1 Retail Stock That Might Struggle in a Recession

Description

Apparel makers are good barometers for recession. Sales and their share prices start declining as customers spending falls.

A similar scenario seems to be playing out with **Gildan Activewear** (TSX:GIL)(NYSE:GIL), as the stock took a pounding on the markets on October 18, 2019, when the company lowered its earnings guidance for the fourth quarter of 2019. Share prices fell from $46.49 to $33.96.

Some analysts expected the stock to rise once the numbers came out and called the fall a one-time occurrence. The markets had a different view of Gildan, however. The stock is now trading just 31 cents north of its 52-week low.

How did Gildan perform in Q3?

There is a slowdown in the imprintables (custom T-shirts) market in North America and internationally, and sock sales for Gildan dropped as well, causing sales to clock in at $740 million in the September quarter, down 2% compared to the prior year. These declines offset strong sales of activewear to global lifestyle brands in the retail channel.

Gildan's gross margin of 27.4% in the third quarter of 2019 was down from 29% in the third quarter last year. This decline was due to higher manufacturing costs, including anticipated increases in raw material costs, inflationary pressure on other input costs, and unfavourable foreign exchange.

Adjusted operating margin for 2019 is expected to be lower than 2018, EPS (earnings per share) for 2019 is now projected to be $1.43 to $1.48 compared to its previous estimate of $1.50 to $1.55.

EBITDA for the full year is projected to be in the range of $545 to $555 million and free cash flow for 2019 is expected to be between $200 to $250 million. The lower earnings forecast drove the stock lower as analysts estimated EPS of $1.66 in 2019.

What next for Gildan and investors?

Gildan is making moves to get back on track. As demand softens, the company says it remains focused on the execution of its supply chain initiatives aimed at driving increased operational efficiency across its manufacturing base.

It expects benefits from these initiatives to materialize, translating to gross margin expansion in 2020. As part of these initiatives, Gildan announced that it will move forward with plans for the closure of its textile and sewing operations in Mexico and the relocation of the equipment at these facilities to its operations in Central America and the Caribbean Basin. This closure will impact 1,700 employees.

Gildan's forward price to earnings multiple is 13.3 with a dividend yield of 2.1%. Compare this to its estimated five-year earnings growth of 5% and we can see that the stock is trading at a premium.

Ten out of 16 analysts covering Gildan recommending a hold on the stock, while six recommend a buy. Surprisingly there is no "sell" recommendation.

The company is projecting full-year 2019 sales to be down low-single-digits compared to 2018. This sales guidance is primarily due to the downturn in imprintables sales.

For the hosiery and innerwear category, Gildan is projecting sales to be flat to down low-single-digits compared to their previous projection of mid-single-digit growth.

The correlation between innerwear and recession is quite well known. People buy less of these during recessions. Is it time to exit Gildan?

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araghunath