THE GLOBE AND MAIL

November 2, 2015

Bombardier stock price would collapse with federal bailout, analysts warn

Bombardier shareholders who have already seen the value of their investment crumble by two-thirds this year could be in for a further nasty shock if the incoming federal Liberal government tops up Quebec's $1-billion (U.S.) aid package, analysts warn.

In a note Monday, Canaccord Genuity analyst David Tyerman slashed his one-year stock price forecast on the company's class B subordinated shares to $1.10 (Canadian) from $1.35 – but cautioned that if prime-minister-designate Justin Trudeau answers the call from Quebec Economy Minister Jacques Daoust to match its aid pledge his stock price target would collapse to just 60 cents.

"We think the probability of such an outcome is low" – about a one-in-four chance, the analyst said in a note, but even that probability of a federal bailout "suggests significant downside share price risk," Mr. Tyerman said, in lowering his recommendation on the stock to sell from hold.

Bombardier's B shares fell 17 per cent last Thursday after the Quebec government promised $1-billion (U.S.) for a 49.5-per-cent stake in the company's troubled C Series airplane development program as well as 200 million warrants for the B stock, with a strike price of $2.21 a share (Canadian). The stock, which ended 2014 at $4.15, closed at $1.38, down 2.82 per cent on the day.

Veritas Investment Research analyst ***Varun Mehrotra*** said in a research note that existing shareholders, who had already seen the value of their investment diluted by nearly 22 per cent when Bombardier sold $940-million worth of equity last February, would see a further 8.3-per-cent dilution as a result of Quebec's equity deal if it exercised its warrants – "but more importantly, shareholders lose 50 per cent of any upside from the C Series while retaining existing balance sheet risk" as the company's debt is now at a high 5.1 times estimates of this year's operating earnings. Meanwhile, the Bombardier family would still retain slim majority voting control even with the latest dilution.

The struggling Quebec transportation giant is expected to burn through close to $3-billion (U.S.) in free cash in its aerospace business in the next three years as it continues to invest heavily in its aircraft programs. Its troubled C Series aircraft program isn't even expected to generate positive cash flow until the turn of the next decade as it burns $2-billion more in capital spending and books losses on initial orders, so even if the plane's popularity rises markedly, "it will not do much to alter Bombardier's exploding leverage," ***Mr. Mehrotra*** wrote.

The company continues to pursue opportunities to counter its liquidity crisis, including selling a minority stake in its passenger rail car manufacturing business. But "even with such desperate measures, we do not expect [Bombardier] to improve its liquidity much in the near term," ***Mr. Mehrotra*** said.

The situation turns even more dire for existing shareholders if the Canadian government matches Quebec's investment, Mr. Tyerman said. If it were to pay another $1-billion for a 49.5-per-cent stake in the C Series, Bombardier's shareholders "would receive 1 per cent of the C Series economics after having invested more than $4.8-billion" to fund the delayed, over budget airliner program, Mr. Tyerman said. Bombardier last week booked a $3.23-billion impairment charge against the C Series program cost – or 60 per cent of the total – as it reported a $4.9-billion third-quarter loss.

The Globe and Mail reported earlier this year that Bombardier had approached the Conservative government for $350-million (Canadian) in repayable loans. Last week, a Liberal spokesman said the government-in-waiting is being briefed on the file and will make a decision after being sworn in on Wednesday. Meanwhile, an Industry Canada spokesman said Bombardier has repaid just over 40 per cent of the $1.3-billion in repayable funds it has received from Ottawa over the years.