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GIL.TO - Q2 2018 Gildan Activewear Inc Earnings Call

EVENT DATE/TIME: AUGUST 02, 2018 / 12:30PM GMT

OVERVIEW:

Co. reported 2Q18 sales of $764m, EPS of $0.51 and adjusted EPS of $0.52. Expects 2018 sales to grow mid-single digits and adjusted diluted EPS to be $1.85-1.90.

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PRESENTATION

Operator

Welcome to the Q2 2018 Gildan Activewear Earnings Conference Call. My name is Paulette, and I will be your operator for today's call. (Operator Instructions) Please note, this conference is being recorded. I will now turn the call over to Sophie Argiriou, Vice President of Investor Communications. You may begin.

Sophie Argiriou - *Gildan Activewear Inc. - VP of Investor Communications*

Thank you, Paulette. Good morning to all and thank You for joining us.

Earlier this morning, we issued a press release announcing our earnings results for the second quarter of 2018. We also issued our interim shareholder report containing management's discussion and analysis and consolidated financial statements. These documents will be filed with the Canadian securities and regulatory authorities and the U.S. Securities Commission and are available on our website at www.gildan.com.

On the call today, I'm joined by Glenn Chamandy, our President and Chief Executive Officer; and Rhod Harries, Gildan's Executive Vice President and Chief Financial and Administrative Officer.

The conference call will begin with Rhod taking you through the results for the quarter and our business outlook for the year after which a Q&A session will follow.

Before we start, let me remind you that certain statements included in this conference call may constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve unknown and known risks, uncertainties and other factors, which could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. We refer you to the company's filings with the U.S. Securities and Exchange Commission and Canadian securities regulatory authorities that may affect the company's future results.

And with that, Rhod, I'll turn the call over to you.

Rhodri J. Harries - *Gildan Activewear Inc. - Executive VP, CFO & Chief Administrative Officer*

Thanks, Sophie. Good morning, everyone, and thank you for joining the call.

We were pleased with the results we announced today, having generated record second quarter sales and EPS and all on an organic growth basis. Our sales increase for the quarter was driven by strong double-digit sales growth in activewear, reflecting increases in several areas. We saw continued strength in higher-margin Fashion Basic products, a 35% sales increase in international markets, higher global lifestyle brand sales and increased activewear shipments to retailers.

Sales growth, combined with SG&A leverage and the benefit of a lower share count, translated to higher-than-anticipated EPS growth in the quarter even after absorbing higher raw material and other input cost as well as the impact of some supply chain headwinds, which we have been managing through well. More importantly, our year-to-date financial performance gives us increased confidence that we will be able to deliver mid-single-digit sales growth for the full year and the higher end of our EPS guidance range.

In addition, free cash flow is coming in ahead of plan, well on track to feed our initial guidance.

During the quarter, we made good progress in executing on our share repurchase program and completed it in July. Consequently, we're increasing our normal course issuer bid up to 10% of our public float.

Now let me take you through the details of our second quarter results before elaborate -- elaborating further on our updated guidance. We generated $764 million of sales this quarter, up 6.8% over last year, which was driven by a 17.3% rise in activewear sales. The growth in activewear was due to higher unit volumes, higher net selling prices and favorable mix driven by fleece and Fashion Basics shipments.

As I mentioned earlier, sales growth momentum in international markets continue to be strong, up 35% in the quarter, with strong growth across all regions.

Our strong activewear sales growth was partly offset by headwinds in the hosiery and underwear category, that we largely anticipated would be impacting us in 2018 as we move certain programs in the mass channel. We also saw some softness affecting licensed and Gold Toe Brand sales.

In underwear, sales were down approximately $7 million in the quarter on a year-over-year basis, primarily as we comped the initial roll-out of expanded space we gained last year when our men's underwear program moved a better in-store shelf placement throughout the chain of a major national retailer.

Gross margin in the quarter was 28.3%, down just over 150 basis points over the same period in 2017. The decline was due to increases in raw material costs and other manufacturing costs, which more than offset the benefit of higher net selling prices, including foreign exchange and more favorable product mix. We also absorbed additional manufacturing costs in the quarter resulting from supply chain disruptions that we have been managing through in Central America.

Moving on to operating performance. We were able to offset some of the gross margin pressure we saw in the quarter with a 50 basis point improvement in S&A leverage as cost reductions from the organizational consolidation that we began implementing at the beginning of the year in response to changes we could see occurring in the marketplace flowed through.

We're making good progress on this front, and even though we are reinvesting cost reductions in e-commerce and distribution capabilities, we are now starting to see SG&A leverage materialize. We continue to expect SG&A leverage to improve more meaningfully in the second half of the year, in line with our previous expectations.

Putting it all together, operating margin of 15.8% and adjusted operating margin of 16.2% were both down 110 basis points over last year.

EPS and adjusted EPS for the second quarter were $0.51 and $0.52, respectively, up just over 6% from the prior year quarter.

Turning to free cash flow. We generated $98 million in the quarter compared to $162 million last year. Despite the decrease, we came in better than planned. The decline was mainly due to less favorable working capital changes than we saw in the second quarter last year and higher capital expenditures, which were primarily for investments in textile and selling capacity expansion, distribution and information technology.

Towards the end of the second quarter, and on track with our plans, we began production at our new Rio Nance VI facility and we are pleased with how this is progressing. As we have previously said, this facility was designed primarily to produce fashion and performance byproducts and expected to give us greater flexibility to meet our manufacturing growth requirements.

Moving on to return of capital. Under our share repurchase program, during the second quarter, we bought back close to 7.2 million common shares for approximately $209 million. In July, we bought back another 906,000 shares and completed the program to repurchase 5% of our issued and outstanding common shares as at the reference date, February 15 of this year.

Today, we announced that we are increasing our share buyback program to up to 10% of the company's public float as at the reference date.

At the end of the second quarter, our net debt was approximately $860 million, representing a net debt-to-adjusted EBITDA leverage ratio of 1.5x, in line with the our leverage framework.

Turning to the outlook. Given our year-to-date financial performance, we feel well positioned to achieve the higher end of our guidance targets for the year. We are now projecting to achieve mid-single-digit sales growth compared to our previous guidance of low to mid-single-digit growth. And we expect adjusted diluted EPS for 2018 to be in the range of $1.85 to $1.90.

We now expect adjusted EBITDA for the year to be in the range of $605 million to $620 million compared to our original guidance of $595 million to $620 million.

Finally, as I mentioned at the beginning of my remarks, with free cash flow tracking ahead of plan, we are also raising our target and now expect free cash flow to be in excess of $425 million, up from our previous guidance of in excess of $400 million.

Let me comment further on our updated full year guidance. We are now projecting double-digit growth in the activewear sales category as we continue to see strong growth trends in Fashion Basics, fleece and international markets. The activewear category has been a strong driver of our business in the first half of the year and we see this continuing through in the second half.

Moving to American Apparel. We provided guidance at the beginning of the year that we expect to do $100 million of sales with this brand for the full year. We continue to be excited about this business and the steady acceptance the brand is gaining with distributors and online with consumers both in North America and internationally. However, while sales are growing nicely, for 2018 we now expect we will end the year with an exit run rate of close to $100 million in sales instead of in-year sales of that amount. This is a great brand and we're taking the necessary steps to sustainably build the difference for the long term.

For socks, primarily due to softness in licensed and Gold Toe Brand sales, we are now projecting the hosting and underwear sales category for the year to be down approximately $85 million compared to our previous projection of about $70 million.

On the cost side, we've incorporated some incremental costs in our updated guidance that relate to our manufacturing and supply chain. Specifically, we are incurring transitional manufacturing costs as we optimize our capacity to support strong sales growth of Fashion Basics, fleece and new private label activewear and underwear programs, higher inflationary pressure on certain input costs, and finally, costs related to recent disruptions in our supply chain in Central America.

Moving to SG&A. Cost savings resulting from our organization consolidation, which we have been reinvesting in our e-commerce and distribution capabilities during the first half of this year, are fully on track. We positioned the company to generate anticipated improvement in SG&A leverage in the range of 100 to 200 basis points in the third and fourth quarters of the year. Consequently, even though we are now anticipating stronger activewear growth in the second half of the year, we continue to expect our total SG&A expenses to remain flat on a year-over-year basis.

After taking into account these various puts and takes, adjusted operating margin for the year is now expected to be slightly down versus our previous guidance of an assumed slight increase.

For the third quarter, we are projecting adjusted diluted EPS growth in the high single-digit to low double-digit range, and we expect strong double-digit adjusted diluted EPS growth in the fourth quarter.

So to wrap up. We delivered a solid quarter and we feel comfortable about delivering on our financial targets for the full year, particularly given the sales growth we are seeing. Moreover, as we continue to execute on our strategic initiatives, we are encouraged by our growth prospects going forward. Given our core competencies as a low-cost, vertically integrated manufacturer, we continue to see attractive opportunities as the marketplace evolves. This includes capitalizing on faster growth areas of printables, particularly in the areas of Fashion Basics and the international markets where growth is getting momentum, we also see opportunities in retail where the landscape continues to shift more towards private label programs. And we continue to focus on taking advantage of the growing opportunity we see with our global lifestyle brand partners.

Operationally, we are making progress on many fronts. We took appropriate action by initiating an organizational consolidation at the beginning of the year to address changes in the market environment. By streamlining the front end of the business, we are gaining operational efficiencies across a common infrastructure from which cost reductions are materializing. We've made investments in e-commerce and distribution capabilities to enhance our growth. And in manufacturing, we are bringing on low-cost, flexible capacity to support growth in new programs.

So overall, our competitive positioning remains strong and we feel well positioned to achieve the longer-term objectives we shared with you during our Investor Day earlier this year of mid-single-digit sales growth and high single-digit to low double-digit EPS growth, strong returns on invested capital and delivering long-term value for our shareholders.

With that, thank you, and I will now turn the call over to Sophie.

Sophie Argiriou - *Gildan Activewear Inc. - VP of Investor Communications*

Thank you, Rhod. That concludes our formal remarks. (Operator Instructions) I'll now turn the call over to the operator for the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Kate McShane from Citi.

Kate McShane - *Citigroup Inc, Research Division - MD, Head of the U.S. Discretionary and U.S. Apparel and Retail Analyst*

I was wondering if you could walk us through some of the primary drivers of the higher input costs and how you're thinking about efficiencies within the supply chain to offset that and pricing going into the second half of next year?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

It's Glenn. The higher costs are mainly related to establishing and building up capacity. We basically have significantly increased the capacity this year on some of our core products. To give you an example, our fleece man capacity, we've increased since the beginning of the year by over 50%. So it's cost associated really with training and some raw material purchases, but mainly in the training area. And as also -- at the same time, it's not only supporting a big increase in our core business, supporting our basic fleece volume in our Printwear channel, but we're also supporting launch of 2 new fleece private label programs and one large underwear program. So it's more a function of training really at the end of the day and the time it takes us to build up the capacity and train the people. So it's -- once it's established and it's running, I mean, that will go away as we go forward in '19.

Operator

Our next question comes from Kenric Tyghe from Raymond James.

Kenric Saen Tyghe - *Raymond James Ltd., Research Division - SVP*

Glenn, just with respect to your activewear performance both in-quarter and looking to your revised or raised guidance for the rest of the year, could you speak to what's driving that outperformance? I mean, are there also some shelf space on your programs wins in this and how should we perhaps think about the evolution? And then part 2 of the question, the $85 million drag on sock, higher than it was. But are you comfortable that it's now contained or any ripple effect from the mass program exit is contained, if you could just help us think about those 2 issues?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Okay. Well, I think, we've -- as a company, we've grown our business really -- from the base of our growth is somewhat the acquisition that we've made over the last 3, 4 years, I mean, Comfort Colors, American Apparel our Anvil brand. I mean, these brands, our investment in yarn-spinning that we made to build up our ring-spun capacity. Just taking it back, we're producing today, to just give you an idea, in Fashion, 30% of our volume today is in the Fashion segment in terms of our yarn capacity. So 3 years ago, we didn't produce any of those products and we made capital investments we thought were to support the future opportunity to market and we complemented that with acquisitions and products in our line to support the growth. So we're just reaping the benefits of our positioning and seeing our Fashion Basics grow in all categories. At the same time, we're very excited about our international growth, it's up 35%. Our e-commerce business is growing as well. We had over 100% increase in our e-commerce sales in the quarter. So we've really positioned ourselves, I think, to support growth. And at the same time, we're looking to also support additional opportunities as we move and look at the -- taking advantage of some of the shifts in the market in terms of private labels. So in all these areas, we think we're well positioned. It's reflected in terms of the growth that we have this year and we see that continuing through in '19. And on the sock side, we planned obviously to have a reduction in socks. I mean, our licensed branded socks are a little weaker than we anticipated. But overall, I think, we really plan to take that out of our forecast, but we also, when you look at the way we've positioned the company, we've taken out, we think, a low-margin business of socks. And really if you take a look at our SG&A, we've invested over 100 basis points in distribution, in e-commerce activity and that's big -- that was in the first half of the year. And we've also -- will have inflation obviously in our base SG&A. At the same time, we're shipping 17% more activewear, which has a fixed cost of distribution and then selling. At the same time, we're maintaining our SG&A flat. And all that growth in spending in these areas is being offset by the amount of SG&A we've taken out of our sock and innerwear business. So at the end of the day, I would say that our socks and innerwear business although it's down, it's going to be very profitable on a go-forward basis and we've rightsized the SG&A and the business to support where we think we're going to end up. So even though it's not growing, but it's going to be much more profitable even on the core business before the reduction. So we're positioned well. We're spending and investing, we're growing and we're consolidating and increasing margins where we think our business is tailing off. And I think, that's sort of the way we look at it as we go forward into next year.

Kenric Saen Tyghe - *Raymond James Ltd., Research Division - SVP*

Great. And then if I can just switch to supporting some of that growth, obviously you're sewing capabilities and the challenges in Nicaragua currently. Could you frame up for us the flexibility within your system or within your capabilities with respect to sewing and perhaps how much worse it would have to get in Nicaragua for it to become a real point of concern or put at risk as some of you are thinking?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Maybe to start with is that we haven't lost any production based on our production plan. The fact, we've actually increasing it because, like I said, we're expanding our fleece production. We're focusing on these new programs we have, so we're actually exceeding our expectations in production that we set forth in the beginning of the year in our internal manufacturing plan. So that's putting that as a moot point. Now we've definitely incurred a little bit higher costs because we're transporting goods. Instead of using road to get in Nicaragua, we're going through Costa Rica. We pretty have a pretty diverse supply chain. We keep enough flexibility in our supply chain to absorb these types of situations. So it's really not, I think, affecting our ability to service, it's more affecting a little bit of our costs that's going to flow-through and it's a minimal in terms of what the actual cost is from the Nicaragua situation, a couple of pennies in Q3.

Operator

Our next question comes from Mark Petrie from CIBC.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

I actually just wanted to follow up on a couple of the topics that you've already touched on. First, I guess, just on the SG&A side, wonder if you could quantify the amount of savings from your efficiency programs that were realized in Q2? And then how should we think about 2019 in terms of the programs that you've already established and are going to impact Q3 and Q4 flowing into 2019?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Right. We're still in integration mode as we're basically in our organizational realignment. It won't really be fully complete before -- sometime in Q2 of next year or so. We're going to continue to have additional SG&A savings based on our realignment. So our objective is, as we go forward to next year, to continue investing in our distribution or e-commerce and our activewear growth, but the same time we think there are still opportunities to leverage our SG&A. So in a perfect world, we're trying to keep our SG&A actually flat for '19. That will be a challenge. But we're going to be pretty close to [about 5] as we go into '19 to answer your question.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Okay, that's helpful. And then I think you said on the private label side you secured 3 contracts of fleece and in underwear. Can you just confirm that and sort of an outlook for private label over the course of the next 12 to 18 months? And then of the contracts you've established at this point, how different do the economics look on those projects versus your existing Printwear business?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, what we said is that we're going to invest our capital where we can get good returns. Part of getting good returns will be making sure that our business is rightsized to support that business, and that's what we've done since the beginning of the year. So we're very confident that we can, with our low-cost manufacturing and everything we have in place, that we can get good returns on capital to support this opportunity in the market. And one thing I can tell you is that, again, part of our long-term planning, I think, in the way we realigned our business, we've -- we saw the world changing 6 months ago, to be perfectly honest with you. And one of the strengths of our company is how we react and I would say that there's a couple of key drivers to that. And one is that e-commerce is never going to go away and it's going to continue to grow, so we need to be -- establish ourselves to be able to support that opportunity. Two, I think is that brick-and-mortar is basically going to continue to focus on private label. We see that throughout all of our customers, they're expanding their private label brands. Three, I think, the brands that are going to survive in the future will continue to focus on a direct-to-consumer strategy. And we believe that nobody is immune to this, that even well-established brands in all segments, including mass, are going to continue to lose to private label. So we've taken this and looked at how we can invest in our e-commerce strategy, our distribution and as well as making sure that we rightsized our SG&A to support the opportunity and make sure we can capitalize on future sales in the segment. So I think we're well positioned and we're very confident to deliver our mid-single-digit growth as we go move into '19.

Operator

And the next question comes from Vishal Shreedhar from Capital Bank (sic) [National Bank].

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Just on the -- your view on the future of branded programs. Obviously, Gildan has a significant base of branded programs still within its business. So maybe your thoughts on how that unfolds. And in the future years, should we expect that branded business to continue to taper. I'm talking about the residual Gildan programs and Gold Toe programs and maybe some of your licensed programs?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, we're definitely 100% focused on all of these activities. I mean, really if you look at the way our business will unfold in the future, I mean, our licensed business we feel very comfortable on its growth trajectory. I mean, there is -- it's just sort of a -- and I guess in a wait-and-see mode right now in terms of new opportunity in expanding our distribution as we look forward into the future. Our Gold Toe business, we're still driving it. We have the -- we're reinvigorating the brand and spending money to support it. Our Gildan brand is still relevant, in a lot of challenge with distribution from mass all the way up to e-commerce. So we're going to continue to support all of those initiatives. But the one thing, I think, is where we see really the opportunity is how we can support the e-commerce side of the business because that's really where we think the market will be in the future and that's where we're really investing our capital right now. So American Apparel brand basically is growing tremendously in e-commerce. We've launched basically a direct-to-consumer in over 200 countries. We've expanded our footprint in product offering in American Apparel -- product offering to our direct-to-consumer customers. So we're going to continue to look at selling our products and every one of our channels of distribution is supporting our brands. And the only nuance of that is that, when you look at mass and as mass consolidates into private label, they're still selling 70% of all the underwear that's sold in the United States today. They're selling 70% of all the socks. So from a volume side, that's really where we still see private label opportunity being a big opportunity for us because it's just the sheer volume of opportunity. So these other areas are going to continue to grow, but we're going to move them into e-commerce in better stores, the upper department stores tier. So I think that's maybe the way you need to look at it in terms of where you really see the opportunity that's going to move the needle for the company as we go forward.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And I just wanted to just dig a little bit deeper on your thought about what the future looks like with respect to private label, particularly in some of these more basic categories. So if we look at the data for, and you can correct me if I'm wrong, Glenn, but if you look at the data for decades and some categories call it men's underwear, private labels never really seem to take off. There's been a variety of initiatives and attempts to have private label occupy a bigger portion of the mix, but it hasn't really seem to have done that. So is there any evidence today aside from perhaps what is a new wave of private label like is e-commerce really the difference maker in this?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Look, I think what we'll end up having is that you will see expansion in private label amongst mass retailers as you go forward. Definitely, it's traditionally been a branded business. But as you go forward, I think that the investments and the commitment amongst major mass market retailers is there, and at the end of the day, they're the gatekeeper to the consumer. So they can drive consumer behavior just like e-commerce companies can drive consumer behavior based on where you're positioned on their page. So both of these are somewhat the gatekeeper ultimately to the consumer. So my belief is that the commitment in terms of driving private label is going to be -- it's something that we'll continue to grow. You can see it as you walk in these stores, the more relevant brands, there's more commitment. It's not no-name brands or it's just -- there's more thought process in merchandising and developing putting into the product. So I think it's here to stay personally. And the other thing you have to take into account, too, is that most mass market retailers also have extensive e-commerce sites and investing heavily in e-commerce where they are looking for brands or looking for product to put on their e-commerce sites. So on the other side, that's the opportunity where, because from an e-commerce perspective, it's a virtual world, whereas you're working on your floor. Basically, you have limited floor space, so you want to sort of control the consumer to sell the products that are sort of your own house brands and I think that's maybe the way you look at it. That's why we're investing so heavily on our e-commerce side because there's not one retailer that we cannot sell all of our brands to if we wanted to. That's from the Walmarts, the Kohl's, the Penneys, Amazon. I mean, there's companies popping up every day that are e-commerce sites. So once you have the distribution capabilities, the world is endless in terms of opportunity to sell your brands. The issue is that I think mass is going to consolidate and brands are going to become much relevant in brick-and-mortar. That's just my view of it and that's sort of where we're betting our future, and we're willing to support those brands as we go forward.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And just one quick one here, Glenn. I'm just having a little bit of trouble following the messaging. So your view is that Gildan has brands and those brands are -- they may be under review in some cases, but Gildan's view is that if they are, they can replace that with private label. Is that a fair way to characterize it?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Yes, that's correct. And I think that the brands that we have, if you look at Gold Toe or our licensed brands, they're really not mass brands, right? They're national chain and department store brands. So they're going to continue to survive in that world, right. When you look at where the other -- like a Gildan brand and mass, it's going to continue to survive. The question is, is it going to be as relevant in a brick-and-mortar as it's going to be online through the Amazons, for example, or through a Walmart.com or et cetera. I think that's maybe the way to look at it. So a combination, we'll continue to drive not just our Gildan brand, but we have Anvil, we've got Comfort Colors, we've got American Apparel. We have a slew of brands basically that I think are relevant to support e-commerce at the same time we'll focus on mass-market private label.

Operator

Our next question comes from Stephen MacLeod from BMO Capital Markets.

Stephen MacLeod - *BMO Capital Markets Equity Research - Analyst*

I just wanted to dig in a little bit further on the private label shift and I just wanted to get a sense as to -- you've cited certainly like an impact on socks from a retailer shift towards private label. Can you just talk about what you've actually seen so far on the underwear side?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, right now, we haven't seen a big shift in underwear. We see some underwear private label growing in some of the mass market retailers, but we haven't seen -- there hasn't been a major shift yet. I think that's still on at the incubator stage. There's been quite a bit of activewear that, I think, has already made that shift in all across the mass market channel. But I think it's in the process basically of growing.

Stephen MacLeod - *BMO Capital Markets Equity Research - Analyst*

Right. Okay. So you would expect that, just based on your previous commentary, that if something that you would anticipate happening over the next sort of 12 to 18 months or whatever that case may be?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

I think in every category in mass, you're going to see extensive private label.

Stephen MacLeod - *BMO Capital Markets Equity Research - Analyst*

Okay. And then just, secondly, just want to talk a little bit about the gross margin evolution and kind of how you see that impacting -- or evolving through the year. I mean, clearly you've had some higher raw material costs and some input costs from disruptions in Nicaragua. You're able to put through price to offset that in the back half of the year? Or do you think the situation just sort of resolves itself? I guess, price with respect to cotton and then also the Nicaragua situation, is that something that is improving?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, I guess, the incremental cost that we have associated with the buildup of our manufacturing capacity to support our activewear growth as well as these new programs, I mean that's factored into our margin in the second half of the year. As far as future pricing, it will be based on other input costs, cotton, inflation and we'll see how that plays out as we move into '19.

Operator

Our next question comes from Patricia Baker from Scotiabank.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

I have a follow-up question on the private label. The contracts that you said you've already secured, will we see those rolled out into your customers in the fourth quarter? And then, secondly, do you anticipate securing even more than those 4 contracts through the second half of the year?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

No, at this point in time we won't secure any more business for this year, but we're definitely looking for securing new programs for '19 obviously. And these programs will roll out end of Q3, beginning of Q4.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Super. And then just another, I'd be interested in your viewpoint. Glenn, you've talked a lot about your view that the mass channel is really moving extensively towards private label and I'm wondering what your view of the private label is? Do you think that there's a shift on the part of mass from going from what was in the past a generic approach to private label and now they're looking at private label to have a more differentiated and exclusive product as opposed to just simply private label?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

I think, private label is more the way, I think, the market will materialize, to be honest with you, because it's -- if you see like, for example, some of the other mass market, I mean, the names that are coming up, the marketing strategies is definitely much more professional. And no, it's not a no-name brand like it historically was in the past. So I think there's a lot more energy, investment and thought put into building these private label brands. You see that on online retailers as well as the brick-and-mortar today. So that phenomenon, I guess, is going to make that marketplace, I think, much more brand oriented even amongst the private -- like a private label is becoming a brand. And that is the investment behind it because it's that -- I mean, that's just the way I see it happening. And I don't know if that answers your question, but it's definitely relevant.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

No, it definitely does because it's -- you're thinking about it the way that I'm thinking about it, which is that, in the past, there was a little effort put behind it. It was low cost and it was just, as I said, simply generic. And it got a lot more involved in it at this point.

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

And even more so that it's looking it's going to become more even premium like -- although it's been a little generic in the past, now I would say you'll find better quality products, more features in the garments, things that are -- will differentiate even traditionally you saw from brands. So there's a lot of emphasis put on the quality of these products as well. So it's really changed. I think it's going to change the landscape as we see in the future because it's not just going to be a price, it's also going to be a value and quality proposition as well.

Operator

Our next question comes from Sabahat Khan from RBC Capital Markets.

Sabahat Khan - *RBC Capital Markets, LLC, Research Division - Analyst*

Just a quick just on just kind of the operating margin outlook for the back half for the year. With kind of pricing you have taken in the first half and the higher input costs that you're alluding to, how do you expect that to (inaudible) in Q3 and Q4? How should we think about margins coming through?

Rhodri J. Harries - *Gildan Activewear Inc. - Executive VP, CFO & Chief Administrative Officer*

So if you look at the margins in the back half of the year, Saba, I mean, as we've said, we've taken our guidance in the operating margin, which we think is going to be strong, right, from a slight improvement to slightly down. And what's driving that really in the back half is, as we've said, we're supporting all this growth, right. [, With all that we've got] effectively manufacturing cost that's coming through to support that growth as we drive our system, we do see some higher inflationary cost coming through, but you would expect that in this overall environment. And then we have the impact of the supply chain that we commented earlier on, right. So if we look at the back half the year, we probably have in total about $0.08, right, of negative headwind that previously we hadn't planned that we're reflecting in our numbers. And that's coming through in both quarters. But again, what I'd like to emphasize is that, for the most part, most of this is being driven as we respond to growth, right, and as we move through the year, as we've upped our overall view of growth. And then obviously, you've got all that good SG&A reduction is also coming through. So I think we feel very good really about the way our margins are evolving, again, as we respond to the environment and we drive for that growth.

Sabahat Khan - *RBC Capital Markets, LLC, Research Division - Analyst*

And then just one on the sales side. In terms of your comfort with mid-single-digit growth for the back half of the year, can we maybe talk about is there any potential upside from American Apparel? And then on the flip side, it looks like the underwear and hosiery sales are, I think, down about $70 million year-over-year if I got that right. Now do you see a bit more of a flattening in the back half of the year there? Or is there any risk at all to that hosiery side?

Rhodri J. Harries - *Gildan Activewear Inc. - Executive VP, CFO & Chief Administrative Officer*

So just to clarify, right, we've taken our guidance for the full year to mid-single-digit growth and if you look where we were in the front half of the year. So in the back half, we're seeing high single digit growth, right, from a growth perspective. So we see a strong back half driven by the activewear growth. On the hosiery business, we've called out the $85 million. The $85 million, I mean, obviously, we're -- as we roll through the year, we started to see the movement out of those programs in mass in the back half of last year, right, and then we see it in the front end of this year and so that'll abate, that'll slow down in the back half. Then we've got private label coming on. So I think, we feel good about the way things -- the underwear and hosiery category, the way it's evolving, we've called it out and we think that, that's -- we've got a good view on that. On American Apparel, as I said in my comments, right, things are going well in American Apparel. Glenn talked about it. We're expanding globally. We're in 2 over -- 220 countries now. The brand is really building very nicely. And I think, as you look at the evolution of the brand, I mean, we had a high double-digit growth rate in the second quarter, that's going to continue as we move through the back half of this -- the brand just continues to build as we move through 2018 and to 2019.

Operator

And our next question comes from Derek Dley from Canaccord Genuity.

Derek Dley - *Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst*

Just switching gears a little bit. You guys had really strong growth in your international markets. Can you just comment on which markets were notably strong? And are you seeing similar trends internationally that you've seen in North America in terms of strong Fashion Basics growth, strong fleece growth and then so on and so forth?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

The answer is all the markets are growing well. Our European market's growing, our Asian market's growing and all these markets are growing basically through, first of all, making sure that we've allocated enough capacity to these markets for the first time, I think, which is really a reflection on our growth opportunity. But also the products and the brand's expansion, we've got American Apparel in Europe now. We basically are bringing Comfort Colors there. We're expanding our product offering in China. So we really have good momentum in all markets, in all products, in all categories really to be perfect honest with you. So we're very excited about the future of our international sales.

Derek Dley - *Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst*

Okay. And sorry, just -- and what about the trends internationally, like is Fashion Basics outperforming similar to what we're seeing...

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Yes. it's the same story, right. I mean, American Apparel, Comfort Colors, it's all -- these are all our fashion-type products basically. In Europe, because it's more mature, we're bringing in more products and brands. In Asia, we're just adding more product because we started in Asia with pretty limited SKU base, and that's our fastest growing market right now. So we're -- it's not as mature between fashion/nonfashion because just keeping up even with the core basics in that market is a challenge for us because of the growth we're having. But in our European markets, we're basically establishing our American Apparel, our Comfort Colors, more fleece. Basically, fleece has been a big driver of our success in Europe. So it's a combination of both to be honest with you.

Derek Dley - *Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst*

Okay. And then this is more just a housekeeping question. But with your increased guidance, tightening the range up on the guidance, does that include full completion of the additional 5% NCIB.

Rhodri J. Harries - *Gildan Activewear Inc. - Executive VP, CFO & Chief Administrative Officer*

Well, if you look at the NCIB, we've completed the first tranche of the 5%. And then as we go forward, we've upped now the buyback to 10%. Really, it doesn't reflect all of the completion of that program. As you look at the higher end of the range, it reflects some additional share buyback, but not the full completion of 5%.

Operator

Our next question comes from Martin Landry from GMP Securities.

Martin Landry - *GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst*

Wondering, you're increasing your share buyback program and trying to see what's the read through in terms of acquisitions. How does your pipeline for acquisition looks like currently?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

I think that's -- what we said earlier in the year is that our focus this year is to consolidate and realign our business units. It's obviously -- it's quasi an acquisition for us from the systems integration, et cetera, perspective. So that's really our focus. And so I wouldn't expect any acquisitions for the balance of this year. But obviously, as we complete that realignment, we'll continue to look at opportunities as we move forward into '19. There's always -- we have a full slate of opportunities. I mean, we always keep obviously our eyes on the market. We know what types of products or brands or distribution that can support the growth of the company to support our organic growth. So it's a question of timing and what's available at the time and making sure that we can, whatever acquisition we do, do in the future that we look at making sure we get good returns on capital like we have on the previous ones. So we're continuing to drive our strategy. I would say for this year, we're going to continue to consolidate and acquisitions you can look forward to as we move into '19 and beyond.

Rhodri J. Harries - *Gildan Activewear Inc. - Executive VP, CFO & Chief Administrative Officer*

I think, Martin, the one thing that you should note about the upping the share buyback, that reflects the strength of our balance sheet. It reflects the strength of our cash flow. It reflects our view on intrinsic value, right, driven by growth longer term. So I think you shouldn't get confused about why we think buying back stock is a good idea effectively. It's these factors and then obviously we'll make sure we have very good flexibility to go after acquisitions as required when we're ready.

Martin Landry - *GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst*

Okay, fair. And just a clarification on your international sales growth. I think your sales internationally are up 30% year-to-date. How much of that is related to American Apparel?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

American Apparel is still relatively small in our international volume. We just launched our direct-to-consumer strategy to provide reach in other countries. So it's relatively small. Most of our American Apparel growth is coming from the U.S. today. And then direct-to-consumer, yes.

Operator

Our next question comes from Jim Duffy from Stifel.

James Vincent Duffy - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

My question is on the activewear acceleration. It's really notable and it stands out relative to what seems a trajectory for the market. I'm curious, is pricing and perhaps anticipated pricing having any influence on the activewear volume? Is there anything you can say about general inventories and sell-through?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, inventories are in good shape. The price increases that we took in activewear were early on in the year. So basically, our momentum in the second half of the year is based on the demand for our products, the growth of our fashion business, which is driven by our American Apparel, our Comfort Colors, our Anvil brand, our fleece growth not just in the North American market, but that's even international markets. That's one area we've really seen international growth in fleece. Our GLB business is growing pretty good. So you know it's everywhere. International is up. So basically, our e-commerce has doubled in the quarters. So we're growing in every single category. I mean, that's really what's happened and what's driving our business. So it's not necessarily that the price has done it, and the inventory and the channel is in good shape relative on a year-over-year basis.

James Vincent Duffy - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Do you characterize it as share gains, Glenn? When we look at the revenue growth, how much of that is higher price per unit versus unit share gains relative to the growth of the market?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, price is not a very impactful to us this year. I mean, it's a couple points. It's nothing really on the overall business. So I mean, basically it's mix is driving our sales because we're selling better and more expensive items like Fashion Basics, more fleece, more GLB. International is growing, obviously e-commerce. So again, it's just all of the initiatives that we put forth in this strategy of the company that's driving the sales.

Operator

Our next question comes from Brian Morrison from TD Securities.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

Glenn, just on the operating infrastructure, I want to understand timing of full support of your e-comm strategy. So just, first, is the distribution infrastructure and consolidation in North Carolina, is that complete? Or what are those standing in the infrastructure, investment reorg that needs to be complete through next year? Second, how long till we get to full capacity on our RN VI? And then, the Alstyle facility, just update us on the surplus capacity? And is there surplus sewing capacity in Mexico?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

What's number two?

Brian Morrison - *TD Securities Equity Research - Research Analyst*

Just RN VI getting to full capacity.

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

RN VI, I'm sorry. Okay, as far as the reorg is concerned, our investment, first of all, we've invested about 100 basis points so far this year in our e-commerce capabilities as well as our distribution capabilities. We've opened up 2 distribution centers to support our e-commerce. They will be fully functional. One of them is really fully functional. The second is going to be fully functional probably within the end of this quarter in Q3. So we've really put that foundation to support our growth in e-commerce because when we look at our e-commerce growth, we're not just supporting the existing brands. We think that there's opportunities for other brands we haven't brought to the e-commerce world, which is like our Comfort Colors, our Anvil, American Apparel, for example, we have a whole slew of opportunity to continue growing that space. So that investment is going. At the same time, the consolidation of our organizational realignment, we've jettisoned distribution centers -- other distribution centers that we're supporting really our innerwear and mainly our sock business and to have major consolidation that's under way right now. And we're also investing in systems, which is the other probably the drag on our ability to move as fast because systems are always a drag. But they're being implemented at the same time. So as we move it to early next year, we will be 100% realigned, having our systems on 1 platform. And that's not just from a front end of the business, but that's also from a distribution perspective and having the capabilities of shipping products from different warehouses, et cetera, et cetera. So we're going to have 3 different types of distribution. We're going to have our mass market, the brick-and-mortar customers; we're going to have our big box distributors; and we're going to have our pick-of-the-piece e-commerce capabilities all put in place once this is all said and done. So it will allow us to execute on even the existing products we're selling like Gold Toe, our Under Armour or socks and all the other products we want to bring to the e-commerce world as we go into the future. So to answer to your question will be sometime at the end of Q1 into Q2 next year until it's fully ramped up and completed.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

That's helpful.

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

As far as Rio Nance VI is concerned, the factory is being ramped up. We should be a fully ramped up, I would say, in the next 12 months from today. And we'll have quite a bit of capacity up and running as we start the year next year. And that's a very important part of our, obviously, our growth strategy because it is going to give us a lot more flexibility to support the Fashion Basics and our performance opportunities in the marketplace. And as far as our overall capacity, including Alstyle we've got enough capacity in place to support over $800 million of additional revenue. I mean, that's what we said in our Investor Day. All these things are in place. We're expanding not just in Rio Nance VI, but we have an expansion going today in Rio Nance V. We're expanding Rio Nance I. And we have a lot of growth opportunities in Mexico, which we're just waiting to see obviously how trade plays out. But we basically have room to more than double the size of that plant where we are. So everything is in place to support the growth in the market. Obviously, we'll continue to add capacity as our sales will allow, but the capacity will not be an issue for us to support future sales as we go forward in the next couple of years.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

And that's going to lead to further efficiencies in the back half of 2019 as well then, correct?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Yes, and that will lead to further efficiencies and also further working capital efficiencies, too, believe it or not because a lot of the fashion products, and there's a big difference between producing a fashion product and a tubular basic T-shirt, so it will give us a chance [we're hoping with] to inventory levels down, respond quickly to the marketplace. So there's a lot of other activities that are taking place for us to build these and improve our service to our customers. All these things will materialize as we move into '19. And also allow us to, I think, to manage our working capital in a much more effective way.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

Sorry, if I can, just one further question. Just -- the success you called out in global lifestyle, can you just confirm it? Is that about $150 million run rate? And just how material that opportunity is?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

No, it's higher than that. And the opportunity, I think, is there. I mean, it's a function of working with our partners. But we think that's a good growth opportunity in the company as the world changes. I mean, one thing, I guess, is when you look at what's happening in trade and you look at what's happening in the world today, the world become look smaller, I think we're well positioned for the North American markets particularly to support the global lifestyle brands as I look at the risking what's happening in China. And also what's going to happen, I think, is maybe one other point is that as you look at what's happening in China, what will end up happening is that there's going to be significant inflation in areas where people will go to, to leave China and mainly, I would say, Vietnam, for example, which would probably be the #1 area where you'll see a lot of inflation because the telecom, the shoe companies, I mean, things where China has built up a big infrastructure, they're going to move into more structured-type environments. They're not going to move to Myanmar or Bangladesh or something like that basically because it's very difficult to operate in those countries. So that's, again, another changing environment. We think that it will well position us in where our manufacturing is located and our ability to support not just our global lifestyle brands, but as well as our private label customers in the future.

Operator

Our next question comes from Keith Howlett from Desjardins Securities.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

Yes, I wondered if you could speak about the sourcing that you do in China, I think, for some of your Gold Toe or your Peds brands and -- so how you're viewing that going forward with the U.S.-China trade situation?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, one of the things that we've done is through our divesting of the sock business that we had that we talked about, we were outsourcing like you just mentioned quite bit of volume, we're actually in-sourcing more volume. So although our stock business is down, we're still running our plants at full capacity by in-sourcing products basically that we were outsourcing in the past. So our Peds, our Under Armour products and a lot of our Gold Toe products are being in-sourced. And we've reduced significantly our reliance on our socks that we've been importing in the past from China. At the same time china has not been part of as the dumping and classified as duty raises already duties on socks coming in from China. So in both of those areas, I mean, we really don't have any concern in our sock business.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

And then I wondered if you could just help us understand retailer shift to private label. Just sort of procedurally, how much notice a branded player would typically get that retailer is going to delist them or move to private label, and on the flip side of that, how long it takes to develop and implement a private -- a major private label program for a major retailer?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Look, I can't speak on the timing of it. But look, at the end of the day, when you're looking at the mass market, it's usually significantly big volumes.

So they obviously have to be planned in advance in order to support the launches of these products. It Takes usually a year before they would commit to doing something like that. But we're working today to continue looking at opportunities for '19 still as we speak. So you need to work pretty much like a year in advance in order to, I think, to solidify and make this transition to be able to support both the transition and the capacity buildup.

Operator

And we have a follow-up question from Stephen MacLeod from BMO Capital Markets.

Stephen MacLeod - *BMO Capital Markets Equity Research - Analyst*

I just wanted to follow up very quickly on the situation in Nicaragua. And I just wanted to get a sense as to what you've seen evolve over the last couple of months, where we are today versus where we are -- where we were 3 months ago.

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, look, I mean, the political situation has not really changed a lot. I mean, obviously, there's a little bit of unrest. But as far as we're concerned, our plants are operating normally. We're running actually more than 100% of our capacity there today as we speak. And at the same time, we did the these transportation, efficiencies and we had to work some of our plants during -- we lost a little bit of production in July where we worked some of our other facilities in overtime and extra shifts to make up for what we did lose. But I don't think it's really something that I'd be concerned about as we go forward.

Operator

And we have a follow-up question from Keith Howlett from Desjardins Securities.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

Ask on your new sewing, I presume it's sewing capacity for fleece and activewear, where that new capacity is located?

Glenn J. Chamandy - *Gildan Activewear Inc. - Founder, President, CEO & Non-Independent Director*

Well, that capacity is mainly in Honduras, which it always has been, so we've -- we're expanding the existing facility that we had and we're actually moving product into one of our other facilities in Honduras as well just to support the growth and the opportunity.

Operator

I will now turn the call back to Sophie Argiriou for closing remarks.

Sophie Argiriou - *Gildan Activewear Inc. - VP of Investor Communications*

Again, I'd like to thank everyone for joining us this morning. This concludes our call, and we look forward to speaking to you soon. Have a great day.

Operator

Thank you, ladies and gentleman. This concludes today's conference. Thank you for participating, and you may now disconnect.
