Gildan's stains washed away

T-shirt maker has corrected its problems

Sean Silcoff, Financial Post
Published: Thursday, July 14, 2005

In its first six years as a public company, Gildan Activewear Inc. battled bad press and skeptical investors as it grew into one of the world's top T-shirt makers.

Investors worried about its ability to compete in a low-cost commodity business, particularly with the lifting of quotas this year on Chinese textiles coming to the United States.

A few years ago, its failed takeover bid for Fruit of the Loom resulted in a corporate espionage lawsuit. Labour groups hounded it for anti-union activities in its Third World plants. And there was that incident in 2001 when Jamaican police found a stash of marijuana in a shipment of Gildan T-shirts, although the company wasn't linked to any wrongdoing.

This year, however, it seems Gildan's stains have come out in the wash.

Since the start of 2005, its stock (GIL/TSX) has risen 75%, making it the sixth-best performer on the Toronto Stock Exchange. It rose 44 cents to a new high of $35.64 yesterday, after Gildan increased its earnings estimate for the year ending Oct. 3 for the second time. It raised its estimate to US$1.50 per share before special charges (up 34% from last year), from US$1.40.

It's not just Canadian investors who are impressed. Gildan has attracted a heavy U.S. following: Investors there now represent half of its shareholders, up from 25% a year ago.

"This has been a breakthrough year in terms of the company achieving credibility and some of that skepticism ... being converted into belief in our sustainable competitive advantage and the potential of our ongoing growth strategy," said chief financial officer Laurence Sellyn.

Investors have been well rewarded in the past for hanging on through Gildan's public relations nightmares; the stock has split twice and appreciated fourteen-fold since the 1998 initial public offering. But in the past year Gildan has succeeded in selling its story like never before.

Gildan made its name as an aggressive, low-cost T-shirt producer, moving production to Honduras and Dominican Republic and undercutting competitors such as Sara Lee Corp.'s Hanes line and Fruit of the Loom, owned by Berkshire Hathaway Inc.

But it has recently burnished that image by improving corporate governance, switching from a dual-class to single-class share structure and adding independent directors. It has also won over its detractors in the labour movement and is in a strong financial position -- no debt and $100-million in free cash after capital expenditures.

But most importantly, the company has convinced investors the threat of Chinese importers is a non-issue.

"All those concerns that were weighing heavily on the valuation of the stock are no longer there," said Desjardins Securities analyst Jessy Hayem. "People are starting to realize this company is delivering quarter after quarter, bumping up their numbers -- and there's more to come."

The initial concern was cheap Chinese-made textiles would flood the U.S. -- which accounts for 85% of Gildan sales -- with the lifting of import quotas this year. That would interrupt Gildan's five-year run of 28% average annual profit and return on equity growth.

But Gildan executives argue shipping costs and remaining 16.5% to 32% duties on China-made textiles make Gildan's Tshirts up to 44% cheaper than the new competitors. Labour -- China's key advantage -- only accounts for 10% of Gildan costs.

The proximity of its plants also gives Gildan an advantage for T-shirt wholesalers, who sell to screen printers. Say, for example, the Toronto Blue Jays hit a hot streak. Gildan's customers will face a surge of orders to print up shirts for the playoffs. Gildan can turn around an order in three weeks, while such a shipment would take months from China. In addition, Chinese producers would have to set up U.S. distribution centres to service clients, at added cost.

And don't forget that U.S. quotas have already been restored on some Chinese textiles after a flood of imports this year.
"Every distributor we talk to -- nobody wants to go to China," said Ms. Hayem. "There's risk involved."

Not everyone is convinced. **Anthony Scilipoti** of **Veritas Investment Research** insists the commodity nature of Gildan's business will catch up to it, with the inevitable arrival of cost-competitive rivals and slowing growth.

In addition, he thinks the stock, which trades at about 20 times earnings, is too rich. "The clothing business is probably the third oldest profession," he said. "Before I believed we had an issue of sheer industry economics. Now I think the valuation is getting ahead of itself."

But Mr. Sellyn says Gildan has years of solid growth ahead, with a goal of more than doubling sales to 60-million "dozens" (or 12 shirts) in five years while increasing earnings 15% to 20% per year.

In its most ambitious move, Gildan is pushing into the retail market, hoping its brand becomes as well-known to shoppers as its rivals. After an initial shipment of about 500,000 dozens to stores this year, the goal is to increase that to 13 million as it adds production capacity in Central America.

Gildan is also talking about initiating a dividend. "More and more, people are becoming believers in the future of Gildan,"
Mr. Sellyn said.