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Grip of Bombardier's founders an obstacle for investors

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Company's lack of lead investor interest and sliding stock price could be due to inflexibility in its management

When Bombardier Inc. raised $1.1-billion in equity earlier this year to help fund its plane development programs, executive chairman Pierre Beaudoin said many investors he met on the marketing tour "recognized how great our company is with the franchises we have ... It's a good story to tell." But the plane maker's sliding stock price since then to two-decade lows tells a different tale – that of a company still struggling to convince the market it can rebound under the grip of its founding family.

Bombardier's bankers completed February's share offering without a lead investor, stunning observers who expected the Caisse de dépôt et placement du Québec to step up to back the hometown champion. A well-placed source said the Caisse sought changes to the company's dual class share structure as a condition of its investment – a change the founding Bombardier-Beaudoin family was unwilling to make.

In the end, the list of investors in the sale was long but their order amounts were relatively small, suggesting no one wanted to make a big bet on Bombardier's management and founders. As one senior investment firm executive said: "A stock can collapse 20 per cent in one day and I might go out and buy some. It doesn't mean I believe in the company."

Sources confirm that at least one buyer of Bombardier shares in February's sale, Toronto-based West Face Capital, unloaded them soon after for a tidy little profit. If the hedge fund's move is any indication, Bombardier's investor base could be much more fluid than the company might like.

"Bombardier is a trading stock. Sell into euphoria, buy into panic," ***Veritas Investment Research*** analyst ***Anthony Scilipoti*** advised his clients in a recent report.

The analyst says that despite boasting about $6-billion (U.S.) in liquidity after its recent share and debt sales, it's curious that the company also raised another $429-million in off-balance-sheet financing to improve its reported free cash flow during the first quarter. Among the actions it took was striking a deal with a third-party intermediary to finance a portion of a customer's expected payment, enabling Bombardier to raise $250-million. It's the first time in 15 years researching the company that ***Mr. Scilipoti*** can remember the manufacturer doing anything similar.

Those actions suggest that more trouble may lie ahead for the company, ***Mr. Scilipoti*** said in an interview. "If they just raised all this money and the balance sheet is okay, why are you resorting to those [mechanisms]? They're saying everything's fine and they're acting like it isn't. That's the point."

Bombardier spokeswoman Isabelle Rondeau declined to address ***Veritas's*** analysis, saying the company never comments on analyst reports.

Bombardier, set to release second quarter results on July 30, hired United Technologies aerospace veteran Alain Bellemare to replace Mr. Beaudoin as chief executive earlier this year. Mr. Bellemare has quickly revamped his executive team while mandating a review of the passenger plane business and analyzing strategic options for its rail unit, including plans to float a minority stake of Bombardier Transportation in Germany. Mr. Beaudoin moved to a new role as executive chairman.

The two men are said to work extremely well with each other and also socialize in their off time. Together, they're betting they can get Bombardier back on track after a series of missed financial targets (sales growth has been negative for three of the past six years) and delays for its new C Series plane. Bombardier is winning praise for the aircraft's technology and performance capability but it hasn't booked a C Series order since September 2014.

Management must make the C Series viable and avoid running out of money, J. P. Morgan analyst Seth Seifman said in a July 14 research note. The company's current cash, combined with credit and proceeds from the train IPO, should be enough to cover the estimated $1.6-billion it will burn through 2018 to develop the C Series and new Global 7000/8000 corporate jets, said Mr. Seifman. "There are a number of moving parts though, and little visibility, so the risk that Bombardier will need more capital is real."

That's a situation Bombardier will want to avoid, because being forced to raise more money through an equity sale would almost surely bring more scrutiny to the ownership issue.

For some investors, the founding family's power over the company – they control 54 per cent of voting rights through a special class of shares – remains a stumbling block for buying into Bombardier in any significant way. The family has said they have no intention to relinquish control, calling the ownership structure an advantage for a cyclical business.

"Eventually, more guys will come to the conclusion" Caisse did, said one senior Bay Street source, which is that the family's control over the company has to be loosened. Bombardier may have to raise more capital "and at some point, the market's going to reject them," the source said. "People are going to say, 'Look, I'm not investing in this company any more because the governance structure has led to a series of bad decisions and lack of accountability.'"

The list of potential shareholders for Bombardier is shrinking as corporate governance issues increasingly come into play, said Ken Lester of Montreal-based Lester Asset Management, who was invited to a lunch with Bombardier executives as part of the equity sale roadshow but declined to invest. "[The dual class system] is a dinosaur now and there's no need for it."