Is it Time to Get into Gildan Activewear Inc.?

Description

Gildan Activewear Inc.'s (TSX:GIL)(NYSE:GIL) financials and stock have recently hit a speed bump as management has had to reduce its 2016 and 2017 EPS outlook due to expected weakness in the branded segments and later than expected shipments. EPS guidance was reduced to the $1.48-1.50 range from the $1.50-1.55 range previously. The stock has declined almost 15%. Is it time to get back in?

Strong cash flows

Despite the weakness and setbacks that we have recently seen with Gildan, the company's competitive advantage remains and lies in the fact that it is the lowest-cost manufacturer of quality apparel with significant manufacturing infrastructure in two main hubs in Central America and the Caribbean basin. This distribution network is quick to respond to customer demand. Also, brand loyalty is very important in the apparel industry, and Gildan has done a tremendous job in getting wholesalers and consumers to switch to its brands.

Looking to future opportunities, the company has significant free cash flows, a strong balance sheet, and it has been deploying this cash to buy back shares, which is good for shareholders. And acquisitions are good for the company's strategic growth as it continues to be a consolidator.

We should expect more of this as well as a possible dividend hike. In the third quarter of 2016, free cash flow increased 72% to $256 million sequentially and from negative free cash flow in the third quarter of 2015. The company bought back 12.2 million shares and completed two acquisitions in 2016.

Along with these strong free cash flow numbers, the company has also been posting strong ROE numbers in the 16% range.

Gildan buys American Apparel brand

The purchase of the brand as well as its inventory was made for $66 million and, importantly, does not include any retail stores. This is positive in that it strengthens Gildan's position in the fashion printwear market and now includes American Eagle, Anvil, and Comfort Colors. Gildan should be able to leverage its extensive distribution and manufacturing capabilities in order to drive margins at the American Eagle acquisition upwards to levels currently being achieved at its operations (over 20%).

The stock trades at a trailing P/E ratio of 23 times, and analysts are expecting relatively flat EPS growth in 2016 versus 2015 and a 10% growth rate in 2017.

In my view, the stock looks promising, but I think that investors had best wait it out a little in order to let valuations come down a bit. From a longer-term perspective, though, I believe the company is in a good position financially and strategically.

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