Investing in Tech Stocks? 3 Red Flags to Avoid

Description

After losing nearly 6% in 2014, stocks are performing better in February. As markets regain almost half of their losses for the year to date, investors should not assume all stocks will recover.

There are some warning signs that investors should watch for before deciding whether a rebound in a particular stock will hold. Here are three red flags to avoid at all costs.

1. Weak outlook

The best place to find a company's outlook for the quarter and the year is in an earnings press release or conference call. **Celestica** (TSX:CLS)(NYSE:CLS), an original equipment manufacturer, recently reported weak revenue from a number of its businesses. Revenue from its communications end market dropped 12% from the previous quarter, and consumer revenue dropped 36%, although Celestica is shifting away from this segment.

Celestica forecast that first quarter revenue will be between $1.3 billion and $1.4 billion. This represents a revenue decline of 6% from the fourth quarter. Celestica is optimistic about its semiconductor segment, and believes that unit will add to the diversified double-digit revenue growth in 2014.

Still, lower prospects in telecom will certainly weigh on results in the short term. Further order delays from customers will raise risks for investors holding Celestica. Celestica cited cloud offerings for customers, but this needs time, energy, and resources. A meaningful cloud infrastructure offering will take time to develop.

2. Slow transition to new business

Wireless communications equipment maker **Sierra Wireless** (TSX:SW)(NASDAQ:SWIR) is another company to be wary of. The firm reported revenue growth of 8.4% to $118.6 million in the quarter, but still reported a loss. Higher operating and R&D expenses hurt earnings. Sierra Wireless lost $1.95 million (-$0.06 per share) compared to a profit of $15.5 million ($0.50 per share) last year.

The company is still progressing steadily with its transition as an M2M (machine to machine) play, but investors should expect profit growth will be slower than expected. Adoption for LTE could also be slow, but Sierra Wireless will benefit. It just announced two embedded wireless modules for 4G LTE networks, based on the **Intel** (Nasdaq:INTC) chipset. Shares are down nearly 30% from its peak reached at the start of this year.

3. Weaker bookings

Investors should be cautious with companies reporting lighter bookings. **EXFO Inc.** (TSX:EXF)(NASDAQ:EXFO), which makes testing and service assurance tools for telecom customers, revealed that bookings dropped to $57.9 million, down from $64.3 million in its first quarter. By contrast, **COM DEV** (TSX:CDV)(NASDAQ:CDVIF) boosted its order backlog to $164.7 million, compared to $131 million in the previous quarter. If ATP ("Authority to Proceed") follow-on orders are included, its backlog would be over $200 million. Backlog was $139 million last year.

Foolish bottom line

Not all stocks are equal when markets recover. Weak bookings, slow transitions to new businesses, and a weak short-term outlook will limit any upside. Investors might be better off selling companies with any of these warning signs as they rebound with the market.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:SWIR (Sierra Wireless)
2. NYSE:CLS (Celestica Inc.)
3. TSX:CLS (Celestica Inc.)
4. TSX:SW (Sierra Wireless)

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