Bombardier Value Not All It Seems

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If you're the kind of person who likes to try to catch a falling knife for a thrill, **Bombardier** shares might be interesting.

Bombardier's is one of those stocks that most investors know well. If they didn't own it as it rose meteorlike in the 1990s, they wish they had. Some of them thought their chance had come after 9/11. But success only came to those who traded. High-flying stocks rarely fall straight down; they swoon, come back, drop again, rise on the backs of another round of speculators, then ultimately peter out.

Bombardier stock, at the current price, is quoted at about 10 times current earnings estimates. That sounds awfully cheap compared with the 30 times it fetched only a few years ago. But, in fact, today's multiple has a solid historical precedent. The high-PE days were relatively brief and highly correlated to the madness of crowds during the bull market.

Still, you might think 10 times earnings isn't bad, with a modest yield to boot. But there are problems; deep problems that no investor should ignore.

Bombardier's troubles with its train customers are no secret. Disagreements happen, but the spat with Amtrak, and the publicity it's generating, isn't good for business. The loss of the New York subway contract was also partly due to quality issues, although some analysts say Alstom, the contract winner, was very aggressive on pricing. Either way, in a highly leveraged business, these matters weigh heavily. In Europe, too, there are sales growth issues, which bodes ill for Bombardier's newly acquired Adtranz division.

The aerospace business is also in disarray, and although in this case it's an industry problem, the company's earnings power is under pressure.

According to UBS Warburg, 29 per cent of Bombardier's touted backlog is exposed to three feeder carriers of United Airlines, which said it was close to bankruptcy yesterday.

The difficulty lies in gauging the extent of the damage. Unfortunately, it's very hard, given the uncertainty, to get a handle on where earnings will go. That assumes the company's earnings quality is reliable, which is bold.

Bombardier's accounting can only be called aggressive, as **Veritas Investment Research's Anthony Scilipoti** has revealed. While most of the sell-side turned a blind eye, **Mr**. **Scilipoti** asked questions about pension assumptions, the accounting of the Adtranz takeover, vendor financing, interest income in the transportation division and so on.

He is a long-standing bear and he has been proven right. His advice: Look to the balance sheet. To do so is to see why the analyst remains bearish.

Bombardier's consolidated assets, as of April 30, totalled $29-billion. Liabilities amounted to $24.6-billion, leaving equity of $4.4-billion or $3.20 a share.

However, strip goodwill from the assets and you're left with book value of about $1.20 a share. Is it fair to strip the goodwill out? Given that most of it relates to Adtranz, which makes no money, it is probably wise. That's a thin reed of equity.

Bombardier has issued a fair amount of debt recently, which isn't surprising given how tough the industry has become. But if the company's forecasts are too rich -- it forecast $1.5-billion in free cash flow this year, which analysts are increasingly finding optimistic -- the debt levels will remain high.

Net debt to capital, including Bombardier Capital, has risen reliably for the past six years and now sits at 72 per cent, **Veritas** says. The company is financing more of its jet sales, the analyst adds.

We're not arguing that Bombardier should trade at book value, but it may not be a stretch to assume that the market equity might get closer to the hard book equity before the company sorts out its problems and the economy picks up.