Celestica Inc.: My Value Pick for the Month

Description

Celestica Inc.'s (TSX:CLS)(NYSE:CLS) shares have been on a tear in the last few years with a 22.5% year-to-date return, a 34% one-year return, and a 63% three-year return. This has come after a period of great uncertainty and hardship for the company.

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Celestica has been on the come-back trail in the last few years, recovering from the loss of its biggest customer, **BlackBerry**, which represented 20% of its revenue in 2012. After this loss, the company embarked on a new strategic direction, focusing on diversification and value-added products with the goal of spurring revenue growth and increasing margins.

At this point, after the stock has done so well, we are left wondering if the shares still represent a good opportunity for investors. In my view, Celestica shares are still attractively valued and represent a good opportunity based on the following five points.

EPS beating expectations

In the last four quarters, the company has beat earnings expectations by a significant margin. The last two quarters were particularly strong. In the fourth quarter of 2016, EPS was 28% higher than consensus expectations, and in the third quarter, EPS was 43% higher.

Improving margins

Although margins have been stuck at just below 4% for a few quarters now, the company maintains that it can get them back up to the +4% long-term potential. Recall that margins were at their lows of the mid-2% range back in 2012, so the company has done a respectable job increasing them from those levels.

Strong cash flow

In 2016, free cash flow came in at $109 million, or $221 million, excluding changes in working capital. This represented an increase of 40% from 2015's free cash flow of $157 million and a very respectable free cash flow margin (free cash flow divided by revenue) of 3.7%.

Strong balance sheet

The company has maintained its strong balance sheet throughout the years, and its debt-to-total-capitalization ratio currently stands at a healthy 16.5%.

Attractive valuation

Trading at a P/E ratio of 15 times, the valuation on the shares is attractive, in my view, especially considering the company's healthy balance sheet, its record of beating expectations, and its strong return on equity of 11%. Its price-to-book multiple is also attractive at 1.6 times.

Two companies in Celestica's peer group, **Flex Ltd.** (NASDAQ:FLEX) and **Jabil Circuit Inc.** (NASDAQ:JBL) have significantly higher valuations, despite being equal or lesser than Celestica in terms of profitability and returns on equity. Flex trades at a P/B of 3.4 times with an ROE of 11.4% — pretty much equal to Celestica — and Jabil trades at a P/B of 2.1 times with an ROE of 6.2% — significantly lower than Celestica.

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