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# Bombardier hit back by its challenge to competitors

by Justin Hsiao

One of the world's leading manufacturers of both planes and trains, Bombardier Inc. (Bombardier), has been crippled by its decision to challenge its competitors amid a weakening demand for aerospace products. On Nov 4, there was a debate in Canada about whether or not the Canada's new liberal government should provide up to USD 1bn to the troubled plane maker after the Quebec regional government pledged a similar amount a week ago by taking a 49.5% stake in the company's C-Series program, which is a family of narrow-body medium-range jets developed in the company's aerospace segment.

Figure 1 shows that the RMI-CRI 1-year Probability of Default (PD) for Bombardier has increased significantly from around 50bps at the beginning of the year to nearly 300bps on Nov 6, indicating a worsening credit profile of the firm. The PD for Bombardier fluctuated in September and October due to several events ranging from the progress of the C-Series program, the release of the third quarter financial statement, to the announcement of aid from the regional government. The market cap of Bombardier has dropped around 50% since the beginning of the year.

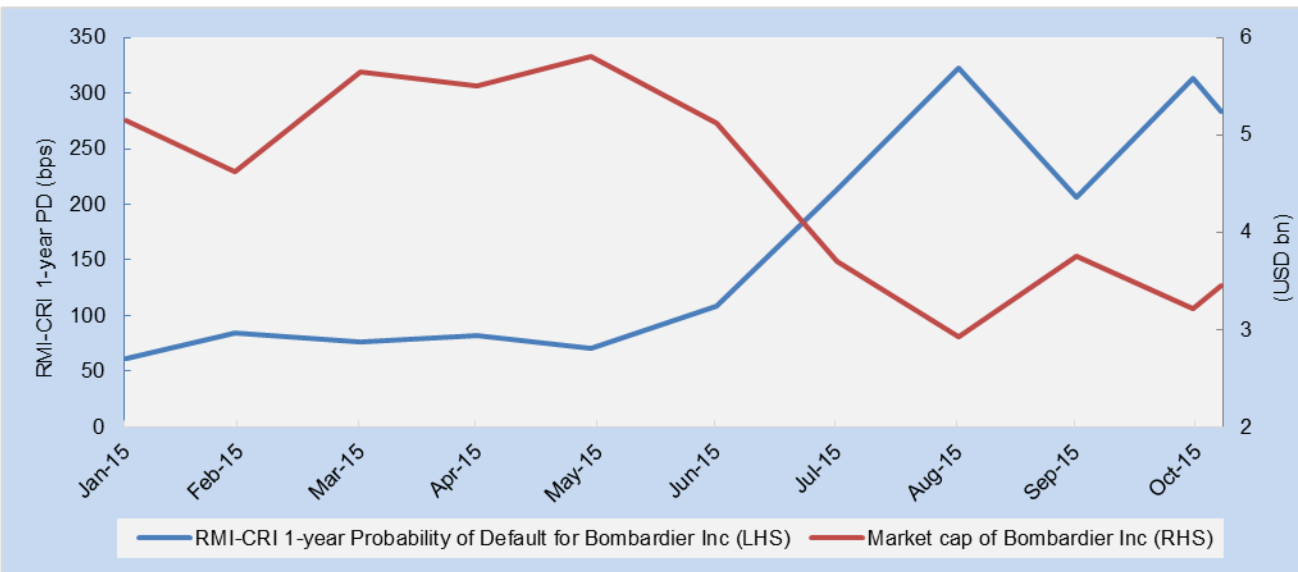


Figure 1: RMI-CRI 1-year PD and market cap for Bombardier Inc. *Source: RMI-CRI, Bloomberg*

All the problems originated from Bombardier's C-Series, which was a bold attempt to break into the medium-range airliner market dominated by Boeing and Airbus. According to the company, the C-Series burns 20% less fuel per trip than its competitors, giving the jet a niche among its peers. However, the development of the C-Series has continued for more than a decade and resulted in huge cost overruns, and the jets still are not commercially viable as yet. The delay in this key project has left a large dent on Bombardier's credit profile.

After taking a massive writedown in its business jets programs and after reporting a USD 4.9bn loss in the third quarter, the Canadian company disclosed net debt had risen to USD 6.8bn as it burnt USD 816mn of cash in the third quarter. As the R&D spending remained high for the delayed C-Series, another product delay for the Global 7000 is likely to increase the overall development expenses even further. The company's free cash flow had been in the negative territory (See Table 1) and is expected to decline further in 2017, showing the limited financial flexibility of the company.

Other concerns include Bombardier's high leverage. According to the company's reports shown in Table 1, the adjusted debt to adjusted EBITA ratio reached 6.6x in Q3 from 5.9x in Q1 and 4.7x at the end of 2014. The company's rising debt burden was mainly caused by the severe decline in EBITA, which stood at USD -

4.5bn in the latest quarter. Moreover, the EBITA is expected to decline in 2016 due to costs associated with ramping up C-Series production and weakness in the business jet segment.

Even though Bombardier's interest coverage ratio (See Table 1) dropped in Q3, the firm's overall liquidity remains healthy. The company's liquidity is supported by Sep 30, 2015 cash and cash equivalents of USD 2.3bn and unused revolvers of USD 1.3bn. The firm does not have any material debt maturities until 2018, when the USD 1.4bn of bonds mature.

| | Q1 2015 | Q2 2015 | Q3 2015 |
|---|---|---|---|
| **Free cash flow (USD mn)** | -749 | -815 | -817 |
| **Adjusted debt / adjusted EBITA*** | 5.9 | 5.8 | 6.6 |
| **EBITA (USD mn)** | 336 | 311 | -4,531 |
| **Interest coverage ratio** | 7.35 | 4.16 | -125.27 |

Table 1: Credit metrics for Bombardier Inc. *Source: Company's reports, Bloomberg*
*Based on company's Non-GAAP financial measure (p.15)

The RMI-CRI 1-year PD for Bombardier reaches a ten-year high, reflecting the group's heavy cash consumption and high leverage. The credit outlook of the firm remains negative but, depending on the funding outcomes from the Canadian government, a possible sale of the transportation segment to raise cash as well as the result of its C-Series launch in the second half of 2016, the company could still withstand the short-term headwinds.

## Credit News

### Indonesia's Trikomsel says tough to raise equity, sell assets to pay debt

**Nov 6.** PT Trikomsel Oke Tbk, an Indonesian mobile phone retailer, claimed that it will default on its SGD 215mn bonds because it has failed to raise the funds needed. Trikomsel also does not intend to pay any upcoming interest payments on its bonds. The company is unable to sell any fixed asset to pay off its debts, without affecting its operations. Current market conditions have also made it difficult for the company to raise enough equity to service its debts. (Reuters)

### Fitch downgrades Standard Chartered to 'A+', maintains negative outlook

**Nov 5.** Fitch Rating downgraded the Long-Term Issuer Default Rating (IDRs) of Standard Chartered PLC (SC) and its subsidiary Standard Chartered Bank (SCB) on Nov 5, 2015. In addition, both their Viability Ratings (VR) and Short-term IDRs were downgraded to 'a+' and 'F1' from 'aa-'and 'F1+' respectively. The recent downgrades occurred as a result of the disappointing Q3 earnings result and its new plan which involves a USD 5.1bn rights issue. Fitch's actions indicated its view of SC's unfavourable profitability, worsening asset quality trends and its underperformance relative to its peers. (Reuters)

### Russian banks face more pain

**Nov 5.** With the slowdown in the Russian economy, the central bank aims to shut down or take over a number of smaller banks, this year. As the Russian economy approaches a second year of recession and is expected to shrink further next year, Russian regulators will continue to shut down smaller banks in view of the expectation of an upsurge in bad loans, potentially reaching its highest point since the 2009 financial crisis. Furthermore, the banks' profitability and credit outlook has taken a further hit, as high-credit profile businesses cut down on their loans, while lower-credit profile businesses carry on with their excessively risky borrowing. (Bloomberg)

### Chinese banks' bad loan ratio hits six-year high

**Nov 4.** China's commercial banks posted an average non-performing loan (NPL) ratio of 1.59% at the end of September, the highest since the 2009 global financial crisis. Meanwhile, the provision coverage ratio for Chinese commercial lenders also dropped to a 6 year low of 167.7% at end September. Chinese lenders are struggling with mounting soured debts as China's economy continues to slow. With six interest rate cuts over the last year and the ongoing liberalization of interest rates, China banks' profits have been further squeezed. Overall, China's top 5 lenders reported last week their slowest Q3 profit in at least the last 3 years. (Bloomberg)

**China Construction Bank joins global list of systemically risky banks** (SCMP)

**YFG units default on loan repayment** (The Edge)

**Arian Silver receives default notice for senior note** (Proactive)

## Regulatory Updates

### FSB releases new measures to promote resolvability, including effective cross-border resolution

**Nov 6.** The Financial Stability Board finalized a recommended list of mechanisms that jurisdictions should consider in their legal frameworks, to achieve cross-border recognition of resolution actions and remove impediments to cross-border resolution. The list of protocols include imposing temporary restrictions and cross-default rights in financial contracts, and the 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity in the event of a bank crisis. The FSB is also seeking the public's opinion on its proposals for implementing temporary funding to support the orderly resolution of a global systemically important bank (G-SIB), as well as developing effective resolution strategies for systemically important insurers. (FSB)

### EU cooks up a stress test for 2016 that no bank will fail

**Nov 5.** 53 European Union banks are slated to undergo a stress test in 2016, with the objective of providing the European Banking Authority, as well as the market participants, a common analytical framework to compare and assess the resilience of the EU banking system in a consistent manner. Collectively, the selected banks hold about 70% of national banking-industry assets in the euro area, each EU member state and Norway. The European Banking Authority also added that the outcomes from the stress test will be published at the beginning of the third quarter of 2016. (Bloomberg)

### India moves toward long awaited bankruptcy reform

**Nov 4.** The government of India published a proposal to overhaul the country's bankruptcy process and invited comments from the public, on what could become the first unified bankruptcy code. The proposed bill aims to speed up decisions involved in bankruptcy proceedings to curb asset stripping and ensure higher recovery rates for creditors, which is key to developing India's credit markets and boost investments. Comments and suggestions are due by Nov 19, after which the government will take a decision on the report and introduce it in parliament. The bill could be passed in the budget session, early next year. (Reuters)

### Surge in SME debt defaults exposes flaws in UAE insolvency rules

**Nov 3.** A new bankruptcy law is urgently required as many foreigners in the United Arab Emirates are fleeing the country after defaulting on unpaid debts. Business owners are running away from their creditors as they face the prospect of going to jail due to bounced cheques tied to empty bank accounts. Bankers want the current law of imprisoning debtors to change as they say that debtors are running out of the country instead of staying to resolve their debts. Lenders hope that a new bankruptcy law would help improve the loan restructuring process and reduce the amount of provisions banks have to make. (Bloomberg)

**FSB publishes the 2015 update of the G-SIB list** (FSB)

**BIS updates Basel III framework for haircut floors for non-centrally cleared securities** (BIS)

**Regulators say banks and investors hold too much in problematic loans** (WSJ)

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