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GIL.TO - Q1 2019 Gildan Activewear Inc Earnings Call

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OVERVIEW:

Co. reported 1Q19 sales of \$624m and adjusted net diluted EPS of \$0.16. Expects sales growth to be in the mid-single-digit range and GAAP diluted EPS to be \$1.75-1.85.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to the Q1 2019 Gildan Activewear Earnings Conference Call. My name is Daryl, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to Sophie Argiriou, Vice President, Investor Communications. Sophie, you may begin.

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

Thank you, Daryl. Good afternoon, everyone, and thank you for joining us. Earlier, we issued a press release announcing our results for the first quarter of 2019. We also issued our interim shareholder report, containing management 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 the company's corporate website.

Joining me on the call today we have Glenn Chamandy, our President and Chief Executive Officer; and Rhodri Harries, Gildan's Executive Vice President and Chief Financial and Administrative Officer. In a moment, Rhod will take you through the results for the quarter and our business outlook for the year, and a Q&A session will follow.

Before we begin, please take note 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, the U.S. Securities and Exchange Commission, and the Canadian securities regulatory authorities.



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

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

Thank you, Sophie. Good afternoon, everyone, and thank you for joining the call. Earlier, we reported first quarter 2019 results, which came in at the high end of our sales and earnings guidance, setting us on track to achieve our full-year targets. During the quarter, we also continued to execute on additional supply chain initiatives as part of our plan to drive increased operational efficiency across our manufacturing base. We expect to see cost benefits to start to materialize meaningfully in the latter part of the year and continue to positively impact gross margin levels as we move into 2020. In addition, our efforts to further drive down SG&A expenses as a percentage of sales that we initiated last year continue into 2019, and we feel good about delivering further SG&A leverage for the full year and ultimately reaching our goal of bringing SG&A as a percentage of sales down to 12% or better by 2020.

In our press release today, we also announced the acquisition of land in Bangladesh, which we plan to use as part of our new major capacity expansion initiative to develop a large scale manufacturing complex in southeast Asia primarily to support our international business. I'll provide more details on this major initiative later in my remarks.

First, let me take you through the specifics of our first quarter performance, which you may recall we expected would be relatively soft. Specifically, when we initiated our guidance in February, we were forecasting first quarter sales and earnings to be down year-over-year, mainly because of lower levels of distributor restocking this year in the imprintables channel; higher raw material cost pressures in the first half of 2019 versus the second half of the year; and as we announced on March 26, the impact of a trade receivable impairment charge primarily related to the imprintables distributor, Heritage Sportswear, that we recorded in the first quarter.

So if we look at the actual results, sales came in at \$624 million for the quarter, down 3.6% versus last year, with \$494 million in activewear sales, and \$130 million of sales in the hosiery and underwear category. Although sales were down this quarter as we expected, the decline came embedded in our guidance of a mid to high single-digit decline, primarily due to stronger than anticipated fleece shipments and an earlier start of the rollout of our new private label's men's underwear program, which we started to ship towards the end of the first quarter. The sales decline was mainly driven by lower activewear sales, which were down 4.1% as distributor restocking levels of imprintables in the first quarter this year were lower than the levels of restocking that occurred in the first quarter of 2018, when distributors bought in advance of the price increase we implemented in March last year, which did not reoccur in the first quarter of 2019. So in activewear, lower restocking offset higher net selling prices and double-digit volume growth in fleece products.

In hosiery and underwear, the slight decline of \$2.4 million in sales, or just under 2% year-over-year, was mainly due to the nonrecurrence of sales under a Gildan sock program, which we were in the process of phasing out at a large mass retailer last year, and lower Gildan branded underwear sales. The impact of these factors was largely offset by higher sock sales of licensed and global lifestyle brands compared to last year, and the benefit of earlier than anticipated shipments of our new private label men's underwear program at our largest national retailer. We are extremely pleased with both the product and the overall execution of the program, and we expect this underwear to be available in stores by the third week of May.

Moving on to gross margin. In the first quarter, gross margin totaled 25.8%, down 140 basis points over the same period in 2018. The expected margin pressure was mainly due to anticipated increases in raw material costs and other manufacturing input expenses over the prior year and unfavorable foreign exchange, which more than offset the benefit of more favorable product mix and higher net selling prices. As a reminder, when we initiated 2019 guidance in February, we indicated that cotton costs for 2019 will be higher than prior year levels with the impact much more weighted in the first half of the year. Further, we also indicated that we would see some pressure on gross margins during the early to mid part of the year from manufacturing costs that would subsequently turn into a positive tailwind as we move into the fourth quarter of the year, given all of our ongoing supply chain initiatives.

Turning to SG&A. We kept expenses in the first quarter flat over the prior year. However, the lower sales base resulted in SG&A as a percentage of sales of 14.9%, up 60 basis points versus the first quarter last year. As we return to sales growths for the remainder of 2019 combined with the benefit of our initiatives to drive organizational efficiencies, we expect to see SG&A leverage in the year materialize.

Consistent with our announcement on March 26 during the quarter, we reported a charge of approximately \$22 million, writing off our trade receivable from Heritage Sportswear, one of our distributors who was under receivership and whose operations are being wound down. On the retailer side, we also reported a trade receivable charge of approximately \$2 million related to the Payless bankruptcy. In all, the total impairment charge of \$24 million for the quarter hurt operating margins by approximately 390 basis points. Consequently, adjusted operating margin of 6.9% was down significantly over the prior year. Combined with higher financial expenses, this translated to adjusted net earnings of \$0.16 per diluted share for the quarter in line with the upper end of our guidance range and down from \$0.34 in the first quarter of 2018. With the lower imprints restocking headwind now fully behind us, we expect to return to sales and adjusted EPS growth next quarter with stronger earnings growth in particular occurring in the second half of the year as inflationary cost pressures ease and benefits from our supply chain initiatives start to materialize meaningfully in the fourth quarter.

Moving to free cash flow. In the first quarter, we consumed about \$128 million of free cash flow compared to \$40 million in the prior year quarter mainly as a result of lower earnings and higher working capital requirements, including planned inventory build. We invested approximately \$23 million in CapEx as we continue to spend towards our capacity expansion plans, including the ramp up of Rio Nance VI, which continues to track well on plan. We also invested in ramping up sewing capacity to align with textile expansion and made investments in IT. Under our share repurchase plan, which we renewed in February, during the first we bought back 876,000 shares for a total cost of approximately \$31 million. At the end of the first quarter, our net debt level was \$892 million, translating to a net debt leverage ratio of 1.6x net debt to adjusted EBITDA, which is within our target leverage framework of 1x to 2x adjusted EBITDA.

Now, before I move to the outlook, let me comment further on our new capacity expansion initiative in southeast Asia, which we are very excited about. Shortly after the close of the quarter, on April 9th, we finalized the acquisition of a sizable land parcel in Bangladesh for a purchase price of \$45 million. The land will be used for the development of our next major manufacturing hub, which will significantly enhance our current production capacity in Bangladesh. Our current plans include the development of a multiplant complex, which will house 2 large textile facilities and sewing operations, and which when fully operational are expected to provide capacity to support well over \$500 million in sales. Our previously communicated textile expansion plans in Central America remain unchanged. And as I previously mentioned, the ramp up of production in our newest facility in Honduras, Rio Nance IV, is coming along very nicely. Therefore, together with our existing and planned capacity expansion in our other manufacturing hubs, this new major initiative in southeast Asia, when fully ramped up, will provide manufacturing capability across our global system to support over \$4 billion of total sales. The first textile plant in the new Bangladesh complex is expected to be constructed over a 24-month period and will be a large scale state-of-the-art Rio Nance-like facility. We will start spending CapEx on this facility immediately in 2019, and we expect this plant to start ramping up during the latter part of 2021. When complete and fully ramped up, we expect this first facility to support approximately \$300 million in additional sales.

The decision to move forward with these manufacturing expansion plans in Bangladesh is the result of substantial analysis carried out by the company to identify a strategic location for a major manufacturing hub in this country with infrastructure which will significantly enhance our positioning as a low-cost socially responsible producer to support growth in international markets and other key growth areas. Bangladesh provides duty-free access to our targeted international markets, and given the size and scope of this new plant and manufacturing infrastructure, we will be able to provide strong low-cost supply with increased skew breadth to drive higher profitability in these markets. In addition, the incremental capacity that we will bring on in Bangladesh will allow us to fully service Europe and Asia from Bangladesh and free up capacity in Central America currently used to support European sales to drive incremental growth in North America.

Gildan has been operating in Bangladesh since 2010 when we bought a small facility, and we have since expanded over the years. We are very pleased with this facility, which currently employed 3,500 people. This experience has given us a good understanding and appreciation of carrying out operations in the country. The land which we acquired is in close proximity to our existing facility. The location offers a number of benefits, including availability and access to clean energy, utilities, and ring-spun yarn supply at competitive rates, proximity to water access and infrastructure, as well as access to a large and knowledgeable local workforce with strong technical expertise in apparel. Finally, we are particularly pleased that we will be able to leverage the expertise of our strong existing local management team. We're excited about our plans, and we look forward to providing a more comprehensive review of our capacity initiatives and capabilities at our upcoming investor conference in Honduras in November.

Moving to the outlook. We are now projecting GAAP-diluted EPS of \$1.75 to \$1.85, and we are reaffirming our guidance of adjusted diluted EPS of \$1.90 to \$2.00 after taking into account the trade receivable impairment charge we took in the quarter with sales growth continuing to be projected



in the mid-single-digit range. The small change in the range for projected GAAP-diluted EPS reflects higher than previously assumed restructuring and acquisition-related costs for the full year. As I mentioned in my introductory remarks, we are continuing to execute on additional supply chain and organizational initiatives, including the consolidation of our Canadian sheer hosiery operations within the company's global supply chain, which we recently just announced, as well as additional sales and marketing initiatives. Consequently, we refined estimates and incorporated expected costs for these additional initiatives and now project restructuring and acquisition-related costs for 2019 to be in the range of \$30 million, compared to our previous projection of approximately \$20 million.

For CapEx, having completed the acquisition of the land in Bangladesh for approximately \$45 million and incorporating land development costs as we start on the site preparation, our CapEx for the full year is now projected to come in at approximately \$175 million compared to \$125 million previously. Correspondingly, free cash flow for 2019 is now projected to be in the range of \$300 million to \$350 million, compared to \$350 million to \$400 million previously. Finally, after reflecting the trade receivable charge in the quarter, adjusted EBITDA is now projected to be in excess of \$605 million compared to in excess of \$630 million previously.

So in closing, first quarter performance was well on plan. We expect a return to sales and earnings growth next quarter with the full in line with the targets I just reconfirmed. We feel good about our growth drivers, including driving share and fashion basics, growing in international markets, leveraging our brands through online platforms, capitalizing on the shift to private label and growing with our global lifestyle brand partners. We are executing well on our operational efficiency initiatives, which we expect will allow us to maintain flat growth margins for the full year in 2019 and which will position us for margin expansion in 2020. Furthermore, we are not letting up on the SG&A side. We remain focused in driving further leverage this year as we work towards our target of bringing SG&A as a percentage of sales down to 12% by 2020.

Bottom line, our business model is strong. We believe we have a well diversified sales growth platform, which together with our low-cost vertically integrated manufacturing system will allow us to achieve our long-term targets of mid-single-digit sales growth and high single-digit to low-double-digit EPS growth with attractive returns on invested capital.

That ends my remarks, and thank you. I will now turn the call back over to Sophie.

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

Thank you, Rhod. That concludes the remarks. So before moving to the Q&A, I just want to remind you to limit of number of questions to 2, and we'll circle back to a second round of questions if time permits. I will now turn the call over to the operator for the question-and-answer session. Daryl?

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) And our first question comes from Heather Balsky from Bank of America.

Heather Nicole Balsky - BofA Merrill Lynch, Research Division - VP

Can you talk about how much of your current international business is supported by your Central America manufacturing facility? And then also, can you provide some perspective on the European Printwear market? Is the supply chain similar with regards to the distributor channel? And how does the competitive environment compare to the U.S.?



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

Okay. Well, on the capacity, about 50% of our international reported capacity's coming from Central America, and the balance is being produced currently in Bangladesh as we speak. So that's to give you an idea. So we have roughly about \$150 million of capacity in Central America with the expansion in Bangladesh. As far as the sales and distribution, it's very similar to the North American market. It operates in the same capacity. It's a little bit more fragmented than the U.S. because the distributors and the size of the market is a little bit smaller, but in all intents and purposes, the way the market performance is exactly like it is in North America.

Heather Nicole Balsky - *BofA Merrill Lynch, Research Division - VP*

And in terms of your customers, are they primarily distributors?

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

Yes, it's exactly like here, distributors. We ship to distributors, distributors sell to the printers, and the printers sell to the resellers. So it's the same concept as what we have here in North America.

Operator

And our next question comes from Omar Saad from Evercore.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

I was wondering now that you're a little bit into the new private label program in the mass retail channel, maybe you'd go into some of the details what you've learned so far. Are there any key differences from this program versus the branded program that you've had in the past, new categories, different categories, more shelf space in certain areas, less shelf space in certain areas? Anything you can kind of give us insight into in how that's going so far and how we should think about it versus prior programs would be helpful. Thanks.

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

Well, yes. What we said earlier on is that this is somewhat of a seamless program for us because what we did is we basically just stopped producing our Gildan brand and replaced it with a private label program. And what we said earlier is that the private label program will allow us to obtain more shelf space than we originally had with Gildan. Obviously, the volume of the program will be larger. And it's on track, and we've begun to ship it in Q1. And we're going to fully roll it out, and it'll be in the stores in Q2.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

And from a margins perspective, should we think about those as similar?

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

What?

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

Margins perspective.



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

Margins perspective.

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

Yes, I mean, look, we're -- I would say that in underwear in general, the margin profile would be similar.

Operator

And our next question comes from Martin Landry from GM Securities. Go ahead, Martin.

Martin Landry - *GMP Securities L.P., Research Division - Director and Equity Research Analyst*

My first question is on Bangladesh. Wondering a little bit, what triggered your decision to expand there? I know in the past there was some discussion about expanding into Costa Rica to establish a hub there. So I'd love to hear a little bit more details about cost profile in Bangladesh versus Central America. And you mentioned duty-free access. If you can talk about which countries you have duty-free access from Bangladesh, that'd be helpful.

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

Okay. Well, we'll start with Bangladesh is -- we've been there since 2010. We've had a very good experience. It's a low-cost country to operate. There's very good energy availability, well educated and good labor force. There's over 4 million government workers in Bangladesh, believe it or not. There's ample supply of ring-spun yarn, which is mainly in the markets outside of the United States. The fashion basics product line is much more prevalent in those markets. So overall, it gives us a lot of opportunity. And the main the focus, obviously, is to continue to expand in international sales. I mean, our story from Gildan from day one is that our sales are a function of our capacity. And we're not able to obtain access to certain markets from Central America. China is our second-largest and fastest-growing market today, Japan, for example. These markets we can't access duty-free from Central America. So really, Europe is the only opportunity we have out of Central America. So for those reasons and those markets being really the driving force of our international sales right now, this has made logical sense for us. And I think it was an opportune time for us. At the same time, we're building this in time because this incremental capacity would be roughly about \$500 million. We have, after this year, an existing about \$500 million still available in our Central America with all the expansions between Rio Nance VI, Rio Nance V, we expanded Rio Nance I. So this will really bridge the gap and give us the ability to, as we build it, to keep our momentum going on top line sales of mid-single-digit growth at least, if not better, depending on what the opportunities are in all of our growth drivers. And really, having this capacity and geographically located in Bangladesh will allow us to have a lot of flexibility. It gives us the flexibility to drive international sales. It gives us the flexibility to move some of the production from our existing Central America to free up capacity for the opportunity to support our private label customers and our brand strategy for Printwear in North America. So it gave us a very good balance and a good mix of, basically, sales and growth and opportunity.

Martin Landry - *GMP Securities L.P., Research Division - Director and Equity Research Analyst*

Okay. That's helpful. And can you compare the cost profile of Bangladesh versus Central America?

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

Well, look, I would say that it's in line because, look, our Central American capacity for the markets that we serve are very competitive. The one area where I think that there could be an advantage for us in Bangladesh is when it comes to ring-spun yarns as we move forward into the future and that being such a big growth category. But other than that, I mean, I would say that everything else is pretty consistent. We built a global low-cost manufacturing hub in Central America that really is great for this market. And the fact is that we just can't use that to support China, Japan, these



other markets. So now we really have a flexible, diverse supply chain, really, to grow globally because we can support not just the existing markets like China, but there's other markets like India. Anywhere in Asia, really, we almost have access to. So it opens up a lot of doors for us, and we're completely selling everything we can make today. So it's going to really help us to drive some of these other, not just the existing markets, but actually open up new markets to continue supporting our growth initiative.

Operator

And our next question comes from Paul Lejuez from Citibank.

Paul Lawrence Lejuez - *Citigroup Inc, Research Division - MD and Senior Analyst*

Question, curious if you can talk about how much did the earlier than anticipated shipments in the men's underwear program help sales in the current quarter. And also curious if you can quantify the gross margin decline in terms of how much raw materials, cost, versus the other inflationary costs that you mention. And also curious about how much higher prices and the favorable mix helped to offset that, if you could quantify those pieces. Thanks.

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

Okay. If you look at the sales for the quarter, based on our guidance, we were guiding to a mid to high single-digit decline for the quarter, so we came in at about \$20 million better than we had anticipated, so really a good delivery, ultimately. If you look at the \$20 million, \$10 million was related to probably fleece shipments in the distributor channel, so a little bit better than we were anticipating versus what we had originally expected, and then \$10 million related to earlier than anticipated shipments of our new private label underwear program, so effectively split half and half. If you look from a margin perspective, our gross margin came in line with what we had expected. Right, so we knew and we had guided that we'd see headwinds from high fiber costs and high manufacturing costs in the quarter. I mean, if you look at our guidance for the full year, we expect that to continue in Q2 and Q3. And then as we move into Q4, what we really see is effectively, especially from a manufacturing perspective, all of those supply chain benefits and initiatives that we've been driving really create a tailwind force which then drives margin expansion in 2020. So all in all, our gross margin came in line with what we expected. I'm not going to get into the details. We did see positive price. We had planned for positive price in the quarter. And we did expect positive mix, and we definitely got that. So it landed in line with what we expected.

Paul Lawrence Lejuez - *Citigroup Inc, Research Division - MD and Senior Analyst*

And how will the benefits of price and mix be running through the P and L for the rest of the year relative to first quarter? Will it start to shrink in magnitude, or does it actually increase over the next several quarters?

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

No. You'll see it basically -- every quarter it'll be similar, right? So we're getting positive price impacts, we're getting positive mixed impacts. Last quarter we did call out the price impact for the full year, which is 200 basis points, which we basically expected to sort of flow through every quarter as it moved through the year.

Operator

And our next question comes from Kenric Tyghe from Raymond James.



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

Glenn, going way back in time, whenever you've announced a very large capacity expansion the likes of what we're seeing in Bangladesh, it's typically been with pretty high visibility and high conviction. You've not typically built it in the hope that you can fill it, but rather in the expectation that you near have it filled. Is that a correct characterization this time around, this high visibility, high conviction build in Bangladesh? And the second part of that question would be is part of that conviction around perhaps some incremental retail opportunities in Europe outside of just filling capacity in the distributor channel as Bangladesh has typically done?

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

Well, I'll say 2 things. One is that the most difficult thing of starting a plant is having enough growth available to support it, right? So in our cases, we're shipping a lot of -- or manufacturing a lot of product from Central America to Bangladesh. So the fact is the ability for us to start this plant up, get it running and ramp it quickly, we just have to ship the revenue that we're currently supporting through Central America into Bangladesh. So that gives us a lot of confidence to go pedal to the metal on this plant and really make a big large scale facility to support what our goals are. But really, I think add the end of the day, during the script, Rhod alluded to the 5 growth drivers. I think the one thing is we're very comfortable with our positioning, and the five levers that we have is our Printwear business is still continuing to develop, we've got -- fashion basics are growing, we've positioned ourselves between -- we have 5 brands in that category today. We have the Gildan brand, the new Hammer launch, Comfort Colors and Anvil product line. And most recently, we're doing fantastic, of course, in our American Apparel line. There's still a lot of areas that we think we can penetrate and new products within even the Printwear channel today. And obviously, we're going to continue to look at leveraging not just those in North America, but leveraging all this in international markets. International has been -- really, our Achilles heel has been capacity. And capacity has been always the issue from day one anyways, but I mean particularly international because it's a harder market logistically to support. So when we get tight on capacity, the first one that really suffered historically has been international. So we know that international growth is very limited -- is very large in terms of its opportunity because we've limited the amount of capacity that we've had. And like we said in the past, is we don't have a full line in a lot of these markets, so we know we can expand the breadth of our product. But again, we need a little bit more capacity and manufacturing availability to get more product depth. It would not only support sales, it'd also support margin enhancement as well. And China's basically on fire for us. I mean, we're growing there rapidly and we have a lot of underdeveloped markets and international opportunity outside of China and Asia. So we feel comfortable in our whole positioning from a Printwear perspective. And when we go to retail, look, we're growing our brand still, our existing brands online, I mean, just leveraging our online platform with companies like Amazon to continue supporting our brand development. And we're taking into account all this opportunity in private labels, the whole shift into the market, like we did with this big launch we had in underwear this year. And we're not able -- private label for us is not just one category. It's underwear, socks, it's activewear. It's everything that we make that becomes available to us, and we're very cognizant of that opportunity and aggressively looking for new opportunities. And then we have our GLB customers, which we're getting new customers all the time. We're expanding with our existing customers, and we're expanding product categories within these customers. And all of our customers are looking for speed to market, which will -- again, we're really teed up in Central America to support the North American market. So when you take all this in account, I think we feel very comfortable in how we launch the facility because we got a big base. At the same time, we have all these growth drivers that will continue to support the mid-single-digit growth and hopefully more if the opportunities arise.

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

Thanks, Glenn, that's super helpful. Rhod, just a quick one for you, Rhod. With respect to your cotton and cotton outlook for the year and reaffirming guidance, can you just confirm am I correct in saying that your cotton requirements are fully hedged through at least the end of 2019 at this point?

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

Yes, I mean, if you look at the pipeline on how long it takes us to effectively turn cotton into product and it flows through our system, you can say we got good visibility on our cotton for the full year.

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

Thanks. It is still typically 6 to 9 months forward covered, correct?

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

Yes.

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

Correct.

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

Correct.

Operator

And our next comes from Sabahat Khan from RBC. Go ahead.

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

Just one on the private label, I guess. The earlier shipment that you had during the quarter, is that -- would you think of that as a timing shift, or does that mean incremental sales for the year? And are there any other updates you can provide on any new programs that you're pursuing?

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

It's timing shift, Sabahat. So it's effectively, we just shipped a little bit earlier than we had planned. It's timing.

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

And as far as the new programs are concerned, look, we're always looking to develop new programs. We have things in the upper. We've obtained new programs that we'll start shipping in Q4. So look, I think we feel very comfortable with our opportunity in private label, the programs we have, the wrap around of some of these programs, new programs coming on, the growth in our North American Printwear, international, GLB. I mean, I think we're pretty well teed up for our mid-single-digit growth for 2020 and basically as we move forward into next year.

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

Okay. And then just on the CapEx increase this year. Is there any directional commentary you can provide on how we should think about the CapEx over the next several years as you do build out the Bangladesh new platform? Should we think similar numbers to this year, or could it be potentially higher than '19?



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

No. I think if you look at our CapEx for the full year, we've given the guidance that it's \$175 million. It's gone up from \$125 million, right? So if you look at it this year, it's probably close to 6%. But on a go forward basis, you're really looking at 4% to 5% CapEx for us, right? So we can build out all of our plans and run our system at that level.

Operator

And our next question comes from Derrick Dley from Canaccord.

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

Can you just talk a little bit about the international market, and just in terms of the different trends that you're seeing there? And which categories are growing faster than others? Is it similar to North America, where you've got a very strong fashion basics business, for example? Just some more color on how that international market looks to you guys.

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

Well, overall the markets are different. Europe is really more like the U.S. market because it's more mature. We've been there since 2000, so we have a big history there. So the same drivers in Europe are what's happening, really, in the U.S.. I mean, fashion basics, so fashion basics is a standard in these markets. That's primarily the #1 selling product that we have in our line, and that's how we developed our fashion basics business, is through developing of our international sales. And also, the other big phenomenon is the fleece. I mean, our fleece business is flying. It was up double digits last year, the high double digits. It was up again this year, the same type of level. And that's not just in the North American market, but that's in the international market. So we're seeing the same phenomenon where people are wearing sweatshirts as casual wear, replacing the -- it's almost becoming a workwear uniform, right? So that phenomenon is really the same. In China, there are some differences in the type of products that are being offered. T-shirts are really big there, but for example, polo shirts are very large as well. Scaling there, they sell a much greater rate than they would in North America, for example. But they still sell in generally the same types of product. It's T-shirts, it's sweatshirts, it's golf shirts. And even in China, for example, it still operates in the same type of a manner in terms of how we go to market. We use distributors, distributors resell the product. It's just a little bit more fragmented. So the U.S. is a much bigger consolidated business with bigger box type distributors, and then in Europe they're a little bit more fragmented and smaller. And then they become a little bit more fragmented and smaller in China because the market is just being developed. But it's growing at a much faster rate, and our sales are growing as a percentage very quickly in these markets. And overall, I would say that most of the markets in Asia really work and function in the same manner as we would in North America.

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

Okay. Thank you. And then switching gears just onto Bangladesh. I know there's been a lot of discussion on the call on it already. But does this, given your commentary that it can support \$500 million in revenue on a base of, call it, \$4 billion at that time, would this have any impact on your tax rate given the new jurisdiction? And then also, what does this mean with your land package in Costa Rica? Do you still own it? And what is the plan there?

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

If you look at the tax impact, right now we don't see any major impacts if you model out our tax rate on a go forward basis. Obviously, as we move through the years we'll give you an update. But I think at this juncture, the rates that we've been given, the effective tax rates, are a good estimate of where we're going to run.

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

And as far as Costa Rica, we're not going to go forward with Costa Rica. We actually are going to sell that piece of land. It's not a very big investment we have there. It's around \$5 million, so we put the land up for sale.

Operator

And our next question comes from Stephen MacLeod from BMO.

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

I just wanted to follow up on 2 things. Just with respect to the private label opportunity, is it correct that you don't actually have product in the store at this point?

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

No, the product will be in the store at the end of May, beginning of June.

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

Okay. And can you give any commentary just ahead of that as to what the pricing strategy is with that particular product with your largest mass customer?

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

I'd rather wait until you can see it in the store yourself, to be honest with you. I don't want to really comment about our customer strategy on pricing.

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

Okay. No, that's fair. And then just secondly, with respect to the gross margin initiatives, can you just talk a little bit about -- I know, Rhod, you gave a little bit of color around how you expect that to flow through. But can you just talk a little bit about some of the initiatives that are behind the Q4 expectation for gross margin expansion? I mean, how much of that is the cost environment becoming more moderate versus actual initiatives driving gross margin growth?

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

This is Glenn. Maybe I'll start with answering the question because I think it's -- one of the things, I think, what we're driving internally, is really building a road map to build our gross margins to the 30% range, okay? And last year, we really focused on our SG&A, and we put a plan together during the year to continue driving and realigning our business units who basically drive down SG&A to 12%. And our objective is to get SG&A down to 12% and get margins closer to 30%. And the drivers of that is to continue looking at inefficiencies in our manufacturing and our supply chain. For example, we closed recently the AKH facility. We bought that plant from an acquisition. We've always told investors what's our competitive advantage. And when we bought that plant, the cost of conversion was 1/3 higher than our cost of conversion. So we ran the plant because we needed capacity, and with the ramp up of what we did in Rio Nance VI, the ramp up of Rio Nance V, the fact that we bought Alstyle in Mexico, which had a big state-of-the-art facility, we were able to shut that plant down, move that volume into our other facilities, and that's going to allow us to obviously increase our margins as we go forward. We also just announced a consolidation of our Canadian hosiery operations into our global supply chain, which is obviously going to be more beneficial than producing goods in Canada. We are realigning all of our sock manufacturing

and our capacity towards the end of Q4 in Honduras. And that, again, will reap benefits as we go towards later on in the year. And then we're looking at optimizing underperforming sewing operations that we have, and we have a couple of plants that -- probably 3 of them that we've identified that are underperforming that we think we can consolidate and reduce costs. And also, we're not going to have the nonrecurrence of the sewing ramp up that we had last year. Last year, we had a lot of sewing additional costs through the Nicaragua story, the Honduras election. And then we also had to chase a lot of product categories. We significantly increased our fleece capacity, et cetera, et cetera. So all these initiatives will continue, and that's what's really driving the benefit of our gross margin as we move into Q4. And then there's other benefits that longer term we're going to continue to still drive, which will come from the product side, like mix. We're continuing to see a big shift at the fashion basics when we get better margins. Our fleece business is growing more rapidly than we anticipated, which would be a margin. Our international markets, basically, will be better served as we develop more capacity at Bangladesh because what's going to happen is we can put more SKUs there, and SKUs provide better mix and greater sales in those markets. So we have a lot of drivers, I think, to expand gross margins. And just like we sort of set on a mission to get our SG&A down to sub-12, I'm telling you today, we're on a mission to get our gross margins. This is not just me. This is resonating, and this is -- we just had our executive management meeting, and the #1 focus for the company is getting margins up to 30%. And we're going to continue to look at SG&A leverage, even from this point on because, look, where our business is structured, we think that we could still leverage SG&A and infrastructure as we grow our top line sales. And we still have some consolidation of distribution centers to do, and we also have some, still, benefit from our business realignment that we haven't fully materialized yet. So all that together, I think that's the way you look at how we're focused as a company and really driving not just our top line growth with our mid-single-digits for all our 5 growth drivers, we're focusing on SG&A and margin expansion.

Operator

And our next question comes from Brian Morrison from TD Securities.

Brian Morrison - TD Securities Equity Research - Research Analyst

Glenn, you just really answered my question. But just for clarity, this 30% range, that supply chain initiatives are inclusive of revenue synergies, cost synergies, but it also includes commodity benefits as well, agreed? And over what timeframe are you targeting this 30% range?

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

Well, I think that just starting on the commodity thing, look, we also still have inflation too, right? So our objective is that inflation in the areas where we're operating is quite rapid, so we have to still deal with inflation. So we anticipate a lot of these moving pieces, so you got to take raw material, and then you got to take in inflation. So that probably even, as we go forward to next year, won't even be a positive or negative, I mean, because of some of the things. So I think that our real initiative right here is to increase margins through operational efficiency, is what we're trying to do. And look, this is something that's going to happen over the next 12 to 24 months. I think that's a good target for us to try and achieve. We're exiting this year. We've already seen margin expansions, so we'll definitely see expansion of margins into 2020. But within Q4, we'll have over 200 BPS of margin expansion basically this year. And hopefully, the question is how much of that will we materialize for the full year next year? But we're building a road map over the next 24 months to the 30%.

Brian Morrison - TD Securities Equity Research - Research Analyst

Okay. Thank you. And one follow up question, Rhod. I'm talking about Bangladesh now. Maybe just ballpark a total cost of the project to completion. I assume that all costs are going to be capitalized until commercial production. And then I know you say there's ample capacity on the ring-spun side, but would there be any plans in the future to source your own ring-spun yarn for this facility at some point?

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

We'll evaluate that, but we feel that there's ample supply in the region. It's a lot easier to obtain because in Bangladesh, there's quite a large capacity within the country, but also it's supported by other countries as well that are in the vicinity, like India and so forth. So there's lots of capacity of yarn available, and we'll evaluate that. Our first step is going to be obviously to build this large scale facility one and build this large scale facility 2, and then we'd have to look for additional land to support any type of incremental yarn spinning in the future.

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

And on the cost, Brian, I mean, this year obviously we spent the money on the land, right, so that's pushed our CapEx up. But again, on a go-forward basis, if you use that 4% to 5% of sales, that factors in the build out of Bangladesh, so I think you get a good estimate of that, what the total impact will be.

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

Okay. And all the costs will be capitalized until you actually start production, correct?

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

Correct.

Operator

And our next comes from Jim Duffy from Stifel.

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

Focusing on the hosiery and underwear category, down 2 is a notable improvement. Sounds like the global lifestyle brands revenue was solid. Are you guys seeing indications of stabilization in those channels?

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

I would say yes. Yes, I mean, we feel very comfortable with our positioning. We've divested ourselves this year in socks of one particular underperforming product or program that we had. But we're seeing good business in our licensed business. It's coming back. Our GLB business is growing in that category, so overall I think we're in a good place. I mean, all of our businesses are growing. I mean, if you look at, really, our online sales are up significantly this year. We're planning for a 40%-plus increase in online sales. International's double digits. Fashion basics is growing double digits, American Apparel double digits, GLB double digits. Private label's up huge. And the one area we're actually seeing some negative downturn is in our Basic business, really, which is the only offset we have. But outside of that, every single one of our growth objectives is really tracking, and then obviously they're growing much faster than the negative tailwind of -- or headwind of the basic category.

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

Great. And then, Glenn, that was a super helpful review of the factors you guys are focused on to drive the business. With respect to the 30% margin objective, you spoke about inflation. What role will pricing play in achieving that 30% margin objective? Is that a component of how you're thinking about getting there?

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

We don't want to use price if we don't have to. Our objective is to drive manufacturing efficiencies and supply chain improvements. I mean, that's historically what's driven our low-cost manufacturing. I mean, price is always a vehicle to really manage more inflation than it is, but I think that's a way of looking at it. If price is to cover inflation, then margin improvement should come from manufacturing efficiencies.

Operator

And 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, so I had a question on the capacity expansion. You got about, as I understand it, \$500 million capacity in Central America. And opening up Bangladesh phase one, I guess, would add another \$150 million freed up in Central America, so you'd be at \$650 million. I guess I'm just wondering what your level of confidence is that you need all that. And then there's Mexico, which I don't think you fully, maybe, executed what you could do in terms of getting capacity out of that. So I guess I'm wondering, do you need all that capacity in Central America?

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

The answer is Mexico is part of our \$500 million, so that's included in the region's capacities. When we stated our available capacity in the region, it's including Mexico. And the thing you have to understand is that we're going to grow mid-single-digits in '20, mid-single-digits in '21 at least. If you take that factored in, because Bangladesh will come online in 2021 but towards the end of the year, and that will really only support 2022 sales. So we'll only be left with about \$150 million or \$200 million left in Central America of capacity, if you at it that way overall in the system. And if business is better, then we'll sell more. I mean, that's the way we'll look at it, and we'll manage accordingly. And we also have to still ramp up Bangladesh. We have to get it going. So that's not going to happen right away either. So I think we're in a good place as we manage all this capacity to continue, and that's the way we sort of programmed, is just to make sure that at least a mid-single-digit growth rate will be able to sustain, because we see that each one of these growth drivers will allow us to continue growing year after year, basically, because it's not a -- and we feel very comfortable with it because there's not one particular thing that's going to let us grow. We don't need any big wins. We just need a little bit here, a little bit there. And some of these 5 growth drivers we feel will continue the 5% or the mid-single-digit grow. So overall, I would say that the capacity is in line with our theory of growth. If we grow a little bit faster, I think we can absorb some of that. And if we don't grow as fast as we think, well, I think it won't affect us anyway because we're just going to have more optimization of our supply chain and lower costs, basically, by having the facility in Bangladesh.

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

And then just on your private label initiative. You've had a T-shirt program going with a major U.S. mass merchant retailer for quite a while now. I'm just wondering if you can say how that program's doing relative to your expectations.

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

Yes. Look, all of our programs are doing really well, and everything is performing to expectations. And we're just continuing to focus to drive additional revenue, and we're excited about the opportunity, and not just in the private label, but as well in all the other categories. So it's a full package, basically, of 5 growth drivers that will continue to drive the top line sales. And I think that's really the story behind Gildan.

Operator

And our last question comes from Mark Petrie from CIBC.

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

I just have a few sort of small follow-ups. I think most everything's but covered. But just to clarify, the impact of the earlier shipments on the private label program, that would have had an immaterial impact on gross margin in the quarter?

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

Correct.

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

And we expect a neutral impact through the course of the year?

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

Neutral from what perspective, Mark? Can you clarify?

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

Oh, just neutral relative to the rest of the business, so gross margins for that program in line with the gross margins of the rest of the business.

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

Correct, correct.

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

And then related to the tax impact that you were talking about earlier, any tax impact as private label grows, or impact to the tax rate, I should say?

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

No. It's factored into our effective tax rate. So I think we're going to be able to basically stay at this level on a go forward basis, given the way that we're operating.

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

Okay. And just last, IFRS 16, I know it's not substantially material to you guys, but looks like removed about \$4 million of SG&A expense and a \$1 million benefit to operating income. Just wanted to ask if that's a good run rate for us to use for the balance of the year.

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

Yes. So if you look at the impact, effectively that's the curve with the IFRS 16 is that we effectively lost -- we took out the rent expense, right, and we added back the depreciation. That was effectively the net impact that was occurring as we put the right to use asset on the balance sheet. The impact that you're seeing now, it'll be steady state on a go forward basis.

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

Okay. And how does that factor into your target of 12% for SG&A rate?

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

It's factored in.

Operator

And we have no more questions at this time. Do the speakers have any final comments?

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

Yes. Excuse me. Before ending the conference call, I would like to remind you that we are holding our annual shareholders' meeting tomorrow at 10:00 a.m. Eastern time here in Montreal at the Centre Mont-Royal. And with that, I'd like to thank you again for joining us today, and we look forward to speaking to you very soon. Have a good evening.

Operator

And thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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