbling down due to relatively poor returns. The debts are a major concern as well.

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Date
2025/07/04
Date Created
2021/07/15
Author
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