



Why Investors Ought to Try This Stock on for Size

Description

As is often the case when stocks make big one-day gains on better-than-expected earnings results, analysts downgrade these stocks on valuation concerns.

That's exactly what happened to Montreal-based t-shirt manufacturer **Gildan Activewear** ([TSX:GIL](#))([NYSE:GIL](#)) August 2 after it delivered record Q2 2018 revenues of \$764 million, 6.8% higher than a year ago, and 6.1% adjusted earnings-per-share growth to \$0.52 a share — also a record.

That's pretty heady stuff for the company, yet Desjardins analyst Keith Howlett downgraded Gildan stock from "buy" to "hold" the very next day on concerns it had gotten ahead of itself.

Irritatingly, the analyst hedged his bet by saying a lot of good things about the company and raising its 12-month target price from US\$31.96 to US\$33.89, about 10% above its current share price.

"Growth in international markets (outside the U.S. and Canada) increased by 35.2%, with China experiencing the greatest growth," Howlett wrote in his note to clients. "The American Apparel brand is expected to have run-rate sales exiting 2018 of US\$100 million."

What to make of Gildan at this point?

It's hard to believe, but I haven't covered Gildan stock since September 2016, when I'd [recommended](#) that GARP (growth at a reasonable price) investors take a position in the company.

It's up 11% since then, so I'm going to re-evaluate whether there's been enough progress in the past two years to continue to recommend that investors hold its stock.

The first positive from the company's second-quarter report is international sales, which Howlett mentioned jumped 35% to US\$89.4 million, or 11.7% of its overall revenue — 250 basis points higher than a year ago.

Meanwhile, its U.S. sales rose 4.8% year over year to US\$644.7 million, accounting for 84.4% of its overall revenue — 160 basis points fewer than a year earlier. The only negative: Canadian sales fell

11.2% in the quarter to US\$30.1 million and now account for just 3.9% of the company's overall sales.

It might be based in Canada, but it sure as heck doesn't sell to Canadians. It would be nice if it could bump that number above 10%.

Overall, the fact that its activewear segment, which includes fleece, grew revenues 17.3% in the quarter to US\$644.7 million, accounting for 81.8% of the company's overall revenue. Successful, double-digit growth in its activewear segment is a must if the stock is to keep moving higher.

Free cash flow is healthy but down

In the company's Q2 2018 press release, it suggested that it would generate at least US\$425 million in free cash flow (FCF) in 2018, allowing it to increase its normal course issuer bid (NCIB) to 10% of its public float; that's very good news, because most companies average between 5% and 10% — a sign the company feels its stock is a good long-term investment.

From a valuation perspective, US\$425 million in FCF works out to an FCF yield of 7%, putting it squarely in GARP territory, where it stood back in 2016, a strong indication that Gildan's stock isn't overvalued at this point.

The bottom line on Gildan stock

In early June, Fool contributor Stephanie Bedard-Chateauneuf [recommended](#) that value investors consider Gildan stock because of two reasons: it's cheap, and the purchase of American Apparel — it paid US\$88 million in 2017 — should help the company grow for years to come.

To that end, the company expects American Apparel revenues to hit US\$100 million by the end of 2018, a solid start to reviving the once-thriving apparel brand run by former Montrealer, Dov Charney.

Personally, I think buying American Apparel will turn out to be a surprisingly successful acquisition that gives it a strong brand with which to capture market share in the U.S.

If you're buying for the next three to five years, \$40 isn't too much to pay for GIL stock. However, I'd consider buying a half position, leaving the other half for a market correction that brings it back to the mid-\$30s.

Two years on, I continue to recommend Gildan stock.

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