



Is the Earnings-Induced Sell-Off in Gildan Activewear Inc. Warranted?

Description

Gildan Activewear Inc. ([TSX:GIL](#))([NYSE:GIL](#)), one of world’s largest manufacturers and distributors of apparel, announced second-quarter earnings results on the morning of July 31, and its stock has responded by falling over 4%. Let’s take a closer look at the results to determine if a sell-off of this magnitude was warranted, or if it represents a long-term buying opportunity.

The results that ignited the sell-off

Here’s a summary of Gildan’s second-quarter earnings results compared with what analysts had expected and its results in the same period a year ago. All figures are in U.S. dollars.

Metric	Reported	Expected	Year-Ago
Adjusted Earnings Per Share	\$0.42	\$0.44	\$0.47
Revenue	\$714.2 million	\$757.68 million	\$693.8 million

Source: Financial Times

Gildan’s adjusted earnings per share decreased 10.6% and its revenue increased 2.9% compared with the second quarter of fiscal 2014. The company’s double-digit percentage decline in earnings per share can be attributed to its adjusted net income decreasing 12% to \$102.6 million, led lower by its costs of sales increasing 4.8% to \$523.6 million and its selling, general, and administrative expenses increasing 11.6% to \$80.1 million.

Its slight increase in revenue can be attributed to sales increasing 12.3% to \$236.3 million in its branded apparel segment, but this growth was partially offset by its sales decreasing 1.2% to \$477.8 million in its printwear segment.

Here’s a quick breakdown of eight other notable statistics from the report compared with the year-ago period:

1. Gross profit decreased 1.9% to \$190.6 million

2. Gross margin contracted 130 basis points to 26.7%
3. Adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) decreased 3% to \$145.9 million
4. Adjusted EBITDA margin contracted 130 basis points to 20.4%
5. Operating profit decreased 12.8% to \$106.2 million
6. Operating margin contracted 270 basis points to 14.9%
7. Cash flows from operating activities increased 1.1% to \$85.2 million
8. Free cash flow increased 51.6% to \$18.5 million

Gildan also made two other announcements. First, it will be maintaining its quarterly dividend of \$0.065 per share, and the next payment will come on September 8 to shareholders of record at the close of business on August 15. Second, the company now expects its full-year earnings per share to be at the bottom of its previous guidance range of \$1.50-1.55 on projected sales of approximately \$2.6 billion, and this is a direct result of its weak performance in the second quarter.

Should you buy in to or avoid the sell-off?

It was a very disappointing quarter for Gildan, so I think the post-earnings drop in its stock was warranted. I also think the stock could continue lower from here because its slowed growth rate will deter potential investors and because its stock still trades at rich valuations, including 28.8 times its earnings-per-share outlook of \$1.50 for fiscal 2015 and 22.5 times analysts' estimated earnings per share of \$1.92 for fiscal 2016, both of which are expensive compared with its five-year average price-to-earnings multiple of 20.5.

With all of the information provided above in mind, I think Foolish investors should avoid Gildan Activewear for the time being, and only revisit the idea of an investment when its stock comes down to more reasonable valuations.

CATEGORY

1. Investing

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1. NYSE:GIL (Gildan Activewear Inc.)
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