Is Celestica (TSX:CLS) Stock Breaking Out?

Description

Shares of supply chain solutions provider **Celestica** (TSX:CLS)(NYSE:CLS) gained close to 8% yesterday. The company announced its third-quarter results on October 24 and reported revenue of $1.52 billion with earnings per share of $0.13. Sales fell 11% year over year in the September quarter.

Advanced Technology Solutions (ATS) business sales were flat, while the Connectivity & Cloud Solutions (CCS) sales fell 17% year over year. ATS accounted for 37% of sales, while CCS made up the other 63%.

So, why is the stock rising, despite a significant fall in quarterly sales? The company reported revenue above its own forecast of sales between $1.4 billion and $1.5 billion. Its reported operating margin of 2.8% was also above the forecast of 2.5%.

Celestica attributed the flat sales in the ATS segment to softness in the capital equipment business. Its CCS segment managed to grow operating margin year over year as well as sequentially driven by cost efficiencies and improved mix.

Revenue growth expected to decelerate in 2019

Analysts expect Celestica sales to fall 14.3% to $1.48 billion in the fourth quarter, which will mean a sales decline of 11.6% in 2019. They now expect sales to fall by 6.2% to $5.5 billion in 2020 and 3.8% to $5.33 billion in 2021.

However, the company is estimated to increase EBITDA from $269 million in 2019 to $306 million in 2021. Its operating margin is also expected to rise from $154 million to $191 million in this period.

This fall in revenue since 2018 has driven the stock lower by 52% since April 2017. So, has the stock bottomed out, or will it raise higher as we head into 2020?

Celestica is trading at a cheap valuation

Celestica investors have lost considerable wealth in the last two years. It lost its biggest customer **BlackBerry**, which accounted for 20% of sales in 2012. However, the company has looked to diversify its revenue base and provide value-added products.

Though analysts expect earnings to fall 52.3% in 2019, it is estimated to rise by 56.9% in 2020. They also expect earnings to rise by an annual rate of 12.5% between 2020 and 2023. The pullback has meant that Celestica stock is currently trading at a market cap-to-sales ratio of just 0.14.

The stock has a forward price-to-earnings multiple of 8.7, which suggests it has upside potential if Celestica manages to meet analyst estimates going forward. Celestica, however, has an unenviable record of missing earnings estimates. It has done so for the last four quarters.

The verdict

Celestica is part of the cyclical semiconductor space. It expects demand in the capital equipment vertical to remain soft and be impacted by cyclical decreases in demand. However, customers are forecasting moderate demand growth in the first half of 2020. This slowdown will be offset by Celestica's industrial and healthcare verticals as it continues to ramp up.

Company CEO and President Rob Mionis stated, "We believe the actions we are taking are strengthening our company. We remain focused on driving productivity, successfully ramping new programs and diversifying our revenue mix to improve profitability and deliver strong and consistent financial returns over the long term."

Despite a solid third quarter, there are still a lot of uncertainties for Celestica investors. For one, the company needs to focus on improving its bottom line as sales continue to plummet. The semiconductor downcycle is also far from over and the trade war continues to impact sales.

Celestica is more a "hold" than a "buy" at the current price.

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