This Incredible Tech Stock Is Severely Underpriced

Description

Hardware is an underappreciated part of the technology industry. Over the past two decades, software has chewed the world and the most exciting technology companies leverage the low costs of development and zero marginal costs of software to create massively lucrative businesses.

Hardware, meanwhile, suffers from its incessant need for capital, razor-thin margins, and intense competitive risks. With this in mind, tech giant **International Business Machines (IBM) Corp.** decided to spin off its Canadian manufacturing unit and focus on software and tech services in the early-2000s. The unit they spun off is now a publicly listed company called **Celestica** (TSX:CLS)(NYSE:CLS).

Celestica has doubled down on its hardware manufacturing and distribution operations, based on the philosophy that even the most cutting-edge software breakthroughs require hardware innovations for deployment.

If you think about it, smart cities, artificial intelligence, and self-driving cars, along with quantum computing and wearable technology, are impossible without a sophisticated layout of sensors, data centers, and semiconductors. That's the gap Celestica hopes to fill.

In recent years, the company has added the Connectivity and Cloud Solutions (CCS) business segment to its core Advanced Technology Solutions (ATS) business to achieve growth in higher-value services. According to the team, this new avenue will expand margins and infuse growth over the next few years.

The company currently expects to generate US$6 billion in revenue this year and touch 3.75% to 4.5% operating margins by the first half of 2021. While some business segments will shrink, others are expected to grow by "low double digit percentages," over the next few years as the company acquires new technology providers and customers.

In addition to its long-term ambitions, the company also has a strong fundamental base. Earnings and cash is enough to be used to pay back all its debt within a short period, the return on capital invested is 5.8%, and the requirements for capital expenditures in the near-term are around 1% of annual revenue.

By its own account, the company is a leader in the in the aerospace and defense market. They deliver advanced avionics, guidance controls, power distribution and cockpit electronics in this space. Celestica plans to expand this offering through acquisitions in the near-future.

One such acquisition was that of Atrenne Integrated Solutions, Inc., a leading designer and manufacturer of ruggedized electromechanical solutions serving multiple markets primarily for military and commercial aerospace applications. This acquisition is an indication of the company's strategy to drive incremental value.

According to a recent note by Canaccord Genuity, the company's cash balance may not only be used for these value-generating acquisitions, but also for potential dividends or buybacks in the future. Celestica has already reduced the number of outstanding shares through a massive buyback program over the past few years.

Nevertheless, the market seems unconvinced by these value signals. The stock trades at a mere 7.77 forward price-to-earnings (PE) ratio. The market price per share is a fraction of sales and book value per share, at 19% and 96% respectively. The stock is down 35% from its mid-2017 high of $19.5.

Bottom line

Celestica operates in an underappreciated part of the global technology industry, which is probably why the stock trades at bargain valuations despite indications of intrinsic value. Tech investors should take a closer look.

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