THE GLOBE AND MAIL

February 8, 2016

A warning to Bombardier investors: Its debt metrics are the worst they've ever been

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Investor sentiment on Bombardier is as high as it's been in some time; this week's news that the federal government will provide cash support for the company's aircraft programs is the latest good news supporting a run that has seen the stock triple since it plunged below $1 a year ago.

The question of whether Bombardier has fixed its balance sheet, however, is another matter. The federal funding, coupled with a debt refinancing late last year, has undoubtedly eased the near-term pressure on the company. Investors should know, however, that the company's leverage metrics are as bad as they've ever been – and may not materially improve when the company releases its full-year results, an announcement slated for next week.

Let's review what's new and good: The $372.5-million interest-free "repayable contribution" from the federal government comes without Bombardier giving up any sort of dilutive stock warrants, as it provided to the province of Quebec as part of its $1-billion 2015 funding deal. (Those warrants are now in the money, thanks to Bombardier's rising share price.)

It's believed Bombardier could settle for less from the federal government in part because of its November offering of $1.4-billion (U.S.) in notes, due in 2021.

The company used the money to pay off a similar amount of debt that was coming due in 2018, giving the company three extra years to worry about how to pay off those obligations.

Here's a couple of things to know about these transactions, though. The federal money is not an imminent injection. Instead, it's expected to be received over the next four years, based on milestones in the development of its aircraft programs.

The November debt refinancing, as beneficial as it is to liquidity, came at a price: The new debt pays 8.75-per-cent annual interest (and were issued at a discount, making the effective rate closer to 9 per cent, notes ***Veritas Investment Research*** analyst ***Dan Fong***). The new notes replaced debt that paid 5.5 per cent and 7.5 per cent. That means the company's annual interest expense should be higher, not lower. And ***Mr. Fong*** also notes Bombardier has historically issued 10-year bonds, so it wasn't able to push out its maturity schedule as long as it might have otherwise.

The combination of these facts means that Bombardier doesn't necessarily have any less debt or more cash today than it did in November – and the results of the fourth quarter may erode its position, if the company remains free-cash-flow negative, as expected.

So for now, we can look the Sept. 30 balance sheet for a sense of Bombardier's position. Its ability to cover interest expense with its earnings (either EBITDA, earnings before interest, taxes, depreciation and amortization, or EBIT, earnings before interest and taxes) was at its worst point in the Sept. 30 quarter. Ratios of debt to EBITDA were better than in 2016's first quarter, but still much worse than at any time in 2015. At Sept. 30, Bombardier's Altman Z-score, an admittedly academic tool used to forecast bankruptcies, was well into the "danger zone" and at its worst level in the company's history.

Now, of course, the balance sheet is a backward-looking measure. What's driving the shares is, in large part, Bombardier management's assurances about break-even cash flows in 2018 and positive flows afterward. Analyst sentiment has turned much more positive, with 10 buys matching the 10 holds in the universe of 22 recommendations on the stock.

And if Bombardier can achieve its goals, the stock may advance well beyond today's closing price of $2.60 (Canadian). That remains a significant if, however, as ***Mr. Fong***, provider of one of the two sell ratings, says. "Call us skeptics, but given Bombardier's historically poor track record of financial performance and the many challenges the Company continues to face, we are not prepared to grant the Company all the operational improvements assumed in management's outlook."

Absent those improvements, focus will return to Bombardier's balance sheet, and what the company will have to do to once again repair it.