

Bombardier and its state aid from Quebec: How did it come to this?



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With a pledge to inject \$1-billion (U.S.) cash into Bombardier Inc. to get its flagship C Series jet to market, the province of Quebec has emerged as the company's fairy godmother. Now, the plane maker has to prove that as Cinderella, it's not a lost cause.

Montreal-based Bombardier was handed a billion-dollar liquidity lifeline by Quebec on Thursday, a strategic investment that will see the province take a 49.5-per-cent stake in the company's fledgling C Series plane program and obtain rights to buy 9 per cent of its outstanding shares. Quebec will ask the Canadian government to match its investment, Economy Minister Jacques Daoust said Friday.

At first glance, it's exactly what Bombardier needs: A significant funding source to push the plane into commercial service and reassure anyone who was anxious about the company's liquidity situation. At a time when the plane maker's revenue is highly challenged by weak orders and volatile economic conditions, it's a decision by Quebec to protect a strategic company "during a period of instability and transition," as National Bank Financial put it.

But industry observers fear government aid won't be the magic wand that ensures the success of Bombardier and its biggest-ever airplane. They argue that the company's big bet on the C Series could yet turn into a nightmare. And they're asking exactly how things got so bad at Bombardier that it had to resort to taxpayer support in the first place.

"Bombardier is desperate and it's unfortunate that the unsuspecting taxpayer is shouldering the burden for management's awful decision making," said Anthony Scilipoti, founder of Veritas Investment Research in Toronto. "What's the future? This aircraft isn't selling."

Eight months after taking over as chief executive officer in a shift of power that saw the founder's grandson, Pierre Beaudoin, become executive chairman, Alain Bellemare insists the plane and train maker is on the road to recovery.

A new slate of executives are in place. Corporate jet production has been scaled back to match demand. Products and programs not considered vital to long-term strategy are being stopped or sold. A deal to monetize a minority stake in the train business looms. Most importantly: The C Series is on the verge of its commercial debut with an accounting reset – as one analyst observed, the \$3.2-billion writedown Bombardier took on the program Thursday is roughly equal to the initial capital expenditure forecast for the aircraft's entire development.

“Don't underestimate the importance of having the government of Quebec with us as an investor in [that plane],” Mr. Bellemare told reporters in an interview Thursday, adding that potential customers wanted certainty that the company would be there in the long term to build out and support the aircraft. “It'll give us traction in the market.”

But where Bombardier and the government consider their deal a sign of strength and opportunity, many investors view it as further proof of a company in serious trouble. After all, if you're going to the government for funds instead of the capital markets, that says a lot about your currency with investors.

In this case, the argument goes, Bombardier concluded it couldn't repeat the share or debt sales it did earlier this year on favourable terms. So, the company went to the one place it knew it could win unconditional support without anyone questioning whether those who got the company into this mess – Bombardier's current board and controlling shareholders, the Beaudoin family – should really be given another chance at fixing it.

In Quebec they found a willing, if somewhat conflicted, financier. Helping Bombardier at a time when teachers are striking to denounce cuts to education budgets wasn't exactly the Couillard government's first choice. And there's likely more than one person in the Premier's cabinet who's simply against this type of corporate intervention.

Still, this is a company that has become a provincial icon, a symbol of French-Canadian power on the world scale and the anchor of Quebec's aerospace industry and its 41,000 high-paying jobs. That's why the government had no trouble backing Bombardier and it's why it would likely do so again. The only debate happening here is whether the terms of this specific deal were the right ones.

“The government was had,” said Quebec Opposition leader François Legault. “It's come out of this looking like a kid in short pants.”

Some analysts believe that's a description better suited to Bombardier itself.

In making a decision to build the C-Series, its largest aircraft yet, with 100 to 160 seats, Bombardier's board knew it would stir the attention of industry giants Boeing Co. and Airbus Group SE. Even if the C Series is the quiet, fuel-sipping workhorse people say it is, Bombardier could come out looking like the weak-muscl'd schoolboy in this battle of the bullies.

Against the smallest planes made by Boeing and Airbus, the C Series is expected to fare well. It has commanded 243 firm orders from carriers including Lufthansa subsidiary Swiss International Air Lines with the potential for dozens more in the near term if sales campaigns with potential customers, such as JetBlue and China Express Airlines, end in deals. In all, Bombardier forecasts a market of 7,000 aircraft in the 100- to 150-seat segment over the next 20 years.

But Bombardier's two larger rivals have been remarkably successful in persuading clients to upsize to their larger flagship narrow-body planes, namely the Boeing 737 and Airbus A320. And that has taken away potentially dozens of deals that could have gone to Bombardier. Airbus announced Friday that it plans to dramatically speed up production of the A320 to an industry-record 60 units a month by the middle of 2019.

It's been more than a year since Bombardier last won a C Series order. The company is being hurt in part by the low cost of oil, which is reviving the market for used aircraft at the expense of new planes, according to market research firm Forecast International.

Optimists argue that once Swiss starts flying the C Series, new sales could materialize as customers see the plane in action making money. But the plane's first test flight and the stockpile of performance data released this summer were also thought to be similar triggers that failed to deliver any new orders, says Bank of Nova Scotia analyst Turan Quettawala.

"The fundamental problem is that the product is nichey and many airlines have decided to [buy larger aircraft]" offered by Boeing and Airbus, Mr. Quettawala said. "That has, and is continuing to, negatively impact interest in the C Series."

Bombardier backers say there were also serious doubts about the company's decision to build its Canadair regional jets when it decided to get into that market in the 1990s. With 1,800 planes ordered and in service to date, the planes remain to this day arguably the country's single biggest aerospace product achievement.

"Would I bet against the Beaudoin family on strategy? No," said one of Bombardier's big fleet customers, who asked for his name not to be published because he's not authorized to speak for the company. "It's been 25 or 30 years since the introduction of the last new single-aisle aircraft in this seat segment. And this plane [has the goods]."

Bombardier confirmed this week it will need \$2-billion to bring the C Series to a point where it's break-even on a cash flow basis in 2020-21, with most of the cash being spent in 2016 and 2017. The company estimates it will have \$5-billion of capital available to start 2016, including Quebec's pledge and access to lines of credit. It also wants to sell a minority stake in the train unit to boost funds.

Analysts at JPMorgan say the Quebec investment is a down payment on Bombardier's strategy that could help reduce credit risk concerns held by potential C Series customers and suppliers.

But they argue that the company will need to do more to ensure the program succeeds. Unlike its rivals, it doesn't have much in the way of reserves to be commercially aggressive in booking new orders. And it also has a new business jet duo to develop, the Global 7000/8000, even as earnings decline.

"This is like a Band Aid for a stab wound," Richard Aboulafia, an aerospace consultant for Teal Group, said of Quebec's aid. "The amount of cash involved is almost comically inadequate for the job."

There was a point amid all the chaos surrounding Thursday's government investment and earnings release when an analyst from Bank of America paused and asked a big-picture question to Mr. Bellemare: How did we get here? How did things go so wrong that one of Canada's manufacturing stars was left striking a deal for public aid?

"The organization was overwhelmed," he answered. Company resources were stretched trying to develop too many new products at the very time its cash intake was shrinking dramatically.

Of course, that explanation covers recent months. What it doesn't address is what the senior leadership and board were doing while the stock lingered below \$5 (Canadian) a share for most of the past four years – and what would prevent this crisis from happening again given that the same board remains in place. Quebec's lawmakers don't seem preoccupied with those questions as they get ready to open the purse strings for Bombardier. But future investors might be.

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