Why Gildan Activewear Inc. Tanked Over 5% on Wednesday

Description

Gildan Activewear Inc. (TSX:GIL)(NYSE:GIL), one of world's leading manufacturers and distributors of apparel products, released weaker-than-expected second-quarter earnings results on Wednesday morning, and its stock responded by falling over 5% in the day's trading session.

Let's take a closer look at the results, three other notable announcements made by the company, and the fundamentals of its stock to determine if we should consider using this weakness as a long-term buying opportunity or a warning sign to avoid it for the time being.

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.

Metric	Q2 2016 Actual	Q2 2016 Expected	Q2 2015 Actual
Net Sales	US$688.9 million	US$693.6 million	US$714.2 million
Adjusted Earnings Per Share	US$0.41	US$0.42	US$0.42

Source: Financial Times

Gildan's net sales decreased 3.5% and its adjusted earnings per share decreased 2.4% compared with the second quarter of fiscal 2015.

Its slight decline in net sales can be attributed to its sales decreasing 1.4% year over year to US$471.2 million in its Printwear segment and 7.9% year over year to $217.6 million in its Branded Apparel segment, and it noted that this was mainly due to its decision to exit certain non-core retailer private label programs, lower net selling prices, the impact of distributor inventory destocking, and the negative impact of foreign currency translation as a result of the stronger U.S. dollar.

Its slight decline in adjusted earnings per share can be attributed to the aforementioned decline in sales as well as 4.4% increase in selling, general, and administrative expenses, which led to its adjusted net earnings decreasing 6% to US$96.4 million.

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

1. Gross profit decreased 0.8% to US$189 million
2. Adjusted earnings before interest, taxes, depreciation, and amortization decreased 0.5% to US$145.1 million
3. Adjusted operating income decreased 4.5% to US$105.4 million
4. Cash flows from operating activities increased 90.1% to US$162 million
5. Free cash flow increased 603.8% to US$130.2 million
6. Inventories increased 8.2% to US$920.9 million
7. Net indebtedness increased 110.7% to US$683.4 million
8. Repurchased 5.2 million common shares for a total cost of US$159.2 million

Other notable announcements

Gildan also made three notable announcements.

First, it announced that it has entered into a definitive agreement to acquire Peds Legwear Inc., which owns the Peds and MediPeds brands and generates annual sales of approximately US$80 million, for a total cash consideration of US$55 million. This acquisition will expand Gildan's offerings of foot apparel and legwear products, and it's expected to close before the end of August 2016.

Second, it provided updated guidance on fiscal 2016. Gildan is now calling for adjusted earnings per share in the range of US$1.50-1.55 and net sales of approximately US$2.65 billion. This compares with its prior guidance of adjusted earnings per share in the range of US$1.50-1.60 and net sales of approximately US$2.6 billion.

Third, it announced that it would be maintaining its quarterly dividend of US$0.078 per share, and the next payment will come on September 6 to shareholders of record at the close of business on August 11.

Should you buy on the dip?

It was a disappointing quarter for Gildan, so I think the drop in its stock was warranted. However, I think the stock still represents a great investment opportunity for the long term for three reasons.

First, it's undervalued. Gildan's stock now trades at just 19.1 times its median earnings-per-share outlook of US$1.525 for fiscal 2016 and only 15.4 times analysts' estimated earnings per share of US$1.90 for fiscal 2017, both of which are inexpensive compared with its five-year average price-to-earnings multiple of 22.9. These multiples are also inexpensive given its estimated 14.2% long-term earnings-growth rate, making it both a value and growth play.

Second, it has been making great acquisitions to drive growth. Gildan has made two strategic acquisitions this year, including Alstyle Apparel and the aforementioned Peds Legwear for a total cash consideration of just US$165 million. Even though these acquisitions may seem very small for a company like Gildan, they can lead to significant growth because it can leverage its existing customer base to maximize sales and use its manufacturing capabilities to extend the brands into other product categories.

Third, it's a dividend-growth play. Gildan pays an annual dividend of US$0.312 per share, which gives its stock a yield of about 1.1%. A 1.1% yield is not high by any means, but it's very important to note that its 20% dividend hike in February has it on pace for 2016 to mark the fourth consecutive year in which it has raised its annual dividend payment, and its ample free cash flow generation and low payout ratio could allow this streak to continue for many years to come.

With all of the information provided above in mind, I think Foolish investors should strongly consider using the post-earnings weakness in Gildan Activewear to begin scaling in to long-term positions.

CATEGORY

1. Investing

TICKERS GLOBAL

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