Value Investors: 1 Canadian Turnaround Stock That You Won't Regret Buying

### Description

The market rewards those who spend time in the market. Price momentum and trading volume will help you understand liquidity. A value investor makes investing decisions by looking at the stock price and the company's growth potential.



You can't grow rich by investing in what's popular today. You grow rich by investing in an underdog that could become popular tomorrow.

## A Canadian turnaround stock that could become large

A good place to find your underdog is in the turnaround story — big companies that took the fall and are working to return to glory. My turnaround pick for September 2022 is business jet maker **Bombardier** (TSX:BBD.B). This plane maker is the phoenix rising from the ashes.

Bombardier hit rock bottom in 2015 after its C-Series aircraft failed, pushing the company into multi-year losses and piling debt. A prolonged pandemic, amid mounting debt, and growing losses pushed the company near bankruptcy. But **Alstom** bought Bombardier's train business in 2021, and the plane maker used the deal proceeds to reduce and restructure its debt. It bought itself three years of no debt maturities, so it could concentrate on business.

The business jet segment was Bombardier's only profitable business and was affected by its other loss-making businesses. From 2021 began the turnaround. The recovery from the pandemic got Bombardier several orders for business jets. Moreover, the company launched its new Challenger 3500 business jets and is securing order wins. The multi-year restructuring has made Bombardier a pure-play business jet maker.

## Bombardier's turnaround to a pure-pay business jet maker

The new Bombardier is playing out its strengths, which is business jets, and it is winning. While its aircraft manufacturing revenue remained stable in the second quarter, it was the service revenue that stole the limelight. The removal of pandemic restrictions has increased the usage of business jets higher than pre-pandemic levels, leading to a growing demand for aftermarket service. Aftermarket takes care of maintenance, repair, and overhaul capacity of the planes that are in use.

Bombardier's multi-year growth plan includes increasing the share of aftermarket service that generates stable cash flow and enjoys a higher profit margin. Its second-quarter service revenue surged 22% year over year, increasing its revenue contribution to 23% from 19% a year ago.

Higher service revenue increased the second-quarter adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization) margin to 12.9% from 9.4% a year ago. The company used the profits to accelerate its debt repayments. Within a year, the new Bombardier reported profit, which the old Bombardier could not do for the last eight years. The company achieved its 2025 free cash flow (FCF) target of over US$500 million in the first, reporting US$514 million in FCF.

## Addressing the elephant in the room

Bombardier's management is not making the same mistake it did in 2014. It is not taking debt to fund its operations. The company is addressing the elephant in the room through accelerated deleveraging. It repaid US$773 million in debt year to date. The next debt maturity is US$510 million in December 2024, but it looks to repay the debt before maturity.



Bombardier has US$7 billion in long-term debt (spread through 2028) and US$1.4 billion in cash reserves. While this is not a strong balance sheet, the progress is tremendous. The company would use any free cash flow to reduce debt, thereby enhancing profitability through interest savings.

**Moody's** upgraded Bombardier's rating, which could help the business jet maker get favourable terms from creditors. Equity accounts for just 34% of the $9.4 billion enterprise value. If the company can maintain its EBITDA margins above 10%, it could reduce its leverage.

## Where is the value in this turnaround?

Bombardier still has a long way to recover, but it is on the right path. Value investing is finding a troubled company with strong management and business strategy. The second-quarter earnings showed that the management's aftermarket strategy works, and Bombardier has the resources to implement it efficiently.

Bombardier stock could fall in the short term but could rebound in the long term.

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