The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the Consolidated Financial Statements.

GENERAL

Celestica is a leading provider of electronics manufacturing services to OEMs worldwide and is the third largest EMS provider in the world with 1998 revenue of $3.2 billion. Celestica provides a wide variety of products and services to its customers, including the high-volume manufacture of complex PCAs and the full system assembly of final products. In addition, the Company is a leading provider of design, repair and engineering services, supply chain management and power products.

Historically, Celestica's business consisted of three segments – EMS, memory and power. Over the last two years, Celestica has refined its strategy to focus on its EMS business. Memory and power represented less than 10% of Celestica's total revenue in 1998.

During 1998, Celestica operated 19 facilities across North America and Europe. The acquisition of IMS in December 1998 provided the Company with an immediate and major presence in Asia, increasing the number of facilities to 24.

In July 1998, Celestica completed its initial public offering and issued 23.7 million shares for net proceeds of $389 million. The net proceeds were used to prepay a significant portion of Celestica's debt, providing the Company with additional flexibility to support its growth strategy and decreasing its total net debt to capitalization ratio from 53% to 11% year over year.

Celestica prepares its financial statements in accordance with accounting principles which are generally accepted in Canada and which, in all material respects, conform to accounting principles generally accepted in the United States except as disclosed in Note 24 to the Consolidated Financial Statements.

ACQUISITIONS

A significant portion of Celestica's growth has been generated by the strengthening of its customer relationships and increases in the breadth of its service offerings through facility acquisitions completed in 1997 and 1998.

In February 1998, Celestica acquired a manufacturing facility in Ireland from Madge Networks, a manufacturer of token ring communication products, asynchronous transfer mode products and related derivative products, for a total purchase price of $23.1 million. The acquisition provided Celestica with a facility in a key geographic area and strengthened its relationship with Madge Networks.

In June 1998, Celestica acquired certain assets of Silicon Graphics' ("SGI") manufacturing facility in Chippewa Falls, Wisconsin for a total purchase price of $14.9 million. This acquisition strengthened the Company's relationship with a strategic customer and provided Celestica with additional advanced manufacturing capabilities.

In December 1998, Celestica acquired IMS through a merger of IMS with Celestica Asia Inc., a subsidiary of the Company ("Celestica Asia"). The Company issued 7.6 million subordinate voting shares with a value of $124.0 million as consideration for the acquisition, and reserved an additional 0.8 million subordinate voting shares with a value of $9.5 million which are issuable upon the exercise of certain IMS options. IMS was an EMS provider with facilities in China, Thailand, Hong Kong, the United States and Mexico and had approximately 3,600 employees. In addition to providing an important Asian presence, this acquisition expanded Celestica's customer base, diversified its end-product markets and broadened its advanced manufacturing capabilities/ low-cost offerings.

Celestica's acquisitions of Hewlett-Packard's PCA-layout design operation in Fort Collins, Colorado in February 1998 and its embedded systems design operation in Chelmsford, Massachusetts in March 1998 have broadened Celestica's service offerings and strengthened its relationships with Hewlett-Packard. Celestica also acquired "Customer Gateway Centres" in Santa Clara, California and Raleigh, North Carolina through its 1998 acquisitions of Analytic Design and Accu-Tronics. These Customer Gateway Centres are design and prototype centres that are conveniently located relative to the Company's customers and serve as an entry to Celestica's full suite of services and large-scale production facilities. In April 1998, the Company acquired a manufacturing facility in Monterrey, Mexico from Lucent Technologies which provided it with a presence in a low-cost geography. The aggregate purchase price paid by Celestica for these acquisitions was $17.9 million.

Celestica's 12 acquisitions completed in 1997 and 1998 had purchase prices ranging from $2.5 million to $133.7 million, totalling $471.3 million. Celestica continues to examine numerous acquisition opportunities in order to:

- expand into new geographies to enhance its global presence;
- create strategic relationships with new customers and diversify end-product programs with existing customers;
- expand its capacity in selected geographic regions to take advantage of existing infrastructure or low-cost manufacturing;
- diversify its business by entering new market sectors and increasing penetration in the communications and other non-computer market sectors; and
- broaden service offerings.

Celestica's near-term targets for expansion are Central Europe and Brazil, and the Company has identified several acquisition candidates in these regions. Celestica also has identified several possible facility acquisitions that would enhance its operations, increase its penetration in non-computer sectors and establish strategic relationships with new customers. Consistent with its past practices, Celestica is engaged in ongoing discussions with respect to several possible acquisitions of widely varying sizes, from small facility acquisitions to significant multiple facility acquisitions. There can be no assurance that any of these discussions will result

in a definitive purchase agreement and, if they do, what the terms or timing of any agreement would be. Celestica expects to continue the current discussions and actively pursue other opportunities.

Celestica expects each acquisition to be accretive to earnings and cash flow after a transition period for the acquisition, generally one year. The initial margins from a newly acquired facility historically have been lower than Celestica's overall margins for several reasons: frequently, the acquired facility is underutilized; some business at the new facility may be lower margin business (such as full system assembly); some newly acquired facilities may be less efficient initially; and Celestica may accept lower initial margins on large-scale projects with significant new customers. The risks of lower margins frequently are mitigated during transition periods by supply arrangements agreed to in connection with a particular acquisition. These arrangements may include limited overhead contribution commitments, take or pay arrangements or limited revenue or product volume guarantees to support the financial viability of the facility until it reaches self-sufficiency. Celestica expects that the results for the acquired facilities will improve over the transition period as Celestica: (i) increases capacity utilization and reduces cost; (ii) completes integration activities; (iii) implements Celestica's processes and disciplines to reduce costs and obtain the cost benefits of its procurement leverage; and (iv) introduces new business from the original customer and others.

RESULTS OF OPERATIONS

Celestica's revenue and margins from period to period are affected by the volume of turnkey versus consignment sales and the mix of business between full system assembly and printed circuit assemblies. With turnkey manufacturing, where Celestica purchases the materials and components, revenue is higher and margins are generally lower. With consignment sales, where the customer purchases all or a portion of the materials and components necessary for production, revenue is lower, since Celestica records only the value-added portion as revenue, and margins are generally higher. The majority of Celestica's revenue is generated from turnkey sales. Moreover, full system assembly business typically generates lower margins than printed circuit assemblies because of the high material content in system assembly as a percentage of revenue and the lower value-added content.

Celestica's contracts with its key customers generally provide a framework for its overall relationship with the customer. Actual production volumes are based on purchase orders for delivery of products. These orders typically do not commit to firm production schedules for more than 30 to 90 days in advance. Celestica minimizes risk relative to its inventory by usually ordering materials and components only to the extent necessary to satisfy existing customer orders. Celestica is largely protected from the risk of inventory cost fluctuations as these costs are generally passed through to customers.

Celestica's annual and quarterly results are primarily affected by the level and timing of customer orders, fluctuations in material costs and the mix of materials and labour and manufacturing overhead costs. The level and timing of a customer's orders will vary due to the customer's attempt to balance its inventory, changes in its manufacturing strategy and variation in demand for its products. Celestica's annual and quarterly operating results are also affected by capacity utilization and other factors, including price competition, experience in manufacturing a particular product, the degree of automation used in the assembly process, the efficiencies achieved by Celestica in managing inventories and capital assets, the timing of expenditures in anticipation of increased sales, the timing of acquisitions and related integration costs, customer product delivery requirements and shortages of components or labour. Historically, Celestica has experienced some seasonal variation in revenue, with revenue typically being highest in the fourth quarter and lowest in the first quarter.

The comparison of results of operations from period to period is significantly affected by the timing of Celestica's acquisitions. There is no certainty that the historical pace of Celestica's acquisitions will continue in the future.

The table below sets forth certain operating data expressed as a percentage of revenue for the periods indicated:

	Predecessor Company	Celestica Inc.			
	Period from January 1, 1996 to October 22, 1996	Period from September 27, 1996 to December 31, 1996	1996 (1)	Year ended December 31, 1997	**1998**
Revenue	100.0%	100.0%	100.0%	100.0%	**100.0%**
Cost of sales	95.1	90.3	94.4	93.0	**92.9**
Gross profit	4.9	9.7	5.6	7.0	**7.1**
Selling, general and administrative expenses	1.7	4.1	2.1	3.4	**4.0**
Amortization of intangible assets	–	0.6		0.8	**1.4**
Integration costs related to acquisitions	–	–		0.6	**0.3**
Other charges	–	–		0.7	**2.0**
Operating income (loss)	3.2	5.0		1.5	**(0.6)**
Interest expense, net	0.5	2.3		1.7	**1.0**
Earnings (loss) before income taxes	2.7	2.7		(0.2)	**(1.6)**
Income taxes (recovery)	1.2	1.6		0.1	**(0.1)**
Net earnings (loss)	1.5%	1.1%		(0.3)%	**(1.5)%**

(1) For the purposes of comparison, the revenue, cost of sales, gross profit and selling, general and administrative expenses of the Predecessor Company for the period from January 1 to October 22, 1996 have been combined with the revenue, cost of sales, gross profit and selling, general and administrative expenses of Celestica for the period from September 27 to December 31, 1996. The Predecessor Company was Celestica International Inc., a wholly-owned subsidiary of IBM Canada Ltd.

Adjusted net earnings

As a result of the significant number of acquisitions made by Celestica over the past two years, management of Celestica uses adjusted net earnings as a measure of operating performance on an enterprise-wide basis. Adjusted net earnings excludes the effects of acquisition-related charges (most significantly, amortization of intangible assets and integration costs related to acquisitions) and other charges (the write down of intellectual property and goodwill, the write-off of deferred financing costs and debt redemption fees and an unusual credit loss) and the related income tax effect of these adjustments. Adjusted net earnings is not a measure of performance under Canadian GAAP or U.S. GAAP. Adjusted net earnings should not be considered in isolation or as a substitute for net earnings prepared in accordance with Canadian GAAP or U.S. GAAP or as a measure of operating performance or profitability. The following table reconciles net earnings (loss) to adjusted net earnings:

	Predecessor Company	Celestica Inc.		
	Period from January 1, 1996 to October 22, 1996	Period from September 27, 1996 to December 31, 1996	Year ended December 31, 1997	**1998**
	(in millions)	(in millions)		
Net earnings (loss)	$ 25.9	$ 3.2	$ (6.9)	**$ (48.5)**
Amortization of intangible assets	–	1.8	15.3	**45.4**
Integration costs related to acquisitions	–	–	13.3	**8.1**
Other charges	–	–	13.9	**64.7**
Income tax effect of above	–	–	(12.3)	**(24.4)**
Adjusted net earnings	$ 25.9	$ 5.0	$ 23.3	**$ 45.3**

Revenue

Revenue increased $1,242.6 million, or 61.9%, to $3,249.2 million in 1998 from $2,006.6 million in 1997. This increase resulted from new program wins with existing customers, principally at Celestica's U.S. facilities, and growth through strategic acquisitions. Revenue for Celestica's Canadian operations grew $280.9 million, or 22.0%, to $1,555.6 million in 1998 from $1,274.7 million in 1997. This increase was the result of increased business with Celestica's existing customers, partially offset by lower revenue for memory/power resulting from memory price declines in 1998 and the conversion of one IBM memory program from turnkey to consignment sales (for which Celestica records only the value-added portion as revenue) in April 1997, with a revenue impact of approximately $115.0 million. Revenue at Celestica's U.S. locations increased $675.1 million, or 250.8%, to $944.3 million in 1998 from $269.2 million in 1997. The U.S. acquisitions completed in 1998 contributed approximately $68.0 million to U.S. revenue. The IMS acquisition contributed no revenue in 1998 since the acquisition did not occur until December 30, 1998. Revenue for Europe increased $286.6 million, or 61.9%, to $749.3 million in 1998 from $462.7 million in 1997, primarily as a result of increased business with existing key customers. The acquisition of the Irish facility contributed approximately $75.0 million in revenue from the date of its acquisition in February 1998.

Revenue decreased $10.2 million, or 0.5%, to $2,006.6 million in 1997 from $2,016.8 million in 1996. Several factors contributed to this result: 1996 revenue included $248.5 million in revenue for a proprietary data storage system ("RAMAC") which was re-sourced by IBM in anticipation of the divestiture of Celestica by IBM in 1996 and one IBM memory program was converted from turnkey manufacturing to consignment resulting in revenue reduction of approximately $115.0 million, as described earlier. In addition, memory/power revenue decreased $636.4 million from $1,120.0 million in 1996 to $483.6 million in 1997. This decrease was primarily attributable to declining memory prices from 1996 to 1997. These 1997 revenue decreases were offset by a $1,043.6 million increase in non-IBM EMS revenue resulting from Celestica's diversification of its customer base. This increase included $732.5 million attributable to acquisitions completed in 1997.

The following customers represented more than 10% of total revenue for each of the indicated years:

	1996	1997	**1998**
Hewlett-Packard			✔
Sun Microsystems		✔	✔
IBM		✔	✔
Cisco Systems	✔	✔	

Celestica's top five customers represented in the aggregate, 71.8% of total revenue in 1998 compared to 70.4% in 1997 and 90.8% in 1996.

Gross profit

Gross profit increased $90.8 million, or 65.0%, to $230.5 million in 1998 from $139.7 million in 1997. Gross margin increased to 7.1% in 1998 from 7.0% in 1997. The improvement in gross profit and gross margin was due to improved cost management and facility utilization in Canada and Europe which was partially offset by a larger percentage of lower margin business associated with the Colorado and New England operations and the transitioning of operations in Celestica's U.S. and Mexico acquisitions.

Gross profit increased $26.7 million, or 23.6%, to $139.7 million in 1997 from $113.0 million in 1996. Gross margin increased to 7.0% in 1997 from 5.6% in 1996. The increase in gross profit and gross margin was primarily the result of an $18.5 million memory inventory write down in 1996 which reduced gross profit and gross margin in 1996, and a shift in the overall mix of 1997 revenue away from memory and power products toward EMS services that generate higher gross margins.

During 1998, the net change in the Company's allowance for doubtful accounts was an increase of $4.9 million to $7.7 million at December 31, 1998 from $2.8 million at December 31, 1997. In addition, the net change in the Company's reserve for inventory obsolescence was an increase of $15.6 million to $47.5 million at December 31, 1998 from $31.9 million at December 31, 1997.

During 1997, the net change in the Company's allowance for doubtful accounts was an increase of $2.0 million, to $2.8 million at December 31, 1997 from $0.8 million at December 31, 1996. In addition, the net change in the Company's reserve for inventory obsolescence was an increase of $14.2 million, to $31.9 million at December 31, 1997 from $17.7 million at December 31, 1996.

The provision for these reserves had the effect of decreasing gross profit for 1998 and 1997 by approximately $28.3 million and $36.7 million, respectively, increasing selling, general and administrative expenses by $2.8 million and $6.7 million, respectively, and decreasing net earnings for 1998 and 1997 by $31.1 million and $43.4 million, respectively. The increases in these reserves and the provisions charged to earnings are consistent with the increases in accounts receivable and inventory balances during the year.

Selling, general and administrative expenses

Selling, general and administrative expenses increased $62.3 million, or 91.2%, to $130.6 million (4.0% of revenue) in 1998 from $68.3 million (3.4% of revenue) in 1997. The increase, both in amount and as a percentage of revenue, was a result of higher selling and marketing expenses incurred to support EMS growth as well as expenses incurred by the operations acquired in the last quarter of 1997 and in 1998.

Selling, general and administrative expenses increased $26.0 million, or 61.5%, to $68.3 million (3.4% of revenue) in 1997 from $42.3 million (2.1% of revenue) in 1996. The increase, both in amount and as a percentage of revenue, was a result of operating expenses incurred by the facilities acquired in 1997 and amortization of deferred financing fees relating to the acquisition of Celestica International Inc. from IBM in the fourth quarter of 1996.

Research and development costs increased to $19.8 million in 1998 from $15.1 million in 1997 and $13.9 million in 1996. Research and development costs were less than 1% of revenue in 1996, 1997 and 1998.

Intangible assets and amortization

Amortization of intangible assets increased $30.1 million, or 196.7%, to $45.4 million in 1998 from $15.3 million in 1997 as a result of two factors. Due to rapid technological changes in the market, together with the changes in the volumes and mix of revenue derived from IBM, effective January 1, 1998, Celestica revised the estimated useful life of goodwill and other intangible assets from 20 years to 10 years and revised the estimated useful life of intellectual property from 20 years to 5 years. The revised estimated useful life more closely aligns Celestica's accounting policies for goodwill, other intangible assets and intellectual property with the accounting policies of other participants in the industry. This change increased amortization expense in 1998 from approximately $22.0 million to approximately $41.3 million, based on the net asset values at January 1, 1998. The balance of the increase from 1997 to 1998 was a result of the amortization of goodwill and other intangible assets arising from the acquisitions completed in the last quarter of 1997 and in 1998.

Amortization of intangible assets increased $13.5 million, or 750.0%, to $15.3 million in 1997 from $1.8 million in 1996. Amortization for 1996 represented only the period from September 27 to December 31, whereas amortization for 1997 included a full year of amortization related to the acquisition from IBM in 1996 as well as amortization related to Celestica's 1997 acquisitions.

The excess of the purchase price paid over the fair value of tangible assets acquired in the acquisitions completed in 1998 amounted to $105.5 million and has been allocated to goodwill and other intangible assets. Of this amount, $92.3 million related to the acquisition of IMS. In the IMS acquisition, Celestica acquired $169.7 million of identifiable assets and assumed liabilities of $128.3 million.

In 1997, the excess of the purchase price paid over the fair value of tangible assets acquired in facility acquisitions amounted to $126.8 million. In these acquisitions Celestica acquired identifiable assets of $336.9 million and assumed liabilities of $182.0 million. As Celestica was not acquiring ongoing businesses, Celestica considered these acquisitions to be primarily the acquisition of ongoing relationships with significant non-IBM customers. Accordingly, Celestica considered other strategic benefits of each acquisition rather than considering multiples of earnings or other financial measures. These strategic benefits included access to increased manufacturing capacity and capabilities, access to particular geographic markets and development of new customer and supplier relationships. In the case of the facilities acquisitions from Hewlett-Packard, Celestica believes that a portion of the purchase price paid in these acquisitions related to the long-term relationships with Hewlett-Packard. Accordingly, for accounting purposes Celestica has allocated to intangible assets the excess of the purchase price paid over the fair value of the tangible assets acquired in the Hewlett-Packard acquisitions. Further, Celestica believes that the relationships with Hewlett-Packard will extend beyond the period of the production agreements and, for accounting purposes, has determined that 10 years is a reasonable period of time over which to amortize the intangible assets acquired in these acquisitions.

At December 31, 1998, intangible assets represented 22.9% of Celestica's total assets compared to 26.1% at December 31, 1997.

In connection with certain acquisitions, Celestica has entered into production agreements with its OEM customers with terms of one to three years in duration. These agreements contain limited overhead contribution provisions or product volume guarantees for only a short period following the purchases. Celestica may enter into similar agreements in connection with future facility acquisitions.

Integration costs related to acquisitions

Integration costs related to acquisitions represent costs incurred within 12 months of the acquisition date, such as the costs of implementing compatible information technology systems in newly acquired operations, establishing new processes related to marketing and distribution processes to accommodate new customers and salaries of personnel directly involved with integration activities. Integration costs decreased $5.2 million to $8.1 million in 1998 from $13.3 million in 1997. All of the integration costs incurred related to newly acquired facilities, and not to the Company's existing operations. No such charges were incurred in 1996 as no acquisitions were made. Celestica expects to incur integration costs in 1999 as it completes the integration of operations acquired in 1998. Celestica expects to continue to incur additional integration costs in the future as acquisitions continue to be an important part of the Company's growth strategy.

Other charges

Other charges are non-recurring items or items that are unusual in nature. Other charges in 1998 totalled $64.7 million, comprised of a write down of the carrying value of intellectual property and goodwill amounting to $41.8 million, the write-off of deferred financing costs and debt redemption fees of $17.8 million and other charges of $5.1 million. The write down of the carrying value of intellectual property and goodwill of $41.8 million consisted of a first quarter charge of $35.0 million relating to certain test and process know-how and non-commercial computer programs and a fourth quarter charge of $6.8 million relating to goodwill. The $17.8 million write-off of deferred financing costs and debt redemption fees related to the prepayment of debt with proceeds from the Company's initial public offering.

At December 31, 1997, Celestica reviewed the carrying value of its intellectual property in the ordinary course of preparing its financial statements for the 1997 fiscal year. A significant portion of this intellectual property was acquired from IBM and is comprised of test and process know-how (a portion of which is used in support of Celestica's higher complexity product sales to IBM), non-commercial computer programs and confidential information used in the manufacturing of Celestica's power products. EMS revenue generated from IBM had decreased in 1997 compared to 1996 as a result of lower PCA demand for IBM mainframes and a reduction in memory component prices for PCAs. Celestica expected to maintain the level of higher complexity IBM business in fiscal 1998 at levels close to that experienced in fiscal 1997. As a result, Celestica concluded that the carrying value of its intellectual property would be recoverable in the future and therefore there was no impairment in the value of its intellectual property at that time.

In the first quarter of 1998, the decline in IBM EMS revenue continued and was greater than expected. In addition, the business mix of sales to IBM had shifted significantly from higher complexity products to lower complexity products. This shift was also unexpected. After further review, Celestica concluded that the decline in IBM EMS revenue and the shift in the mix of sales to IBM would continue for the remainder of the year. The manufacture of the lower complexity products does not require the use of much of the technology purchased from IBM in 1996. As a result of these specific changes in volumes and mix of products, Celestica updated its forecast of revenue derived from IBM. Celestica carried out a further review of the carrying value of its test and process know-how at the end of the first quarter of 1998. Further, the reduction in business from IBM was offset by an increase in non-IBM business resulting in the development and implementation of more state-of-the-art technologies which replaced some of the test and process know-how purchased from IBM. Based on this review, Celestica wrote down certain of the test and process know-how by $24.5 million.

Separately, in late March 1998, Celestica made a decision to replace certain of its non-commercial computer programs with new programs and to discontinue use of the non-commercial computer programs acquired from IBM. As a result, Celestica wrote down the carrying value of these programs by $10.5 million.

In December 1998, as a result of the merger with IMS, certain goodwill in the amount of $6.8 million became impaired and was written off.

Other charges of $13.9 million in 1997 resulted from a credit loss relating to a customer which filed for bankruptcy. Celestica has not experienced any other material credit losses. As part of Celestica's risk management strategy, Celestica now insures against substantially all its credit risk with external credit insurers.

Interest expense

Interest expense, net of interest income, decreased $1.4 million, or 4.2%, to $32.2 million in 1998 from $33.6 million in 1997. Celestica incurred interest charges of approximately $11.6 million on additional borrowings to finance acquisitions completed in the first half of 1998 and the growth in operations of the Company. Debt levels during the second half of 1998 were lower than in the first half of 1998 as the net proceeds from the initial public offering were used to prepay a significant portion of the Company's debt, yielding interest savings of approximately $13.8 million.

Interest expense, net of interest income, increased $18.7 million, or 125.5%, to $33.6 million in 1997 from $14.9 million in 1996, which was comprised of $8.4 million for the period from January 1 to October 22, 1996 and $6.5 million for the period from September 27 to December 31, 1996. This increase was primarily due to higher levels of long-term debt as a result of the change in capitalization related to the acquisition of Celestica from IBM and long-term debt incurred to finance the 1997 acquisitions.

Income taxes

Income tax expense in 1998 is comprised of a current income tax expense of $15.0 million and a recovery of deferred income taxes of $17.0 million, resulting in a net recovery in income taxes of $2.0 million in 1998 compared to a net income tax expense of $2.2 million in 1997. This income tax recovery resulted primarily from the recognition of the tax benefit of net operating losses incurred in 1998 in certain jurisdictions which exceeded the current income tax expense on operating profits generated in other jurisdictions.

Income taxes decreased $22.6 million, or 91.1%, to $2.2 million in 1997 from $24.8 million in 1996, comprised of $20.3 million for the period from January 1 to October 22, 1996 and $4.5 million for the period from September 27 to December 31, 1996. During the fourth quarter of 1997, with an effective date of January 1, 1997, Celestica adopted a new Canadian GAAP standard whereby future income taxes are recognized based on assets and liabilities carried on the balance sheet. The adoption of the new standard resulted in a reduction of income tax expense of $4.5 million in 1997.

Celestica has recognized a net deferred tax asset at December 31, 1998 of $40.6 million which relates to the recognition of net operating losses and future income tax deductions available to reduce future years' income for income tax purposes. Celestica's current projections demonstrate that it will generate sufficient taxable income (in excess of $115.0 million) in the future to realize the benefit of these deferred income tax assets in the carry-forward periods, not exceeding 15 years.

LIQUIDITY AND CAPITAL RESOURCES

For the year ended December 31, 1998, Celestica generated cash from operating activities of $81.6 million. Earnings generated $84.9 million in cash which was used to partially fund the operations and acquisition activities of the Company. Average non-cash working capital as a percentage of revenue decreased to 8.0% in 1998 from 11.0% in 1997. Investing activities in 1998 included the acquisitions of Analytic Design, Accu-Tronics (Celestica North Carolina), Celestica Mexico, the SGI facility (Celestica Wisconsin) and the Madge Networks facility (Celestica Ireland) which used cash, net of cash acquired, of $48.7 million. The acquisition of IMS was completed by issuing subordinate voting shares with a value of $124.0 million and reserving additional subordinate voting shares with a value of $9.5 million which are issuable upon the exercise of certain IMS options.

In July 1998, Celestica replaced its then outstanding credit facilities with a global, unsecured, revolving credit facility of $250 million provided by a syndicate of lenders. The new credit facility permits Celestica and certain designated subsidiaries to borrow funds directly for general corporate purposes (including acquisitions) at floating rates. The credit facility is available for a period of five years. Under the credit facility, Celestica is required to maintain certain financial ratios; its ability and that of certain of its subsidiaries to grant security interests, dispose of assets, change the nature of its business or enter into business combinations is restricted; and a change in control is an event of default. No borrowings were outstanding under the credit facility at December 31, 1998.

The only other financial covenant in effect is a debt incurrence covenant contained in Celestica's Senior Subordinated Notes due 2006. This covenant is based on Celestica's fixed charge coverage ratio, as defined in the indenture governing the Senior Subordinated Notes.

Celestica believes that cash flow from operating activities, together with borrowings available under its global, unsecured, revolving credit facility, and its share issuance on March 4, 1999 will be sufficient to fund currently anticipated working capital, planned capital spending and debt service requirements for the next 12 months. The Company's planned capital spending for 1999 is approximately $125 million of which approximately $46 million is committed as of January 31, 1999. In addition, Celestica regularly reviews acquisition opportunities, and may therefore require additional debt or equity financing. Celestica also intends to increase the availability of committed revolving credit by $150 million to provide additional liquidity and financing flexibility in 1999.

Celestica prices the majority of its products in U.S. dollars, and the majority of its material costs are also denominated in U.S. dollars. However, a significant portion of its non-material costs (including payroll, facilities costs and costs of locally sourced supplies and inventory) are denominated in Canadian dollars and British pounds sterling (approximately Cdn$320 million and £84.0 million on an annualized basis, respectively). As a result, Celestica may experience transaction and translation gains or losses because of currency fluctuations. At December 31, 1998, Celestica had forward foreign exchange contracts covering various currencies with expiry dates up to January 2000 in a notional amount of $163.9 million. The fair value of these contracts at December 31, 1998 was an unrealized loss of $10.2 million. Celestica may, from time to time, enter into hedging transactions to minimize its exposure to foreign currency and interest rate risks. Celestica's current hedging activity is designed to reduce the variability of its foreign currency costs and involves entering into contracts to sell U.S. dollars to purchase Canadian dollars and British pounds sterling at future dates. In general, these contracts extend for periods of less than 18 months. There can be no assurance that such hedging transactions, if entered into, will be successful.

A portion of the costs of the operations Celestica acquired through the IMS acquisition are denominated in other currencies, such as the Thai baht, the Hong Kong dollar and the Chinese renminbi. The recent economic problems in Hong Kong and Thailand, including the devaluation of the Thai baht, did not adversely impact IMS. Celestica does not expect the impact of future exchange rate changes in these currencies to have a material effect on Celestica's operations.

YEAR 2000

General

The year 2000 issue concerns the potential exposures related to the automated generation of business and financial misinformation resulting from the fact that certain computer systems, embedded systems and hardware use two digits, rather than four, to define the applicable year. On January 1, 2000, these systems and programs may recognize the date as January 1, 1900 and may process data incorrectly or stop processing data altogether. Celestica relies upon vendor-supplied technology and recognizes the potential business risk to its assets and systems associated with the arrival of the year 2000.

Status of remediation

Celestica has identified three phases in its year 2000 project: identify, test and validate. The identification phase involves the collection and validation of an inventory of computer related devices and an evaluation and assessment of each inventoried item. The testing phase includes remediation (repair, replace or retire) and various levels of testing for compliance. The validation phase includes the verification that the system or process will continue to function in the year 2000 and beyond.

As of January 31, 1999, Celestica had identified approximately 700 year 2000 projects that were considered mission critical – that is, projects where the failure to complete the year 2000 remediation on a timely basis would cause a substantial disruption in, or cessation of, a significant portion of Celestica's business. Mission critical projects include remediation of all hardware and software for all information technology ("IT") applications and systems, all manufacturing processes and all production facility processes. As of January 31, 1999, Celestica had completed assessment on approximately 98% of mission-critical projects, testing on approximately 73% and validation on approximately 60%.

Non-mission critical projects include non-IT systems such as those which may be used in the operation of certain non-production machinery and equipment. As of January 31, 1999, Celestica had completed assessment on approximately 97% of such non-mission critical projects, testing on approximately 88% and validation on approximately 71%.

Celestica expects to complete all year 2000 remediation for these projects by the end of June 1999. The failure to complete the remedial actions on a timely basis could have a material adverse effect on Celestica's business, results of operations and financial condition.

Third party compliance

Celestica's year 2000 project scope extends to assessing issues affecting suppliers' and customers' products, services, systems and operations. In early 1998, Celestica sent questionnaires to substantially all of its vendors and suppliers requesting information regarding their year 2000 compliance, and Celestica is following up on all unsatisfactory responses. Based on information available to it at December 31, 1998, Celestica believes that approximately 67% of its suppliers are year 2000 compliant. Celestica will undertake on-site supplier reviews to confirm compliance where it considers it appropriate.

In addition to these formal inquiries, Celestica has been working closely on year 2000 issues with those third parties with which Celestica has significant relationships, including, in particular, significant customers and suppliers. Mutual testing of electronic data interfaces between Celestica and its significant customers and suppliers is being performed in an effort to ensure their year 2000 compliance.

Contingency plans

Celestica is developing contingency plans for potential year 2000 failures. Celestica intends to develop, where practicable, contingency plans for all mission critical processes. Celestica plans to complete these contingency plans by June 1999.

Estimated costs

Celestica currently estimates that the total costs for its year 2000 remediation projects, including remediation at IMS, will be approximately $10.0 million. As of December 31, 1998, Celestica and IMS had each incurred $3.0 million for year 2000 projects. Year 2000 expenditures are financed through funds generated from operations, and are capitalized to the extent they enhance the capabilities and useful life of the underlying systems. Celestica has not deferred any major information technology projects as a result of its year 2000 remediation efforts.

Part of Celestica's overall acquisition strategy is to implement common technology platforms across all of its major locations. In addition, Celestica has been refreshing many of its existing systems (supply chain systems, engineering systems and office systems) in support of its corporate growth

strategies. Since the migration to common technology platforms is part of Celestica's overall acquisition and integration strategies and no significant systems implementation was accelerated as a result of year 2000 issues, none of these costs have been included in Celestica's estimate of year 2000 remediation costs noted above.

Celestica has not assessed the financial impact of not being year 2000 compliant. Failure to be year 2000 compliant could have a material adverse effect on Celestica's business, results of operations and financial condition.

BACKLOG

Although Celestica obtains firm purchase orders from its customers, OEM customers typically do not make firm orders for delivery of products more than 30 to 90 days in advance. Celestica does not believe that the backlog of expected product sales covered by firm purchase orders is a meaningful measure of future sales since orders may be rescheduled or cancelled.

RECENT ACCOUNTING DEVELOPMENTS

During 1997, the Canadian Institute of Chartered Accountants ("CICA") issued a new accounting standard for income taxes which is substantially consistent with the existing accounting standard under U.S. GAAP. This new standard has been adopted by Celestica effective January 1, 1997. The change would not have had a significant effect on the accounting for income taxes of Celestica for the period from September 27, 1996 to December 31, 1996. The new accounting standard was not applied to the accounting for income taxes of the Predecessor Company. See Note 24 to the Celestica Consolidated Financial Statements for details of the differences between the accounting for income taxes under Canadian and U.S. GAAP.

The CICA also issued a new standard for the reporting of segmented information in financial statements, effective for fiscal years beginning on or after January 1, 1998 (quarterly financial information beginning after January 1, 1999). Celestica has adopted the new standard for its fiscal year ended December 31, 1998. See Note 22 to the Celestica Consolidated Financial Statements for segmented information.

As of January 1, 1998, Celestica implemented SFAS No. 130 "Reporting Comprehensive Income." Comprehensive earnings (loss) for the year ended December 31, 1998 were consistent with net earnings (loss) for the year for purposes of presentation of financial information in accordance with U.S. GAAP.

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes methods of accounting for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. The Company will be required to implement SFAS No. 133 for its fiscal year ended December 31, 2000. The Company expects the adoption of SFAS No. 133 will have no material impact on its financial position, results of operations or cash flows.

In March 1998, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use." SOP 98-1 requires that entities capitalize certain costs related to internal-use software once certain criteria have been met. The Company will be required to implement SOP 98-1 for its fiscal year ended December 31, 1999. The Company has not yet determined the impact of SOP 98-1 on its financial position, results of operations and cash flows.

In April 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires that all start-up costs related to new operations must be expensed as incurred. In addition, all start-up costs that were capitalized in the past must be written off when SOP 98-5 is adopted. The Company will be required to implement SOP 98-5 for its fiscal year ended December 31, 1999. The Company expects that the adoption of SOP 98-5 will have no material impact on its financial position, results of operations or cash flows.