Celestica Inc.: A Good Quarter But Limited Visibility Going Forward

Description

Celestica (TSX: CLS, NYSE:CLS) has risen 11% on higher than average volumes since the company reported its second quarter 2013 results
last Friday. This due to the fact that results were better than analyst expectations. Let's take a quick look at a snapshot of the results.

Q2 Results			
($US billion)	2013	2012	% change
Revenue	$1.495	$1.744	-14.3%
EPS	$0.21	$0.22	-4.5%
Operating Margin	2.9%	3.3%	-12.1%

Revenue declined 14.3% while EPS declined 4.5%. Margins were 40 basis points lower due to excess capacity in the semiconductor business as well as restructuring efforts. Excluding the effect of losing **Blackberry's** business, which accounted for approximately 20% of revenues in 2012, revenue was up 3%. This is a very impressive performance and shows that management has done an excellent job replacing Blackberry.

Sequentially (quarter over quarter), the numbers tell a different story. There was growth across all markets except servers. The sequential strength in second quarter results was driven by the communications segment, as demand was much better than expected.

Sequential Revenue Growth	
Diversified	11.0%
Communication	14.0%
Servers	-7.0%
Storage	8.0%
Consumer	12.0%

Celestica’s strategy has been to diversify its customer base, get into higher margin markets, and accelerate revenue growth. The company has made progress on these targets but still has a ways to go.

CLS sales segments

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As we can see from the chart, Celestica has successfully diversified into a variety of end markets. Further to this, Celestica’s top 10 customers contributed 66% of revenue this quarter down from 71% last year. And there is only one customer that accounts for more than 10% of revenue. So while we would like to see even greater diversification to further mitigate the risk in investing in the stock, good progress has been made.

While progress on revenue growth has been good, the outlook is uncertain. In addition, the companyis still seeing operating margins deteriorate. This quarter saw a 40 basis point decline in margins dueto excess capacity in the semiconductor business as well as restructuring efforts.

Going Forward

On the conference call, management reiterated that the demand environment right now is volatile, which makes forecasting difficult. Visibility beyond 90 days is very poor. For the third quarter of 2013, management expects challenging end markets and is forecasting total revenues of $1.425 to $1.525 billion and EPS of $0.17 to $0.23 (not including the share buyback). At the mid-point of this guidance range, this equates to a 1.3% decline in revenue and a 4.8% decline in EPS. Celestica is in the enviable position, though, of having a very strong balance sheet with minimal debt and a cash balance of $554 million. Plans for a share buyback program, whereby the company will buy back up to 10% of shares in the next year also bodes well for shareholders.

Bottom Line

Celestica's management is doing an impressive job turning the company around. But while sequential revenue growth has been better than expected, the fact remains that the macro environment in which the company operates is still very uncertain, so predictability of earnings and revenues is very low. The stock is trading at roughly 22x earnings. Celestica's strong balance sheet is surely a big reason why the stock is trading at this multiple. At this point, however, investors should be questioning whether the stock warrants this multiple given the challenges that it faces and the results that we have seen.

Celestica's stock has had a nice run but remains trapped in a highly challenging business environment. For a smoother ride to market thumping investment returns, a proven strategy is to invest in those businesses that dominate their environment, not the other way around. In the Motley Fool's special **FREE** report "**3 U.S. Stocks That Every Canadian Should Own**" we profile 3 such businesses. Simply **click here now** to download your copy of this report at no charge.

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Fool contributor Karen Thomas owns shares in Celestica. The Motley Fool doesn't own shares of any of the companies mentioned at this time.

CATEGORY

1. Investing

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1. NYSE:CLS (Celestica Inc.)
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