Celestica

Management's Discussion and Analysis of Condition and Results of Operations

THIRD QUARTER 1998

The following discussion of the financial condition and results of operations of Celestica and the Predecessor Company (Celestica North America Inc.) should be read in conjunction with the Celestica interim and annual Consolidated Financial Statements.

Overview

Celestica was formed to effect the acquisition of Celestica N.A. from IBM in October 1996 by an investor group, which included management of Celestica, led by Onex. Celestica N.A. was established on January 1, 1994 and is the successor to a manufacturing business that was an important supplier to IBM for over 75 years. In 1993, Celestica, which had for many years been competing with outside suppliers for IBM business, began marketing its services to non-IBM OEM customers. Celestica serves its customers by providing a broad range of EMS services complemented by the provision of memory and power products. As a result of a shift in Celestica's strategic focus to become a full service EMS provider, Celestica's revenue mix has changed over the past several years with EMS revenue now constituting a majority of total revenue.

Celestica's EMS revenue has grown both organically and through acquisitions in 1997 and 1998 consistent with Celestica's overall corporate strategy to enhance revenue and profit by strategically expanding its geographic base of operations, broadening its service offerings and adding depth to its customer base.

Since January 1997, Celestica has completed the following eleven acquisitions:

• assets of Design to Distribution Limited, one of the largest European EMS providers, effective January 1, 1997

• assets related to Hewlett-Packard's printed circuit assembly facility in Fort Collins, Colorado and its system assembly facility in Exeter, New Hampshire, in July, August and October 1997

• Ascent, a Canadian-based manufacturer and developer of high and low voltage power supply products, in October 1997

• the Dublin, Ireland manufacturing operation of Madge Networks, a manufacturer of token ring communication products, ATM products and related derivative products, in February 1998

• assets related to Hewlett-Packard's embedded systems organization in Chelmsford, Massachusetts in March 1998, and its PCA-layout design operation in Fort Collins, Colorado, in February 1998

• a manufacturing facility from Lucent in Monterrey, Mexico, in April 1998

• Analytic Design, a "Customer Gateway Centre" in Santa Clara, California, in May 1998

• assets related to SGI's manufacturing facility in Chippewa Falls, Wisconsin in June 1998

• Accu-Tronics, a "Customer Gateway Centre" in Raleigh, North Carolina, in September 1998

Customer Gateway Centres provide design, quick turn prototyping and high complexity, low to medium volume assembly as well as a seamless entry to Celestica's various larger manufacturing campuses.

On July 7, 1998, Celestica closed its initial public offering, raising net proceeds of $389.3 million, including the initial offering and the exercise of the underwriters' over-allotment option and after deducting underwriters' commissions and other related expenses. The proceeds were used to prepay debt and for general corporate purposes. Concurrently with the initial public offering and the prepayment of debt, Celestica established a $250.0 million global, unsecured, revolving credit facility with a five-year term. During the third quarter, this facility was syndicated to a group of six financial institutions.

During 1997, Celestica's three largest customers, IBM, Sun Microsystems and Cisco Systems, each represented in excess of 10% of total revenue and in the aggregate represented 51.3% of total revenue (compared to 86.3% for the three largest customers in 1996). Celestica's next five largest customers represented approximately 35.5% of Celestica's total revenue in 1997 (compared with 4.7% for the next five largest customers in 1996). IBM represented 26.8% of total revenue in 1997. During 1996, IBM represented 77.2% of total revenue and was the only customer representing in excess of 10% of total revenue. Celestica expects Hewlett-Packard to continue to be a significant customer in the future as a result of Celestica's acquisition of two Hewlett-Packard facilities in the United States in 1997 and the recent award to Celestica of a share of Hewlett-Packard's commercial personal computer final assembly business for North America. In the nine months ended September 30, 1998, Celestica's three largest customers were Hewlett-Packard, Sun Microsystems and IBM, which represented, in the aggregate, 56.1% of total revenue. IBM represented 10.8% of total revenue in the nine months ended September 30, 1998.

Commencing in late 1995, memory module prices began to fall precipitously. On average, memory module prices were approximately 85% lower in 1997 than in 1995. Because of the high material content of memory products, Celestica's memory products revenue declined sharply. The fundamental market shifts that occurred in the memory industry caused Celestica to introduce initiatives related to its overall inventory policy and supplier strategies. Celestica now employs a strategy of risk management relative to its inventory and, in most cases, orders material and components only to the extent necessary to satisfy existing customer orders. Specific inventory management strategies with certain suppliers are designed to minimize Celestica's risk of cost fluctuation for certain components. These changes have resulted in inventories that are more closely aligned with firm orders from customers and current market prices. Celestica's risk of fluctuation in inventory costs is further minimized by the general pass-through of component costs to customers. However, Celestica's inventory is susceptible to certain obsolescence factors. For accounting purposes, Celestica records certain provisions for inventory obsolescence caused by shrinkage, price declines, physical damage and technological obsolescence.

Due to the nature of turnkey manufacturing (where Celestica procures some or all of the components necessary for production), Celestica's annual and quarterly results are primarily affected by the level and timing of customer orders, fluctuations in materials costs and the mix of materials, labor 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 also are 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 labor. Historically, Celestica has experienced some seasonal variation in revenue, with revenue in the fourth quarter slightly higher than revenue in each of the first three quarters.

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. IBM EMS revenue 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, 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 with 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.

Due to rapid technological changes in the market, together with the changes in the volumes and mix of revenue derived from IBM, for accounting purposes, 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 to 5 years, which 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 has been applied prospectively from January 1, 1998 and will increase amortization expense in 1998 from approximately $22.0 million to approximately $41.3 million, based on the net asset values at January 1, 1998.

At September 30, 1998, intangible assets, including the intellectual property referred to above, represented 21.5% of Celestica's total assets. These intangible assets are being amortized to income over five to ten years on a straight-line basis.

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 23 to the Celestica 1997 Consolidated Financial Statements.

Statements contained herein, which are not historical facts, are forward-looking statements which involve risks and uncertainties which could cause actual results to differ materially from those expressed in the forward-looking statements. Among the key factors that could cause such differences are: the level of overall growth in the EMS industry; variability of operating results among periods; dependence on the computer and communications industries; dependence on a limited number of customers; and the ability to manage expansion, consolidation and the integration of acquired businesses. These and other factors are discussed in the Company’s initial public offering prospectus and other public filings.

Results of Operations

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.						
	Year ended December 31,	January 1 to October 22,	September 27 to December 31,	Year ended December 31,		Three months ended September 30,		Nine months ended September 30,	
	1995	1996	1996	1996[1]	1997	1997	1998	1997	1998
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	94.4	95.1	90.3	94.4	93.0	91.7	92.6	93.1	93.1
Gross profit	5.6	4.9	9.7	5.6	7.0	8.3	7.4	6.9	6.9
Selling, general and administrative expenses	1.7	1.7	4.1		3.4	4.0	4.3	3.8	4.0
Amortization of intangible assets	—	—	0.6		0.8	1.0	1.3	0.8	1.5
Integration costs related to acquisitions	—	—	—		0.6	0.5	0.2	0.2	0.2
Unusual charges	—	—	—		0.7	—	—	1.1	0.8
Write-down of intellectual property	—	—	—		—	—	—	—	1.5
Operating income (loss)	3.9	3.2	5.0		1.5	2.8	1.6	1.0	(1.1)
Interest expense, net	0.3	0.5	2.3		1.7	1.9	0.5	1.6	1.3
Net earnings (loss) before income taxes	3.6	2.7	2.7		(0.2)	0.9	1.1	(0.6)	(2.4)
Income taxes	1.4	1.2	1.6		0.1	0.6	0.3	0.1	(0.4)
Net earnings (loss)	2.2%	1.5%	1.1%		(0.3)%	0.3%	0.8%	(0.7)%	(2.0)%

(1) For the purposes of comparison, the revenue, cost of sales and gross profit of the Predecessor Company for the period from January 1 to October 22, 1996 have been combined with the revenue, cost of sales and gross profit of Celestica Inc. for the period from September 27 to December 31, 1996.

From the perspective of financial performance, 1997 was Celestica's first full year of operations as an independent enterprise and as such was a transitional year. Total revenue in 1997 was substantially the same as 1996. Several factors contributed significantly to this result: as anticipated at the time of Celestica North America’s ("Celestica N.A") acquisition, IBM retained production of a proprietary data storage system ("RAMAC") that had contributed revenue of $248.5 million in 1996; revenue declined more than $600.0 million due to deflation in memory component prices; and one IBM memory program was converted from turnkey manufacturing to consignment sales (for which Celestica only records the value-added portion as revenue) effective April 1997 with a revenue impact of approximately $115.0 million. This program was Celestica's only significant consignment program for the periods presented. Substantially offsetting these factors were EMS revenue gains from organic growth (which resulted from an increase in sales volume) and from acquisitions completed in 1997.

Particularly because of the significant number of acquisitions Celestica has made, management of Celestica uses adjusted net earnings to measure operating performance from period to period. Adjusted net earnings excludes the effects of acquisition related charges (most significantly, the amortization of goodwill, intellectual property and intangible assets representing the excess of cost over the fair value of tangible assets acquired) and unusual charges (an unusual credit loss, write-down of intellectual property, write-off of deferred financing fees and debt redemption fees), and the income tax effect of those 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.					
					Three months ended September 30,		Nine months ended September 30,	
	Year ended December 31, 1995	January 1 to October 22, 1996	September 27 to December 31, 1996	Year ended December 31, 1997	1997	1998	1997	1998
	(in millions)		(in millions)					
Net earnings (loss)	$62.8	$25.9	$3.2	$(6.9)	$1.4	$6.3	$(8.9)	$(44.7)
Amortization of intangible assets	—	—	1.8	15.3	3.9	10.8	10.5	34.6
Integration costs related to acquisitions	—	—	—	13.3	2.1	1.3	2.9	5.6
Unusual charges	—	—	—	13.9	—	—	13.9	17.8
Write-down of intellectual property	—	—	—	—	—	—	—	35.0
Income tax effect of above	—	—	—	(12.3)	(1.3)	(2.2)	(7.5)	(21.7)
Adjusted net earnings	$62.8	$25.9	$5.0	$23.3	$6.1	$16.2	$10.9	$26.6

Three months and nine months ended September 30, 1998 compared to the three months and nine months ended September 30, 1997

Revenue. Revenue increased $402.5 million, or 98.4%, in the three months ended September 30, 1998 to $811.6 million from $409.1 million for the same period last year. Revenue for the nine months ended September 30, 1998 increased $1,000.5 million, or 75.6%, to $2,323.9 million from $1,323.4 million in the same period last year. Revenue growth is attributable to both organic growth and strategic acquisitions. Revenue increased $38.0 million, or 4.9%, in the three months ended September 30, 1998 to $811.6 million from $773.6 million in the three months ended June 30, 1998. In terms of geographic segmentation, for the nine months ended September 30, 1998, approximately 78% of the revenue was generated in North America with the balance being generated in Europe.

Gross profit. Gross profit increased $26.1 million, or 77.2%, for the three months ended September 30, 1998 to $59.9 million from $33.8 million in the same period last year. Gross margin decreased to 7.4% for the three months ended September 30, 1998 from 8.3% for the same period last year primarily as a result of an overall shift in revenue mix toward lower margin business associated with the Colorado and New England campuses. For the nine months ended September 30, 1998, gross profit increased $70.2 million, or 77.1%, to $161.3 million from $91.1 million for the same period last year. For the nine months ended September 30, 1998, gross margin remained flat at 6.9% compared to the same period last year. Gross profit increased $6.2 million, or 11.5%, for the three months ended September 30, 1998 to $59.9 million from $53.7 million for the three months ended June 30, 1998. Gross margin increased to 7.4% for the three months ended September 30, 1998 from 6.9% in the three months ended June 30, 1998 as a result of a shift in business mix.

Selling, general and administrative expenses. Selling, general and administrative expenses increased $18.8 million, or 116.0%, to $35.0 million for the three months ended September 30, 1998 from $16.2 million for the same period last year. For the nine months ended September 30, 1998, selling, general and administrative expenses increased $43.9 million, or 87.8%, to $93.9 million from $50.0 million for the same period last year. The increase was a result of higher selling and marketing expenses incurred to support the expanded breadth of EMS and other services and expenses incurred by the operations acquired in the last quarter of 1997 and in 1998. Selling, general and administrative expenses increased $2.5 million, or 7.7%, in the three months ended September 30, 1998 from $32.5 million for the three months ended June 30, 1998 to support the higher revenue levels, as well as the addition of selling, general and administrative costs incurred by Celestica Wisconsin which was acquired at the end of June 1998. Research and development expense increased $1.2 million or 38.7%, to $4.3 million (0.5% of revenue) in the three months ended September 30, 1998 from $3.1 million (0.8% of revenue) for the same period last year. Research and development expense for the nine months ended September 30, 1998 increased $3.2 million, or 29.9%, to $13.9 million (0.6% of revenue) from $10.7 million (0.8% of revenue).

Amortization of intangible assets. Amortization of intangible assets increased $6.9 million, or 176.9%, to $10.8 million for the three months ended September 30, 1998 from $3.9 million for the same period last year. Amortization of intangible assets for the nine months ended September 30, 1998 increased $24.1 million, or 229.5%, to $34.6 million from $10.5 million for the same period last year. Effective January 1, 1998, the Company revised the estimated useful life of goodwill and other intangible assets from 20 years to 10 years and of intellectual property from 20 years to 5 years. This change increased amortization expense in the three months and nine months ended September 30, 1998 by $5.5 million and $18.8 million, respectively. The balance of the increase 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.

Integration costs related to acquisitions. Integration costs related to acquisitions decreased $0.8 million to $1.3 million for the three months ended September 30, 1998 from $2.1 million for the same period last year. For the nine months ended September 30, 1998, integration costs related to acquisitions increased $2.7 million to $5.6 million from $2.9 million for the same period last year. These costs relate to the acquisitions completed in the second half of 1997 and in 1998 and were for information technology, new processes and salaries associated with integrating these operations. Celestica expects to incur additional integration costs during the balance of 1998 and first half of 1999 relating to the 1998 acquisitions.

Unusual charges. During the three months ended September 30, 1998, Celestica did not incur any unusual charges. During the nine-month period ended September 30, 1998, Celestica incurred unusual charges related to the write-off of deferred financing costs and debt redemption fees associated with the prepayment of debt from the proceeds of Celestica's initial public offering and the write-down of the carrying value of its intellectual property by $35.0 million. During the nine months ended September 30, 1997, Celestica incurred a credit loss totaling $13.9 million relating to a customer which filed for bankruptcy. Celestica has not experienced any other material credit losses. As part of the Company'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 $4.2 million, or 53.2%, to $3.7 million for the three months ended September 30, 1998 from $7.9 million for the same period last year. Interest expense, net of interest income, for the nine months ended September 30, 1998 increased $7.4 million, or 33.9%, to $29.2 million from $21.8 million for the same period last year. The increase for the nine-month period is a result of increased debt levels incurred to finance the 1997 and 1998 acquisitions. Interest expense, net of interest income, decreased $9.3 million, or 71.5%, in the three months ended September 30, 1998 to $3.7 million from $13.0 million for the three months ended June 30, 1998 as a result of the prepayment of a significant portion of the outstanding debt with the proceeds of the initial public offering.

Income taxes. Income tax expense increased $0.5 million to $2.8 million for the three months ended September 30, 1998 from $2.3 million for the same period last year. Recovery of income taxes for the nine months ended September 30, 1998 increased $11.0 million to $10.1 million from an expense of $0.9 million a year earlier. This increase was primarily due to the tax recovery associated with the unusual charges recorded in 1998.

Year ended December 31, 1997 compared to year ended December 31, 1996

Revenue. Revenue decreased $10.2 million, or 0.5%, to $2,006.6 million in 1997 from $2,016.8 million in 1996.

Non-IBM EMS revenue increased $1,043.6 million, or 330.1%, to $1,359.7 million in 1997 from $316.1 million in 1996 primarily resulting from Celestica's diversifying its customer base both organically and through acquisitions. Organic non-IBM EMS revenue increased $311.1 million, or 98.4%, to $627.2 million in 1997 from $316.1 million in 1996. Non-IBM EMS revenue from operations acquired in 1997 was $732.5 million. Celestica Colorado and Celestica New England operated on a consignment basis prior to October 31, 1997 and on a turnkey basis thereafter.

IBM EMS revenue decreased $168.9 million, or 50.8%, to $163.3 million in 1997 from $332.2 million in 1996. This decrease was a result of lower PCA demand for IBM mainframes and a reduction in memory component prices for PCAs. IBM-RAMAC revenue decreased $248.5 million to $nil in 1997 from $248.5 million in 1996. This decrease was a result of the re-sourcing of the RAMAC program which was planned in anticipation of the sale of Celestica N.A. by IBM in 1996.

Memory/Power revenue decreased $636.4 million, or 56.8%, to $483.6 million in 1997 from $1,120.0 million in 1996. This decrease was primarily attributable to declining memory prices from 1996 through 1997 as described below.

Gross profit. Gross profit increased $26.7 million, or 23.6%, to $139.7 million in 1997 from $113.0 million in 1996. Gross profit as a percentage of revenue increased to 7.0% in 1997 from 5.6% for 1996. The increase in gross profit and margin was primarily a result of an $18.5 million memory inventory write-down in 1996 and a shift in the overall mix of revenue. EMS services accounted for 75.9% of revenue in 1997 and 44.5% of revenue in 1996.

During 1997, the net change in Celestica'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 Celestica'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 1997 by approximately $36.7 million, increasing selling, general and administrative expenses by approximately $6.7 million and decreasing net earnings for 1997 by approximately $27.1 million. 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.

In the first quarter of 1996, the cost of memory decreased by approximately 45% and has decreased since then to approximately 15% of its 1995 value. Given the magnitude of DRAM (dynamic random access memory) components in the price of finished memory products, Celestica recorded an inventory write-down of $18.5 million during the first half of 1996. This was due largely to (i) the devaluation of DRAM inventories Celestica had built up to satisfy anticipated customer demand for standard memory products, and (ii) fixed price and volume purchase commitments.

Selling, general and administrative expenses. Selling, general and administrative expenses increased $25.9 million, or 61.1%, to $68.3 million in 1997 from $42.4 million in 1996, comprised of $30.5 million for the period from January 1 to October 22, 1996 and $11.9 million for the period from September 27 to December 31, 1996. Selling, general and administrative expenses, as a percentage of revenue, was 3.4% in 1997 compared to 1.7% for the period from January 1 to October 22, 1996 and 4.1% for the period from September 27 to December 31, 1996. The increase in the post-acquisition period was a result of higher sales-related expenses associated with building Celestica's non-IBM EMS business. The increase in 1997 was a result of operating expenses of $10.4 million incurred by the facilities acquired in 1997 and amortization of deferred financing fees relating to the acquisition from IBM of Celestica N.A. in the fourth quarter of 1996. Research and development expense increased $1.2 million, or 8.6%, to $15.1 million in 1997 from $13.9 million in 1996, comprised of $11.1 million for the period from January 1 to October 22, 1996 and $2.8 million for the period from September 27 to December 31, 1996. Research and development expense as a percentage of revenue remained stable at 0.7% in 1997.

Amortization of intangible assets. Amortization of intangible assets increased $13.5 million, or 750%, to $15.3 million in 1997 from $1.8 million in 1996. All of the amortization of intangible assets was incurred during the period from September 27 to December 31, 1996. This increase was a result of a full year of amortization in 1997 of goodwill and intangible assets acquired in 1996 compared to a partial year in 1996 and amortization of additional goodwill and intangible assets acquired with Celestica U.K., the Hewlett-Packard and the Ascent acquisitions in 1997.

Integration costs related to acquisitions. Integration costs related to acquisitions increased $13.3 million to $13.3 million in 1997 from $nil in 1996. This increase was a result of the costs incurred related to the integration of operations acquired in 1997, including: $4.5 million associated with implementing compatible information technology systems in the newly acquired operations; $1.7 million associated with establishing new processes, primarily related to new marketing and distribution processes to accommodate planned additional customers; and $7.1 million related to salaries of personnel directly involved with integration activities. None of the integration costs incurred related to existing operations.

Unusual charges. Unusual charges increased $13.9 million in 1997 from $nil in 1996. The unusual charge was the result of a credit loss totalling $13.9 million in 1997 relating to a customer which filed for bankruptcy. Revenue associated with this customer totaled $15.4 million in 1997; there were no outstanding accounts receivable related to this customer as at December 31, 1997. 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 increased by $18.7 million, or 125.5%, to $33.6 million in 1997 from $14.9 million in 1996, 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 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, 1997 of $13.7 million, of which $12.9 million related to the recognition of net operating losses available to reduce future years' income for income tax purposes. Celestica's current projections demonstrate that it will generate sufficient income for income tax purposes in the future to realize the benefit of the net operating loss in the 15-year carry-forward period.

Year ended December 31, 1996 compared to year ended December 31, 1995

Revenue. Revenue decreased $838.4 million, or 29.4%, to $2,016.8 million in 1996 from $2,855.2 million in 1995.

Non-IBM EMS revenue increased $208.1 million, or 192.7%, to $316.1 million in 1996, from $108.0 million in 1995, reflecting Celestica's strategy to grow its non-IBM EMS revenue. IBM EMS revenue decreased $110.3 million, or

24.9%, to $332.2 million in 1996 from $442.5 million in 1995 primarily as a result of lower PCA demand for IBM mainframes, and a reduction in memory component prices for PCAs. IBM-RAMAC revenue decreased $296.0 million, or 54.4%, to $248.5 million in 1996 from $544.5 million in 1995 as a result of the decision to re-source this program internally within IBM in mid-1996 in anticipation of the sale of Celestica N.A. by IBM. Memory/Power revenue declined $640.2 million, or 36.4%, to $1,120.0 million in 1996 from $1,760.2 million in 1995 substantially due to the decline in memory prices.

Gross profit. Gross profit in 1996 decreased $46.6 million, or 29.2%, to $113.0 million in 1996 from $159.6 million in 1995. Gross profit as a percentage of revenue remained constant at 5.6% in 1996 despite a negative margin impact of 0.9% resulting from a $18.5 million inventory write-down due to lower average memory prices in 1996.

Selling, general and administrative expenses. Selling, general and administrative expenses decreased $5.2 million, or 10.9%, to $42.4 million in 1996, comprised of $30.5 million for the period from January 1 to October 22, 1996 and $11.9 million for the period from September 27 to December 31, 1996, from $47.6 million in 1995. Selling, general and administration expenses, as a percentage of revenue, was 1.7% for the period from January 1 to October 22, 1996 and 4.1% for the period from September 27 to December 31, 1996 and was 1.7% of revenue in 1995. The increase in selling, general and administrative expenses in the post-acquisition period, as a percentage of revenue, was primarily attributable to an increase in amortization of deferred financing charges and higher research and development costs. Research and development expenses increased by $2.4 million, or 20.9%, to $13.9 million (0.7% of revenue) in 1996, comprised of $11.1 million for the period from January 1 to October 22, 1996 and $2.8 million for the period from September 27 to December 31, 1996, from $11.5 million (0.4% of revenue) in 1995. The increase in the post-acquisition period was primarily due to higher development costs in support of non-IBM business.

Amortization of intangible assets. Amortization of intangible assets increased $1.8 million to $1.8 million in 1996 from $nil in 1995. The increase was the result of the amortization of the goodwill and intangible assets acquired on the acquisition of Celestica N.A. from IBM.

Interest expense. Interest expense increased $5.5 million, or 58.5%, to $14.9 million in 1996, 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, from $9.4 million in 1995. This increase was primarily due to the increased amount of long-term debt as a result of the change in capitalization related to the acquisition of Celestica N.A. from IBM.

Income taxes. Income taxes decreased $15.0 million to $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, from $39.8 million in 1995 due to a decrease in operating results for the 1996 period.

Quarterly Results of Operations

The following table sets forth certain unaudited quarterly financial information of Celestica from the first full quarter following the acquisition of Celestica N.A. from IBM until the quarter ended September 30, 1998. Historically, Celestica has experienced some seasonal variation in revenue, with revenue in the fourth quarter slightly higher than revenue in each of the first three quarters. This variation may be offset in part by organic growth and acquisitions. This information has been derived from the quarterly consolidated financial statements of Celestica which are unaudited but which, in the opinion of management, have been prepared on the same basis as the Consolidated Financial Statements and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the financial results for such periods. The operating results for any previous quarter are not necessarily indicative of results for any future period.

Quarter Ended[(1)]

	March 31, 1997	June 30, 1997	September 30, 1997	December 31, 1997	March 31, 1998	June 30, 1998	September 30, 1998
				(in millions)			
Revenue	$483.6	$430.7	$409.1	$683.2	$738.7	773.6	811.6
Cost of sales	457.2	399.8	375.3	634.6	691.0	719.9	751.7
Gross profit	26.4	30.9	33.8	48.6	47.7	53.7	59.9
Selling, general and administrative expenses	14.8	19.0	16.2	18.3	26.4	32.5	35.0
Amortization of intangible assets[3]	3.3	3.3	3.9	4.8	13.2	10.6	10.8
Integration costs related to acquisitions	0.3	0.5	2.1	10.4	2.7	1.6	1.3
Unusual charge	—	13.9[2]	—	—	—	17.8[5]	—
Write-down of intellectual property	—	—	—	—	35.0[4]	—	—
Operating income (loss)	8.0	(5.8)	11.6	15.1	(29.6)	(8.8)	12.8
Interest expense	7.0	6.9	7.9	11.8	12.4	13.0	3.7
Net earnings (loss) before income taxes	1.0	(12.7)	3.7	3.3	(42.0)	(21.8)	9.1
Income taxes[6]	1.5	(2.9)	2.3	1.3	(10.2)	(2.6)	2.8
Net earnings (loss)	$(0.5)	$(9.8)	$1.4	$2.0	$(31.8)	$(19.2)	$6.3

(1) Includes the results of operations of (a) Design to Distribution Limited (Celestica U.K.) acquired effective January 1, 1997, (b) the assets acquired from Hewlett-Packard in Colorado and New England in multi-stage transactions in July, August and October 1997, on a consignment basis prior to October 31, 1997 and on a turnkey basis thereafter, (c) Ascent acquired in October 1997, (d) the manufacturing operation of Madge Networks acquired in February 1998, (e) the manufacturing operation acquired from Lucent in April 1998, (f) Analytic Design acquired in May 1998, (g) the manufacturing operation acquired from SGI in June 1998 and (h) Accu-Tronics (Celestica North Carolina) acquired in September 1998.

(2) Represents a credit loss of $13.9 million relating to a customer which filed for bankruptcy.

(3) Effective January 1, 1998, Celestica revised the estimated useful life of goodwill and intellectual property for accounting purposes from 20 years to 10 years and 5 years, respectively.

(4) Effective March 31, 1998, Celestica completed a review of the carrying value of its intellectual property. As a result of this review, Celestica concluded that certain processes and technologies acquired from IBM in 1996 were no longer in use and the future benefit of other technologies was less certain than was previously the case. Accordingly,

Celestica's results of operations for the three months ended March 31, 1998 included an unusual non-cash charge of $35.0 million to reflect a write-down of the carrying value of this intellectual property.

(5) Celestica incurred $17.8 million of unusual charges for the three months ended June 30, 1998 related to a write-off of deferred financing fees and debt redemption fees associated with the prepayment of debt from the proceeds of the initial public offering.

(6) Celestica changed its method of accounting for income taxes in accordance with a new accounting standard issued under Canadian GAAP in the fourth quarter of 1997 and applied this change retroactively to all quarters in 1997.

Liquidity of Capital Resources

For the nine months ended September 30, 1998, Celestica generated cash from operating activities of $69.4 million, comprised of a loss of $44.7 million, deferred taxes of $20.9 million, and an increase in deferred pension of $2.4 million offset by depreciation and amortization charges of $63.3 million, a decrease in working capital requirements of $31.3 million and non-cash unusual charges of $44.2 million, representing the write-down of intellectual property and the debt redemption fees associated with the prepayment of debt from the proceeds of the initial public offering. For the nine months ended September 30, 1997, Celestica generated cash from operating activities of $4.3 million, comprised of a loss of $8.9 million, deferred taxes of $3.4 million, an increase in the deferred pension asset of $3.4 million, and an increase in working capital requirements of $6.4 million, offset by depreciation and amortization of $28.8 million.

Investing activities during the nine months ended September 30, 1998 consisted primarily of the acquisitions of Analytic Design, Inc., Celestica North Carolina (formerly Accu-Tronics) and the assets that formed Celestica Mexico, Celestica Wisconsin and Celestica Ireland for a total purchase price, net of cash on hand, of $52.6 million, and capital expenditures of $52.9 million. Investing activities for the nine months ended September 30, 1997 consisted primarily of the acquisitions of Celestica Limited and certain assets that formed Celestica Colorado and Celestica New England for a total purchase price, net of cash on hand, of $163.1 million and capital expenditures of $20.3 million.

During the nine months ended September 30, 1998, Celestica reduced its long-term debt by $384.6 million, as a result of the prepayment of debt with the proceeds from its initial public offering. During the same period Celestica issued capital stock for cash proceeds, net of issuance costs, of $400.8 million. For the nine months ended September 30, 1997, Celestica issued capital stock totaling $159.5 million and increased its long-term debt by $126.9 million to finance the 1997 acquisitions.

Adjusted EBITDA

Management believes that adjusted EBITDA (adjusted for charges such as integration costs related to acquisitions, an unusual credit loss and write-down of intellectual property) is a measure useful to it for evaluating Celestica's liquidity and ability to generate cash. In particular, for measuring comparative operating results from period to period, management adjusts EBITDA for these items.

Adjusted EBITDA is derived as follows:

	Predecessor Company		Celestica Inc.					
					Three months ended September 30,		Nine months ended September 30,	
	Year ended December 31, 1995	January 1 to October 22, 1996	September 27 to December 31, 1996	Year ended December 31, 1997	1997	1998	1997	1998
	(in millions, except percentages)		(in millions, except percentages)					
Net income (loss)	$62.8	$25.9	$3.2	$(6.9)	$1.4	$6.3	$(8.9)	$(44.7)
Adjustments:								
Interest expense, net	9.4	8.4	6.5	33.6	7.9	3.7	21.8	29.2
Income taxes	39.8	20.3	4.5	2.2	2.3	2.8	0.9	(10.1)
Depreciation expense	9.3	8.8	2.0	19.2	5.5	10.4	16.2	27.1
Amortization of intangible assets	—	—	1.8	15.3	3.9	10.8	10.5	34.6
Amortization of deferred financing fees	—	—	0.4	2.6	0.8	0.3	2.2	1.7
EBITDA	121.3	63.4	18.4	66.0	21.8	34.3	42.7	37.8
Integration costs related to acquisitions	—	—	—	13.3	2.1	1.3	2.9	5.6
Unusual charges	—	—	—	13.9	—	—	13.9	17.8
Write-down of intellectual property	—	—	—	—	—	—	—	35.0
Adjusted EBITDA	$121.3	$63.4	$18.4	$93.2	$23.9	$35.6	$59.5	$96.2

Adjusted EBITDA as a percentage of revenue	4.2%	3.7%	6.4%	4.6%	5.8%	4.4%	4.5%	4.1%

Capital Resources

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. 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 the facility requires that Onex remain the controlling shareholder of Celestica. No borrowings were outstanding under the credit facility at September 30, 1998. Based on certain covenants, the borrowing available as at September 30, 1998 was $227.6 million.

The only other financial covenant in effect is a debt incurrence covenant contained in Celestica's Senior Subordinated Notes due 2006. Other than certain permitted debt (as defined), Celestica may not incur debt unless its fixed charge coverage ratio, as defined in the Indenture governing the Senior Subordinated Notes, exceeds 2.0 to 1.0 on a pro forma basis.

Celestica believes that cash flow from operating activities, together with borrowings available under its global, unsecured, revolving credit facility, will be sufficient to fund currently anticipated working capital, planned capital spending and debt service requirements for the next 12 months, and to fund its cash obligations under the Merger Agreement with International Manufacturing Services, Inc. ("IMS"). Celestica's planned capital spending for 1998 is approximately $67.6 million of which $52.9 million is spent as of September 30, 1998. Celestica will continue to selectively seek acquisition opportunities, and may therefore require additional debt or equity financing.

Investing activities during the year ended December 31, 1997 consisted primarily of acquisitions by Celestica for an aggregate purchase price of $280.0 million and capital expenditures of $32.1 million. The acquisitions included: the shares of Ascent; certain assets and the assumption of certain liabilities of Celestica U.K. from ICL; and the assets of Hewlett-Packard's printed circuit assembly facility in Fort Collins, Colorado and its systems build assembly facility in Exeter, New Hampshire and related inventory. The acquisitions were funded by cash on hand, borrowings and the issuance of Subordinate Voting Shares totaling $277.4 million. See Note 3 to the Consolidated Financial Statements.

In connection with the asset acquisitions completed in 1997, Celestica acquired identifiable assets of $336.9 million and goodwill and other intangible assets representing the excess of cost over the fair value of tangible assets acquired in facility acquisitions of $126.8 million and assumed liabilities of $182.0 million. As a result, the increase in accounts receivable in 1997 was primarily related to acquisitions completed by Celestica in 1997. In determining to acquire these assets, as Celestica was not acquiring on-going businesses, Celestica considered these acquisitions to be primarily the acquisition of an on-going relationship 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 February 1998, Celestica acquired a manufacturing facility in Dublin, Ireland from Madge Networks. The acquisition was funded by cash on hand of $9.0 million and $14.1 million in debt financing. In June 1998, Celestica acquired a manufacturing facility in Chippewa Falls, Wisconsin from SGI for a total purchase price of $14.9 million which was funded by cash on hand. In April, May and September 1998, Celestica acquired a manufacturing facility from Lucent in Monterrey, Mexico, Analytic Design, a Customer Gateway Centre in Santa Clara, California, and Celestica North Carolina, a Customer Gateway Centre in Raleigh, North Carolina, for a combined purchase price of $17.9 million which was financed by $7.0 million in cash, $8.5 million from Celestica's credit facilities and $2.4 million in Subordinate Voting Shares. All of these acquisitions were made for strategic reasons and to increase Celestica's depth of service offering.

Celestica acquired goodwill and other intangible assets relating to the 1997 acquisitions totaling $126.8 million. Annual amortization of intangible assets has increased by $17.0 million as a result of the additional goodwill and other intangible assets assumed by Celestica for the 1997 acquisitions. Except as described in "Recent Developments" with respect to the proposed acquisition of IMS, the 1998 acquisitions have not resulted in any significant additions to goodwill and other intangible assets and therefore will have a minimal impact on the expense for amortization of intangible assets.

Celestica financed a portion of the 1997 acquisitions with additional debt. Total interest expense for the facilities acquired in 1997 was $10.2 million.

Celestica expects each acquisition to be accretive to earnings and cash flow after a transition period for the acquisition, generally approximately one year. In that transition period, initial margins on the business at the newly acquired facility generally are lower than Celestica's overall margins for several reasons: frequently, the acquired facility is underutilized (including Exeter, United Kingdom and Mexico); some business at the new facilities is lower margin business (such as system-build at Exeter, which has lower margins but is capable of higher turns) than Celestica's EMS services business at its Toronto site; and Celestica may negotiate lower initial margins on large-scale projects with significant new customers. These margins during the transition are evaluated by Celestica in the context of the risk reduction inherent in the supply arrangements agreed to in connection with the acquisitions, which mitigate Celestica's start-up risk in the new facility. In some cases, limited overhead contribution commitments, take or pay arrangements or limited revenue or product volume guarantees 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 increases capacity utilization and reduces cost; integration activities are completed and costs are fully expensed; Celestica implements its processes and disciplines to reduce costs and obtains the cost benefits of its procurement leverage; and Celestica introduces new business (generally a 12 to 18 month sales cycle) from the original customer and others.

In connection with the acquisition of assets from Hewlett-Packard, Madge Networks and SGI, Celestica has entered into certain production agreements with Hewlett-Packard, Madge Networks and SGI 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.

In the case of the Hewlett-Packard acquisitions, Celestica believes that a portion of the purchase price paid in these acquisitions relates to the long-term relationships being developed 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 relationship 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.

In the case of the 1998 acquisitions, except as described in "Recent Developments" with respect to the proposed acquisition of IMS, the excess of the purchase price paid over the fair value of the tangible assets acquired was not significant.

Celestica believes that cash on hand, funds provided by operations and available borrowings under the credit facility will be sufficient to satisfy its currently anticipated working capital and capital expenditure requirements for the next twelve months and to fund its cash obligations under the Merger Agreement with IMS. Celestica will continue to selectively seek acquisition opportunities, and therefore may require additional debt or equity financing.

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 (including approximately C$320 million and £84.0 million on an annualized basis). As a result, Celestica may experience transaction and translation gains or losses because of currency fluctuations. At September 30, 1998, Celestica had forward foreign exchange contracts covering various currencies with expiry dates up to January 2000 in a notional amount of $238.7 million. The fair value of these contracts at September 30, 1998 was an unrealized loss of $14.1 million. At October 31, 1998, Celestica had forward foreign exchange contracts covering various currencies with expiry dates up to January 2000 in a notional amount of $208.1 million. The fair value of these contracts at October 31, 1998 was an unrealized loss of $13.4 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.

Recent Developments

On November 2, 1998, Celestica announced its intent to acquire International Manufacturing Services, Inc. ("IMS"), pursuant to a Merger Agreement, on or about December 31, 1998. The purchase price, including costs of acquisition, is expected to be approximately $140 million, and will be financed by a combination of newly issued Subordinated Voting Shares and cash. The final purchase price and the total cash required will depend on the level of cash elections made by IMS stockholders. The maximum amount of cash required for payment to IMS stockholders is approximately $72 million. In connection with the Merger, Celestica expects to repay all long-term debt and bank indebtedness of IMS, of which approximately $23.1 million was outstanding at July 31, 1998. The cash requirement will be funded with cash on hand and borrowings under Celestica's global, unsecured, revolving credit facility.

The purchase price for IMS represents a premium over IMS' current book value, and will generate between approximately $81.5 million and $85.8 million of goodwill and other intangible assets before giving effect to any in-process research and development write-offs. The valuations and other studies required to determine the fair values of the assets acquired, including any in-process research and development, and liabilities assumed have not been completed. Celestica expects that the assets will have an average weighted life of nine to ten years. Celestica has not completed its analysis of the integration costs it will incur in connection with the Merger. Any write-off is expected to be recorded in the quarter in which the Merger is completed, and integration costs are expected to be expensed as they are incurred.

Changes to Earnings

For the quarter ended March 31, 1998, Celestica recorded a non-cash charge of $35.0 million to reflect a write-down of the carrying value of certain intellectual property.

Celestica incurred certain charges relating to the initial public offering. These charges are summarized as follows:

• In the second quarter of 1998, a pre-tax charge of $17.8 million ($14.2 million after tax) associated with the repayment of indebtedness, comprised of $9.2 million for the write-off of unamortized deferred financing costs, $7.4 million for the premium payable on the redemption of a portion of Celestica's Senior Subordinated Notes due 2006 and $1.2 million for a redemption fee payable on repayment of two of Celestica's term facilities. This charge is an extraordinary charge for purposes of U.S. GAAP.

• For U.S. GAAP purposes only, a non-cash stock compensation expense of $2.9 million relating to options that vested immediately on completion of the initial public offering ($4.2 million for the year ending December 31, 1998). No similar charge is required to be recorded by Celestica under Canadian GAAP.

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 and programs use two digits, rather than four, to define the applicable year of business transactions. 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 all together. 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.

Celestica’s year 2000 plans described below do not include any plans relating to IMS’ year 2000 issues since Celestica has not had an opportunity to review IMS’ plans concerning the year 2000. Celestica has not assessed the impact such issues may have on IMS. Year 2000 issues affecting IMS could have a material adverse effect on Celestica after the merger.

Status of Remediation

Celestica has identified projects that it deems to be mission critical at all of its campuses. These projects have been classified based on the relationships of the systems involved and the impact of these systems on Celestica’s business. Celestica deems a project to be mission critical if the failure to complete the year 2000 remediation for that projecton 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, software, microcode, application programs, files, databases or firmware for all information technology applications and systems, all manufacturing processes and all production facility processes. In addition, Celestica’s year 2000 project scope extends to assessing issues affecting suppliers’ and customers’ products, services, systems and operations. Celestica has also identified additional projects which it deems to be non-mission critical, such as projects covering certain non-information technology systems.

Celestica’s year 2000 readiness project is being managed through a worldwide hierarchy of year 2000 owners at each of its campuses. Celestica has identified three phases in its year 2000 project: identify, test and validate. The identification phase involved the collection and validation of an inventory of computer related devices (including all business and manufacturing systems, applications and supporting infrastructure), and 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 year 2000 and beyond. The identification phase was completed in early 1998. The testing and validation phases are expected to be completed by June 1999.

As of October 31, 1998, Celestica had identified approximately 510 mission critical projects. Assessment had been completed on approximately 93% of such projects, testing on approximately 67% of such projects and validation on approximately 53% of such projects. Celestica expects to complete the year 2000 remediation for most mission critical projects by the end of 1998 with the exception of some site-specific projects and supplier certifications, which Celestica anticipates will be completed by June 1999.

As of October 31, 1998, Celestica has also identified more than 1,000 projects which it deems to be non-mission critical. These projects include non-IT systems such as those which may be used in the operation of certain non-production machinery and equipment, lighting, building security and telephone systems. Assessment has been completed on 100% of such projects, testing completed on approximately 87% of such projects and validation on approximately 75% of such projects. Celestica expects to complete all year 2000 remediation for these projects by the end of June 1999.

Although Celestica currently anticipates that the remedial actions described above will be completed on a timely basis, the failure to do so could have a material adverse effect on Celestica’s business, results of operations and financial condition.

Third Party Compliance

In early 1998, Celestica mailed questionnaires to substantially all of its vendors and suppliers requesting information regarding the year 2000 compliance of their products, services, systems and operations. Celestica is logging and tracking all responses to these questionnaires. Celestica personnel follow up on all unsatisfactory responses. As of October 31, 1998, Celestica had confirmed that approximately 40% of their suppliers are year 2000 compliant. Celestica will undertake on-site supplier reviews to confirm compliance, as deemed necessary.

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

Contingency Plans

Celestica is developing its contingency plans for potential year 2000 failures. Contingency plans will be developed for all mission critical processes. For those instances where Celestica determines that a contingency plan is not practicable, the worst case failure scenarios will be identified with an assessment on the impact to Celestica’s business and a probable remedy; site crisis and rapid response teams will be established to tackle the anticipated crisis. To date, most likely worse case scenarios have not been assessed. Celestica is planning to complete these contingency plans by March 1999.

Estimated Costs

Celestica currently estimates that the total costs for year 2000 remediation projects will be between $3 and $5million (including internal costs), with estimated costs to repair software problems between $1.8 and $3 million and estimated costs to replace problem systems and equipment between $1.2 and $2 million. A total of $2.5 million has been incurred through October 31, 1998.

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.

Year 2000 expenditures will be capitalized to the extent that they enhance the capabilities and useful life of the underlying systems. Celestica is currently on budget and on schedule to substantially complete year 2000 readiness by June 1999. However, there can be no assurance that Celestica will be able to be year 2000 compliant by such time, or have developed contingency plans for potential year 2000 failures.

Year 2000 expenditures are financed through funds generated from operations. Celestica has not deferred any major information technology projects as a result of its year 2000 remediation efforts.

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.

Forward-Looking Statements

This Form 6-K contains forward-looking statements, including (without limitation) statements concerning possible or assumed future results of operations of Celestica, including those statements preceded by, followed by or that include the words "believes", "expects", "anticipates", "estimates", "intends", "plans" or similar expressions. For those statements Celestica claims the protection of the safe harbour for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions. you should understand that the following important factors, in addition to those discussed in Celestica's prospectus included in its Registration Statement on Form F-1, including those under the caption "Risk Factors", could affect the future results of Celestica, and could cause those results to differ materially from those expressed in such forward-looking statements; the level of overall growth in the electronics manufacturing services industry; variability of operating results of Celestica among periods; Celestica's dependence on the computer and communications industries; Celestica's dependence on a limited number of customers; and Celestica's ability to manage expansion, consolidation and the integration of acquired businesses.

Celestica cautions you not to put undue reliance on any forward-looking statements contained in this Form 6-K.

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.

Accounting for Stock Options and Share Issurances

Under Canadian GAAP, there is no requirement to record compensation expense upon the grant of compensatory stock options to employees or upon the issuance of shares at less than fair market value.

Under U.S. GAAP, the following alternative methods are available for accounting for employee stock options: (i) Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"); and (ii) Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"). Celestica has elected to follow APB 25 and related interpretations in accounting for its employee stock options. Under APB 25, an unearned compensation charge would be recorded at the date of the grant of the options in an amount equal to the difference between the market value of a common share at the grant date and the exercise price. Compensation expense is recognized over the vesting period of the option.

During the year ended December 31, 1997, Celestica issued certain employee stock options pursuant to various employee share purchase and option plans.

In 1998, Celestica amended the vesting provisions of 2,952,775 of the 3,117,945 employee stock options issued in 1997. Under the previous vesting provisions, such options vested based on the achievement of earnings targets. A portion of the options issued in 1997 now vests over a specified time period and the balance vests upon completion of the Offering. Under U.S. GAAP, this amendment requires a new measurement date for purposes of accounting for compensation expense resulting in a charge equal to the aggregate difference between the fair value of the underlying Subordinate Voting Shares at the date of the amendment, determined on the basis of the anticipated initial public offering price discounted to reflect the private company status of Celestica at the time, and the exercise price for such options. As a result, under U.S. GAAP Celestica will record a $15.6 million non-cash stock compensation charge to be reflected in earnings over the vesting period as follows: 1998 — $4.2 million; 1999 — $1.9 million; 2000 — $2.5 million; 2001 — $3.2 million; 2002 — $3.8 million. No similar charge is required to be recorded by Celestica under Canadian GAAP.

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.

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 not determined the impact that this accounting standard will have on its disclosure of segmented information when Celestica adopts the new standard for its fiscal year ended December 31, 1998.

The Financial Accounting Standards Board in the United States has issued pronouncements entitled "Earnings per Share," "Disclosure of Information About Capital Structure," "Reporting Comprehensive Income" and "Disclosures About Segments of an Enterprise and Related Information." The adoption of the pronouncement "Earnings per Share" in 1997 for U.S