Is The Bombardier Golden Era Fading?

Analysts Divided On What Fate Awaits Erstwhile High Flier

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It has been quite a run.

Agile **Bombardier Inc.** has in the past 10 years captured the global No. 1 spots in the regional and corporate jet markets and -- for good measure -- in the rail-equipment sector, too.

The Montreal-based industrial giant, which by the early 1990s had already made a name for itself as a world-beating exporter of subway cars, Challenger corporate jets, water bombers and -- of course -- snowmobiles, was on a tear.

It pioneered the regional jet market, reshaping the commercial aviation industry as airlines adopted the cheaper, more efficient mid-sized aircraft in droves.

It piled acquisition upon acquisition, scooping up troubled plants for a song and then turning them around with the help of generous financial aid from governments in several countries.

Revenue tripled between fiscal 1996 and 2002, from $7.1-billion to $21.6-billion, an average annual growth rate of 18 per cent.

The company's employee count also climbed, jumping from 25,000 to 80,000 worldwide.

Bombardier was hailed as a true national champion.

The company's share price soared, and Bombardier became the only manufacturer on the list of Canada's Top 10 companies rated by market capitalization.

But some observers are beginning to wonder whether the erstwhile stock darling's golden era is fading as it undergoes what is perhaps its biggest crisis of confidence in a decade.

Bombardier's beaten-down class B shares closed off 9 cents at $7.90 yesterday on the Toronto Stock Exchange. They lost more than 20 per cent of their value in the past week alone on investor jitters over U.S. airline restructurings and repeated technical problems with the Acela high-speed train linking Boston, New York and Washington.

Post-Sept. 11 turmoil in the U.S. airline industry -- a crucial market for Bombardier -- and a bitter conflict with U.S. passenger-rail giant Amtrak over Acela have highlighted the company's vulnerabilities, raising questions about future performance.

There is concern, as well, about possible unpleasant surprises yet to come, particularly from Bombardier's financing division.

Has Bombardier's much-vaunted regional jet (RJ) program peaked as the market reaches saturation point, a situation exacerbated by the financial difficulties of the big U.S. airlines? And is the company's strategy to offset the cyclical airline business with a huge bet on the rail sector at risk, given French rival Alstom SA's aggressive foray into North America, the Acela contretemps, the loss of a huge bid to build new cars for the New York subway system, and the trouble in Europe with the Adtranz rail equipment acquisition?

Analysts are divided.

"They make a good airplane, but I'm inclined to think the RJ market [for both Bombardier and Brazilian rival Embraer SA] has been overbuilt," said Morten Beyer, head of aviation consulting firm Morten Beyer & Agnew in Arlington, Va.

"We expect the market to slow down."

Richard Aboulafia of Teal Group Corp. outside Washington, D.C., said: "It ain't the good old days any more. There were a lot of illusions that the RJ and business jet markets could keep going up and up. Well, that was just a recipe for a strong correction. This is a reality check."

RJs and corporate jets -- the latter's slumping sales have yet to recover -- have been Bombardier's growth engine, accounting for the lion's share of profit.

On the lower-margin rail side, CIBC World Markets' corporate debt department recently flagged the potential problems. "The loss of the [New York subway] contract is disappointing, but it is too early to conclude that this is a beginning of a trend toward a string of contract competition losses for Bombardier. However, Alstom's aggressiveness could definitely affect Bombardier Transportation's North American margins. We will carefully watch for future hits and misses in the transport division."

Mr. Aboulafia sees a silver lining for Bombardier in aerospace.

"I think Bombardier is the unspoken potential winner" if ailing carriers such as United Airlines Inc. manage to renegotiate so-called scope clauses in contracts with mainline pilots that cap the number of RJs that can be added to their fleets. That would allow the airlines and their feeder lines to buy more RJs.

There are also reassuring signs that the major U.S. airlines, even those going through painful financial restructurings, will continue to support a switchover from bigger, costlier planes to less expensive RJs, he said.

"There are definitely cash concerns, but history shows us that -- even in the worst of times -- when new aircraft acquisitions are part of the business model, they can get funded."

Mr. Beyer believes it will be very tough to win scope concessions from the pilots, who are opposed to a bigger role for the RJs because of significantly lower salary scales.
The larger context, at any rate, is one of a gradual slowdown in the global RJ market, he contends.

Anthony Scilipoti of **Veritas Investment Research Corp**. in Toronto has been telling investors to pay close attention to the potential for looming writedowns, layoffs and restructuring charges in Bombardier's aerospace division as it struggles to cope with the downturn.

He points out that the company is running into a corporate aircraft overbuild as production outpaces deliveries.

Bombardier has also been increasing the interim financial assistance it provides to its airline customers as well as financing a greater proportion of the purchase price of its corporate jets, he observes. That kind of financial exposure to the troubled airline and private jet industry should not be ignored, he wrote in a recent research report.

Subsidiary Bombardier Capital had a total asset services portfolio of $7-billion as of April 30 of this year, $2.4-billion of which was related to corporate jet lending and $1.3-billion to commercial aircraft financing.

Ihor Danyliuk of Merrill Lynch & Co. said in a recent note that Bombardier may have to further increase its interim financing of RJ purchases, thus reducing the company's projected free cash flow outlook. Commercial aircraft interim financing jumped to $705-million at the end of this year's first quarter from $396-million at the end of the last year's fourth quarter, he said.

Bombardier spokesman Yvon Turcot brushed aside the raising of red flags over financing, saying Bombardier Capital continues to maintain prudent lending practices and is not excessively exposed.

He also dismissed as overblown fears that the $45-billion aircraft order backlog is shrinking.

"There is still action" on the order book, he said.

"There are new orders," perhaps not on the scale of the 75-jet announcements of yore, but in steady, smaller spurts of four or five, he added.

The "pessimistic analyses" Bombardier has been getting from the investment brokerages that have been slashing their earnings estimates and share-price targets bear no relation to reality as the company sees it, Mr. Turcot insisted.

Analyst Richard Stoneman of Dundee Securities in Toronto says don't count Bombardier out yet. "The pre-9/11 backlog is adequate to bridge the uncertainty in the aerospace industry."

Bombardier remains a solid, diversified, well-managed manufacturer with continued growth potential, he said. His take is that the stock cruised ahead of itself.

"The stock got up to $25 real fast two years ago. I said, 'Holy jeez, it's too high.' Now it's too low."