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Bombardier Report

Analysis of Bombardier:

Bombardier took on its present form in 1976 when MLW-Worthington, a

manufacturer of locomotives, acquired Bombardier Ltd., a manufacturer of snow

tractors and snowmobiles. The company was renamed Bombardier Inc. in 1978. The

company has been active ever since in the acquisitions of various aerospace and

transportation companies around the world.

Nature of the Business

Bombardier conducts business in five main areas: transportation

equipment, aerospace, defense, motorized consumer products, and in financial and

real estate services. The total revenues increased by 20% from $5. 9 billion to

$7. 1 billion over the last year.

To be able to see the extent of Bombardier's operations it is best to

look at each manufacturing group separately.

Aerospace

Aerospace is Bombardier's most important industry. It accounted for 47%

of sales and 33% of profit in 1995 and makes Bombardier the fourth largest

civilian airplane manufacturer in the world. Bombardier's customers are spread

out over the globe. They range from government and private commercial airlines

to wealthy individuals and corporations in need of private jets. The products

that are driving the growth in this division are the RJ, the Global Express, and

the Lear-45. De Havilland, which was recently purchased with help from the

Ontario government, produces the Dash-8 series of airplanes. The Dash-8 has had

its production rate increased to 48 planes a year with about 81 on order.

Modified versions of the Dash-8 are in the works that could enable an even

bigger increase in production. Bombardier has cut costs and increased the

profit margin at de Havilland to improve profitability. Bombardier will likely

exercise the option to buy the remaining 49% from the Ontario government. The

outlook for the success of the RJ is very good, although most of its sales rely

on a small number of companies, these companies are pleased with the RJ's

performance to date. Bombardier's entrant into the long-range market is the

Global Express that has " about 60 orders" on the table, but needs 100 to break

even at a price of $34 million. It is experiencing strong competition from

Gulfstream, which produces a plane that is targeted for the same market as the

Global Express. Bombardier has been successful in turning around the troubled

Learjet operations and now expects Learjet to expand its aircraft production

with the introduction of the Lear-45, which already has 90 orders on hand. The

Canadair 50 seat regional jets are continuing to be turned out at a rate of 60

per year. Overall the Aerospace industry has strong growth potential, provided

that Bombardier sticks to its successful niche marketing strategy. Bombardier

is competing with some of the biggest companies in the world. Boeing, McDonnell

Douglas, Lockheed Martin, and Raytheon are all counted as the opposition.

Transportation Equipment

This industry is responsible for 22% of sales and 22% of profits for

1995. The nature of this group is cyclical. Bombardier manufactures subway

cars, high speed trains, passenger cars, and a variety of other equipment, which

is primarily sold in the North American and European markets. Bombardier has

made many acquisitions in this industry that are usually acquired at a loss.

These acquisitions along with the huge loss in the Eurotunnel contract has made

it difficult for Bombardier to show it's real profitability in this industry.

Revenues have increased by 20% since 1994. Bombardier has 28% and 12% of the

North American and European markets respectfully. The outlook for expansion in

the North American market is encouraging with the contract with Am-Trac to

supply high-speed trains and equipment for use in the United States. Recent

developments in Mexico has led to an increase in demand for railway cars in that

country. As well, the acquisition of Waggonfabrik Talbot will give Bombardier a

strong foothold in the European market that already accounts for 60% of sales.

One area of concern is that Bombardier's competitors in this industry are

becoming stronger. The merger between Asea Brown Boveri (ABB) and Damhler-Benz

has created a strong competitor. The reemergence of Morrison Kundsen has also

increases the competition in this area. The fact that more and more

transportation authorities are being privatized and will need to adapt their

fleets to meet consumer preferences creates a positive outlook. To accomplish

these adaptations these companies will have to renew their 1000's of vehicles.

Motorized Consumer Products.

The biggest products in this group are the Sea-Doo and Ski-Doo

recreation vehicles. This group accounted for 23% of sales and 38% of profit.

High profit margins have helped Bombardier achieve success in this market.

Sales in the Sea-Doo area have increased by 20% last summer making Sea-Doo the

leader in the personal water craft market. The increase in Ski-Doo's sales has

been about 8% per year over the last few years giving Bombardier the number two

position in the market behind Polaris. Other competitors in this group are

Arctic Cat and Brunswick. Bombardier has also recently expanded into electric

vehicles marketed to closed gate communities in the southern US mainly occupied

by seniors. The markets for personal recreation vehicles is cyclical, but the

strong economy in North America right now is helping to buoy sales. A problem

on the horizon for Bombardier is that the aging demographics of its market may

mean a fall in purchases in the future. Defense

Defense accounted for 6% of sales and -2% of profit. The major products

in this group are the Starstreak missile, Shorts Missile Systems, and various

support services. Customers are mainly governments in the UK, US, Middle East,

France, and Canada. Bombardier has seen the demand for its products in this

market shrink over the past few years. Efforts are being made to outsource

production and carry over technology from defense to civilian uses. The major

competitors in this market are the same as in the aerospace industry as well as

Loral and Rockwell.

Financial Services

2% of sales and 9% of profit was contributed to this group. Bombardier

deals in three main areas. It gives loans and leases to dealers of its own

products and other dealers, it provides leasing and financing to its customers,

and it provides financing and support for Bombardiers other divisions. There

are really no competitors because Bombardier knows it's own business better than

anyone else. The major banks may provide some competition in areas of customer

financing. The success of this division depends on the successes of the other

groups.

Management Quality

Bombardier management has acquired a very good reputation for turning around failing businesses. Bombardier management has been able to see opportunities and take advantage of them. The ability to turn around businesses,

strong stability, strategic vision and good returns to shareholders in the past have displayed that the Bombardier management is, at the least, of good quality.

Ownership Control

There are a total of 335, 505, 211 common shares. 88, 756, 982 of these shares are Class A, which have voting rights of 10 votes each. The other 246, 748, 229 shares are Class B with 1 vote each. The Class B shares can be converted to Class A shares under special situations.

There are 1, 236, 900 cumulative, non-voting preferred shares totaling 30. 9 million dollars. The dividends received from these shares are either 75%

of prime or 1. 875%, which ever is greater.

Family members of the founder, J. Armand Bombardier, some of which are

management own about 62% of the voting shares.

Dividend Policy

The payout ratio objective of the company is to achieve 30% of net

income as dividends.

Financial Analysis:

Financial Strength (please refer to Appendix A and B for calculations)

Bombardier has a total of $2, 289, 200, 000 worth of debt and $30, 900, 000

worth of preferred stock. The values of significant ratios are: Debt to equity

of 87. 4%, Total debt to Total capital of 57%, and Share holder equity to Total

capital of 41%. These indicate that Bombardier has a significant amount of debt

and any situations where additional debt might be taken on should be scrutinized.

The most current bond rating comes from the CBRS in 1995 and is A-1,

meaning very good quality and should have good performance throughout the

economic cycle. Value line gives Bombardier a timeliness rating of 2, which is

an above average rating. An average rating of 3 for safety was also achieved.

S&P gave the stock a rating of A-1, which is also an above average rating on the

stocks past performance. These ratings show Bombardier to be a stable,

dependable company without much risk associated with it. The total capital has

increased to $4, 007. 5 million from $3, 634. 1 million in the year ending on

January 31, 1995.

Profitability Levels (for calculations please refer to Appendix C)

Net Income would have been $308. 0 Million in 1995 without the huge write

off that was incurred in the contract with the Eurotunnel. This is a healthy

gain from $241. 9 in the previous year. The following numbers are buoyed up

because of the Eurotunnel write off, that should not be accounted for as it was

a special circumstance and does not help in determining the real value of the

firm. The NPM was 4. 335% and the ROTC was 16. 1% in 1995. The ROE was a good

18. 9%. All of these numbers are also in sink with the patterns of growth that

Bombardier has experienced in past years.

Growth Rates (for calculations please refer to Appendix D)

The 5 year annual growth rate(from 1990 to 1995) are: 19. 7% in sales,

25. 3% in earnings, 17. 3% in dividends, and 21. 3% in EPS. The differences in

earnings and EPS growth is due to the fact that the number of shares outstanding

has increased over the past 5 years. These results are over an entire economic

cycle, from the recession in 1990 to the strong growth in 1995. All of these

numbers are respectful and attest to the quality of the Bombardier company. The

forecasted EPS used an average NPM, skipping the poor years between 1990 and

1992, of 4. 5% and a predicted sales of $8, 359. 13 million (using 5 year sales

growth rate). The estimated EPS for the year ending Jan. 31, 1997 is $1. 13.

Profit Variability (for consistency Value Line figures have been used)

Referring to the Variability graph the trend lines for ROE, NPM, and

Sales growth can be seen. The ROE over the past ten years has been stable,

except in the recession in the early 90's, but it has since returned to pre-

recession levels. The NPM has remained stable at around 4. 5% over the last ten

years. The major concern is the wild variability in sales growth, which has

varied wildly even in good times.

Quarterly earnings per share have trended higher over the last four years,

with some spikes occurring in the fourth quarter of each year and dropping in

the first quarter of the next year. Based on the past trend the 4th quarter

should bring an increase in earnings.

Dividend Record (for calculations please refer to Appendix E)

The estimated dividend is $. 23, with a . 959% yield, and a payout ratio

of 21. 7% for 1995.

Considering the trend in quarterly earnings a spike in earnings for the 4th

quarter should occur. If management tries to adhere to their payout objective

an increase in dividends should occur in the 4th quarter to bring the total to

23 cents for the year from the 15 cents already paid out this year.

Industry Comparisons

The preceding charts are comparing Bombardier to its competitors using

Value Line numbers but with a price as of November 28, 1996 and earnings

annualized over the last four quarters. It can be seen that Bombardier has the

lowest EPS, second highest P/E, second highest P/S, average NPM, average

earnings growth, and second lowest size as measured by market capitalization.

The TSE 300 has a P/E of 24. 14. Bombardier's P/E comes in under the market

value at 21. 94 is bang on the market, but is higher than the average P/E for the

industries where it operates: Aerospace/Defense (15. 7), Electrical Equipment

(14. 6), Recreation (15. 9).

Stock Analysis:

Risk Classification

The inherent risk in Bombardier is low and the institutional rating

services acknowledge this (CBRS, A-1; S&P, A-; Value Line Safety, 3). The huge

size of Bombardier and the diversification also classify Bombardier as a

conservative company. The appropriate market capitalization rate for Bombardier

is 11% given this information, please refer to appendix F for breakdowns.

Investor Preference

A past annual sales growth over the past 5 years of 17. 5% and Value

Line's estimated future growth of 12% over the next 5 years; as well as past

growth of 18% in earnings with estimated future growth of 18. 5% are signs of a

growth stock. This stock has remarkable growth rates and prospects for such a

big company it is a good base for a growth stock and investors should view it as

such.

Stock Price Volatility

Value Line gives Bombardier a beta of . 85, which indicates a less

sensitive reaction to market fluctuations. With the phenomenal growth that we

are experiencing in the TSE right now, Bombardier's stock will not be going up

as much (only 85% of the increases). Of course, beta is dead and is just a

reflection of past performance with no bearing on the future.

Price Momentum

Bombardier's average stock price over the past ten years has been

steady. The stock has been split 2 for 1 five times in ten years. If this

price trend continues, a price of $25 is achievable in the next year. Even

during the recession of the recession of the early 90's the price still grew,

although at a lower rate than other years. In the long run the stock will not

be able to sustain the appreciation and there will be a correction.

Stock Price Sensitivity

Bombardier's stock is affected by the level of interest rates. The financial

services sector is more affected by the interest rate level than the rest of the

company. Bombardier's business can be affected by interest rate levels in many

ways. If interest rates are high then individuals, companies, and government's

may postpone purchases to wait for lower interest rates. If interest rates are

low, like we are now experiencing, then new customers and ones who postponed

purchases because of high interest rates in the past are more willing to buy

Bombardier's products.

Valuation Ratios (for calculations please refer to Appendix G) All calculations

use the price as of November 28, 1996 of $24. 60 and the estimated EPS for the

next year. The valuation ratios are as follows: P/E = 21. 94

P/CF = 17. 63

P/S = 1. 078

P/BV = 4. 98

CA/CL = 1. 67

RPGM = $19. 31

Expected Total Return = 15. 9%

The DDM could not be utilized because the growth rate (14. 95%) is greater than

the discount rate (10. 5%).

Opinion

Using general preferences the following results have been obtained: 1)

The P/E ratio is 21. 94 which is greater than 20x the current EPS over

the last 4 quarters of 20. 4 (This is an upper limit for stock purchases). The

P/E is greater then the industry P/E's of the areas it manufactures in, It is

also higher than it's own P/E in the recent past. The market P/E is 24. 14 and

more than the P/E of Bombardier, but in an environment with low interest rate

high P/E values are usually found, so all P/E are probably to high in these

times of low interest rates. P/E's are usually preferred if they are under 15x.

2) The projected EPS of $1. 12 times 25 is 28. This is greater than the

current P/E, which does not point to an overvaluation. 3) The P/E is over

the ROE of 18. 9%. This points to an overvaluation. 4) The total return

of 14. 25% is greater than the discount rate of 11%. This is a sign of a good

buy. 5) The ROE is just over the acceptable rate of 18%. 6) The

SE/TC is . 413 and is not preferred because it is under 70% 7) The P/BV of 4. 98

is over the generally preferred multiple of 4x. 8) The P/CF of 17. 63 is

over the generally preferred multiple of 10x.

The above facts give conflicting signs of whether the stock is overvalued or not.

One fact that settle the disputing evidence is that the calculated FV from the

RGPM is $19. 31 and is well under the current market price of $24. 60. There is

no single factor that determines whether a stock is overvalued or not, but in

this case I believe that there is more evidence to support the view that the

stock is overvalued. A case could be made to hold the stock if it is already

owned, if the shareholder feels confident in the stock, but otherwise a

recommendation not to buy or to sell is given in the best interest of the

investor for the long run.