

Introduction

Hanesbrands Inc. is a leading manufacturer and marketer of everyday basic innerwear and activewear apparel in the Americas, Europe, Australia, and Asia/Pacific under some of the world's most well-known apparel brands, including Hanes, Champion, DKNY, Maidenform, Playtex, and Wonderbra. Unlike most apparel companies, Hanesbrands Inc. primarily operates its own manufacturing facilities. Its products are marketed to consumers through mass merchants, mid-tier retailers and department stores, specialty stores, and e-commerce sites. Hanesbrands also operates its own consumer-facing outlet stores, retail stores, and e-commerce sites.

HANES Brands Inc

The company's current market cap is about \$6.7 Billion, and its enterprise value (i.e., market cap + total debt net of cash) is approximately \$11 Billion. Its revenues and free cash flows during the previous fiscal year were a \$6.5 Billion and \$569 Million respectively. The company's common stock has fluctuated between a high of \$25.73 and a low of \$16.38 over the past 52 weeks and currently stands at around \$18.58. Is Hanesbrands Inc. undervalued at the current price?



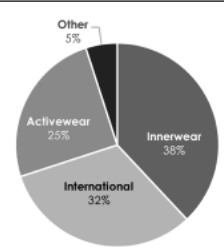

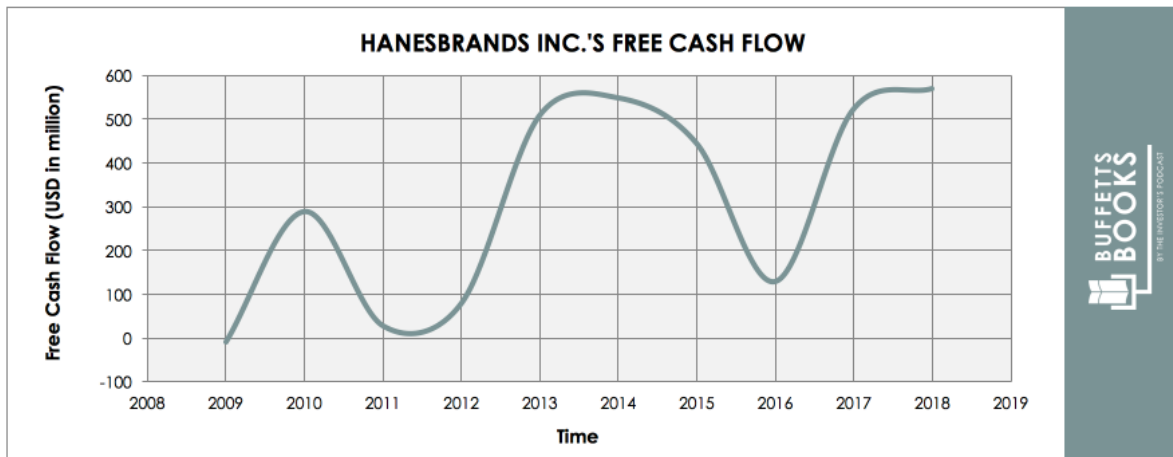
HANESBRANDS INC. AT A GLANCE (NYSE: HBI)			
A socially responsible, leading marketer of everyday basic innerwear and activewear apparel in the Americas, Europe, Australia, and Asia-Pacific			
KEY STATISTICS		KEY BRANDS	
Founded	1901		
Global HQ	Winston-Salem, NC		
Employees*	~67,200 in 45 Countries		
Market Cap**	\$6.052B		
KEY FINANCIALS	2017	2018 GUIDANCE	GLOBAL SUPPLY CHAIN
Revenue	\$6,471	\$6,720 - \$6820	
Adj. Op. Profit***	\$935	\$950 - \$985	
Op. Cash Flow	\$656	\$675 - \$750	
2017 SALES BY SEGMENT		2017 SALES BY CATEGORY	
			
LARGEST GLOBAL BASIC APPAREL COMPANY WITH OVER A CENTURY OF HISTORY			
<small>*As of 12/30/2017 **As of 5/11/2018 ***Non-GAAP Measure.</small>			

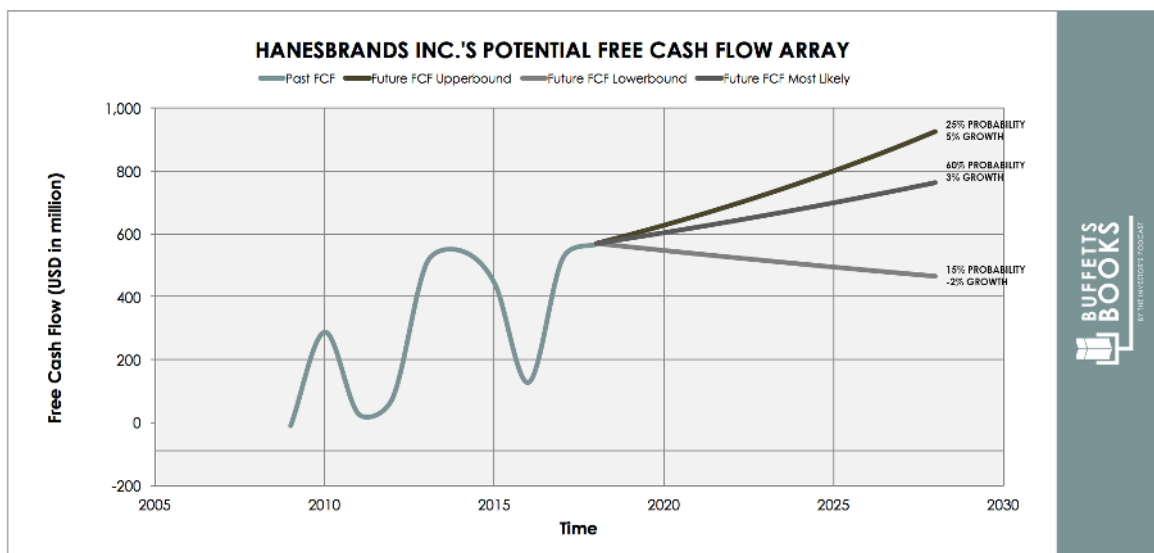
Figure 1: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

The Intrinsic Value of Hanesbrands Inc.

To determine the intrinsic value of Hanesbrands Inc., we'll start by looking at the company's historical free cash flow. A company's free cash flow is the true earnings which management can either reinvest for growth or distribute back to shareholders in the form of dividends and share buybacks. Below is a chart of Hanesbrands' free cash flow for the past ten years.



As one can see, the company's free cash flow has grown over the last ten years from less than \$0 in 2008 to \$569 million in 2017, with some lumpiness between due to large increases in inventory in some years. Over the last nine years, from 2009 to 2017, free cash flow grew at a compounded annual growth rate (CAGR) of 8.9%. To determine Hanesbrands Inc.'s intrinsic value, an estimate must be made of its potential future free cash flows. To help us build this estimate, below we have calculated and displayed an array of potential outcomes for future free cash flows.



When examining the array of lines moving into the future, each one represents a certain probability of occurrence. The upper-bound line represents a 5% growth rate which is less than the 8.9% annual growth achieved over the past nine years as companies can seldom maintain growth rates above the general rate of the economy for prolonged periods. This 5% growth rate has been assigned a 25% probability of occurrence to

account for a number of factors including fierce competition and the move from retail to e-commerce (i.e., the “Amazon” effect). Hanesbrands Inc. still derives the majority of its revenue from retailers (although it is working hard to go direct-to-consumer via various e-commerce channels including Amazon).

The middle growth line represents a 3% growth rate to match the current rate of a 10-Year Treasury Note, which is a good proxy for projected GDP growth over the next ten years. Hanesbrands is likely to grow at least as fast as the overall economy. This scenario has been assigned a 60% probability of occurrence.

The lower bound line represents a -2% growth rate in free cash flow and assumes that the company will shrink slowly over time. This scenario has been assigned a 15% probability as it is not very likely, but certainly possible if apparel trends change, competition intensifies, and brand equity erodes over the next ten years.

Assuming these potential outcomes and corresponding cash flows are accurately represented, Hanesbrands Inc. might be priced at a 9.1% annual return if the company can be purchased at today's price of \$18.50. We'll now look at another valuation metric to see if it corresponds with this estimate.

Based on Hanesbrands Inc.'s current earnings yield, which is the inverse of its EV/EBIT ratio, the company is currently yielding 6.90%; this is above the Consumer Discretionary Sector median average of 6.40% suggesting that the company may be undervalued on a comparable basis. Analysts project that Hanesbrands Inc. will have an earnings yield (EBIT yield) of 8.9% based on next year's earnings compared to 7.4% for the Consumer Discretionary Sector. Finally, we'll look at Hanesbrands Inc.'s free cash flow yield, a metric which assumes zero growth and simply measures the firm's trailing free cash against its current market price. At the current market price, Hanesbrands Inc. has a free cash flow yield of 6.9%.

Taking all these points into consideration, it seems reasonable to assume that Hanesbrands Inc. is currently trading at a discount to fair value. Furthermore, the company may return around 9.1% annually at the current price if the estimated free cash flows are achieved. Now, let's discuss how and why these estimated free cash flows could be achieved.

The Competitive Advantage of Hanesbrands Inc.

Hanesbrands Inc. has various competitive advantages outlined below.

- **Brand Value.** One of Hanesbrands Inc.'s most powerful competitive advantages is its brand value. Hanesbrands Inc. owns and sells under several industry-leading and trusted brands including *Hanes*, *Champion*, *DKNY*, *Bali*, *Maidenform*, *Playtex*, and *Wonderbra*. You may even recall the slogan, “Just wait'll we get our Hanes on you” and that Michael Jordan has long endorsed the *Hanes* brand. Many of these brands have leading market-share positions in key categories in various regions of the world.










OUTSTANDING PORTFOLIO OF LEADING INNERWEAR BRANDS									
UNITED STATES		OTHER AMERICAS		EUROPE		AUSTRALIA / NEW ZEALAND		ASIA	
 BALI		 MADENIFORM		 Playtex		 Champion		 abanderado	
 DIM		 BONDS		 bras./things					
Intimates	#2	CANADA		FRANCE		AUSTRALIA		JAPAN	
Men's UW	#1	Intimates	#2	Men's UW	#1	Men's UW	#1	Men's UW	#5
Kid's UW	#1	Men's UW	#2	Socks	#3	Women's UW	#1	Women's UW	#6
Socks	#1	MEXICO		Intimates	#2	Kid's UW	#1	Socks	#7
Hosiery	#1	Men's UW	#1	Hosiery	#1	Bras	#1	PHILIPPINES	
T-Shirts*	#1	Bras	#3	GERMANY		Hosiery	#1	Men's UW	#1
		BRAZIL		Hosiery	#1	Socks	#1		
		Men's UW	#2	Socks	#2	NEW ZEALAND			
		ARGENTINA		SPAIN		Men's UW	#1		
		Women's UW	#2	Men's UW	#1	Women's UW	#1		
				Intimates	#2	Kid's UW	#2		
				ITALY					
				Intimates	#2				
				Men's UW	#3				
#1 or #2 MARKET-SHARE POSITION IN KEY CATEGORIES IN 12 COUNTRIES									
<small>*T-shirts is total Outerwear and Innerwear</small>									

Figure 2: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

For a competitor to challenge Hanesbrands Inc.'s competitive brand position, they would have to deploy a large amount of capital and resources for advertising and celebrity endorsements. As shown in the slide below, Hanesbrands Inc. has spent considerable amounts on marketing its brands (\$750 million plus from 2014 through 2017).


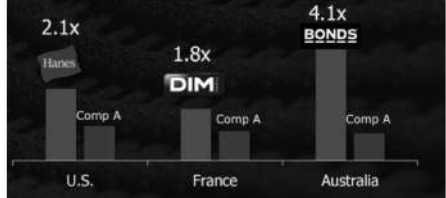


INVESTED CONSISTENTLY IN CONSUMER ENGAGEMENT & GLOBAL INNOVATION PLATFORMS TO REINFORCE BRANDS	
<p>Strengthening Our Brands</p>  <p>2014 - 2017 Consistent Marketing \$750M+ Extensive R&D \$250M+</p>	<p>Market Share (Men's Underwear)** **</p>  <p>2.1x Hanes, 1.8x DIM, 4.1x BONDS U.S., France, Australia</p>
<p>Innovate-to-Elevate Globally (X-Temp Technology)</p>  <p>U.S. → FRANCE</p>	<p>U.S. Innerwear Market Share*</p>  <p>Rank: UW #1 Total, #1 Online; Bras #2 Total, #2 Online; Socks #1 Total, #2 Online; IW #1 Total, #1 Online 88% Branded, 12% Private Label; 92% Branded, 8% Private Label</p>
MARKET SHARE SUPPORTED BY CONSUMER LOYALTY	
<small>*NPD Consumer Panel R12 end Dec '17 **Kantar Consumer Panel R12 end Dec '17; BDA Tracking, Dec '17 MAT</small>	

Figure 3: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

This assessment was conducted from the tools provided in Preston and Stig's Intrinsic Value Online Training Course.

Hanesbrands Inc.'s various brands help to differentiate the company's products and likely grant it some pricing power with consumers. This pricing power is one factor that allows the company to outperform the industry on a number of key metrics.

	Hanesbrands Inc.	Consumer Discretionary Sector
ROIC (ttm)	11.10%	7.30%
EBIT Margin (ttm)	11.30%	7.30%

- Scale Advantages and Sophisticated Supply Chain.** Hanesbrands Inc. has developed extensive manufacturing capabilities that enable it to produce quality products and at an economical price. The company's global supply chain (with 50 owned facilities) allows it to maximize low-cost production and international distribution. Because most facilities are wholly owned and operated, the company has been able to develop expertise in improving manufacturing processes and techniques all the way from initial design to distribution—which enables them to find the lowest-cost production methods for new product innovations. In other words, the company's production process is as much a priority as the new product itself.

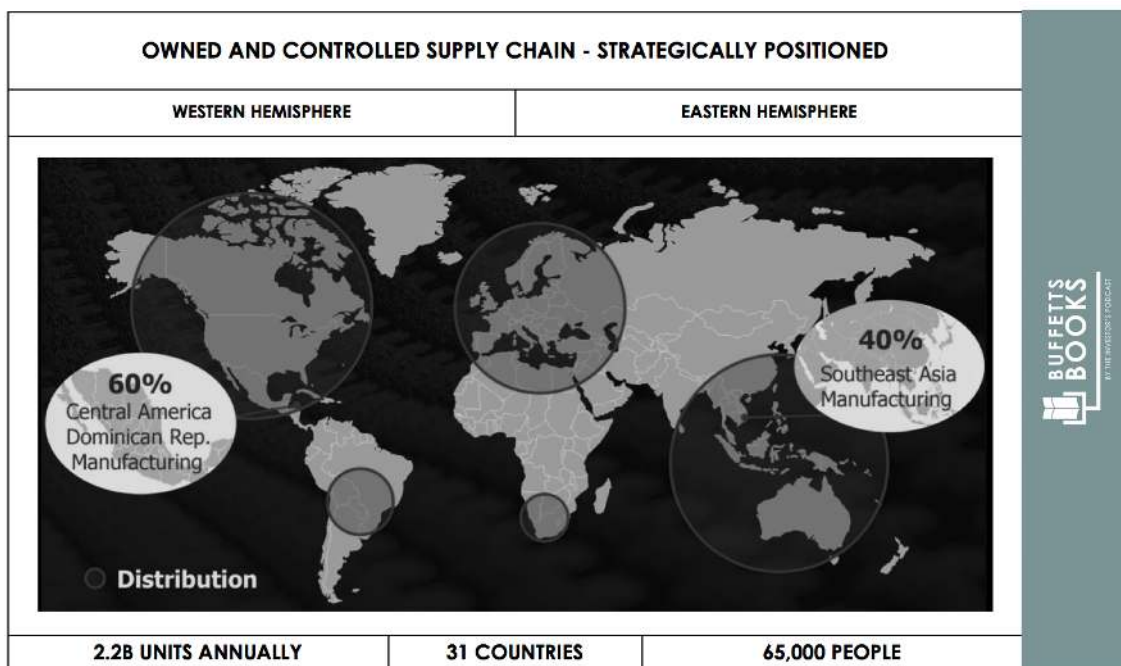


Figure 4: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

Hanesbrands Inc.'s superb manufacturing capabilities also allow the company to deliver high returns on acquisitions. Hanesbrands Inc. has been able to acquire other apparel companies (e.g., Maidenform and DBApparel) and cut costs by integrating their manufacturing needs into its own low-cost manufacturing facilities and supply chains. Given the success Hanesbrands Inc. has achieved in integrating prior

acquisitions, as well as its consistent flow of deals (about one or two per year), acquisitions could become a core driver of returns for shareholders going forward. Although there is always some risk in making acquisitions, the current management team has shown that it is capable of execution and future acquisitions could be a way to not only leverage its manufacturing platform and drive cost savings but also to gain exposure to new high-growth, high-margin product lines.



Figure 5: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

Hanesbrands Inc.'s Risks

Now that Hanesbrands Inc.'s competitive advantages have been considered, let's look at some of the risk factors that could impair our assumptions of investment return.

- The apparel industry is subject to fluctuations in consumer spending, commodity price fluctuations (such as cotton prices), and retailer shrinkage and bankruptcies. That said, Hanesbrands is probably in a better position than most players, as much of its business (38% of Hanesbrands Inc.'s business in 2017) is driven by moderately priced replenishment innerwear products and also because of its vertically integrated supply chain (manufacturing and distribution).
- Competition in the innerwear and activewear categories is fierce, and the pricing power Hanesbrands Inc. can expect to achieve from its brand names is somewhat limited as consumers likely have a limited threshold for brand premium pricing given the availability of almost identical products from other strong brands. Competitors include Gildan, Fruit of the Loom, Jockey, Warnaco, and Victoria's Secret. Additionally, Hanesbrands Inc.'s business is sensitive to changes in retailers' private label strategies, which we recently saw when Target decided that it will not renew its contract for the exclusive C9 by Champion apparel line in 2020. Target has decided that it is going to sell its own private label products. Over the last twelve months, C9 generated \$380 million in revenue, which is 5.7% of Hanesbrands Inc.'s total revenue during the same period.
- Finally, even though most consumers generally replenish innerwear items when the economy is doing poorly, consumers may demand lower prices or be willing to trade down to a different brand or delay purchases when times get really tough. Thus, in an economic downturn, margins could experience pressure if items must be discounted to sell through inventory.

Opportunity Costs

Whenever an investment is considered, one must compare it to any alternatives to weigh up the opportunity cost. At the time of writing, 10-year treasuries are yielding 2.98%. If we take inflation into account, the real return is likely to be closer to 1%. The S&P 500 Index is currently trading at a Shiller P/E of 32.1 which is 89.9% higher than the historical mean of 16.8. Assuming reversion to the mean occurs, the implied future annual return is likely to be -2.8%. Hanesbrands Inc., therefore, appears to offer a much better return for investors at present, but other individual stocks may be found which offer a similar return relative to the risk profile.

Macro Factors

Investors must consider macroeconomic factors that may impact economic and market performance as this could influence investment returns. At the time of writing, the S&P is priced at a Shiller P/E of 32.1; this is 89.9% higher than the historical average of 16.8 suggesting markets are at elevated levels. U.S. unemployment figures are at a 30 year low suggesting that the current business cycle is nearing its peak. U.S. private debt/GDP currently stands at 199.6% and is at its highest point since 2009 when the last financial crisis prompted private sector deleveraging.

Summary

Hanesbrands Inc. is competitively positioned given advantages that are difficult for competitors to replicate: (1) well-known and respected brands often worn by generations and (2) scale advantages and a mostly-owned extensive supply chain. Analysts believe the company is poised to post significant operating margin growth through recognition of synergies (\$85 million in 2018 and 2019) following a recent string of acquisitions, \$100 million in net cost savings from Project Booster (a cost-saving plan announced by management last year), and \$30 million-\$40 million in manufacturing efficiencies.

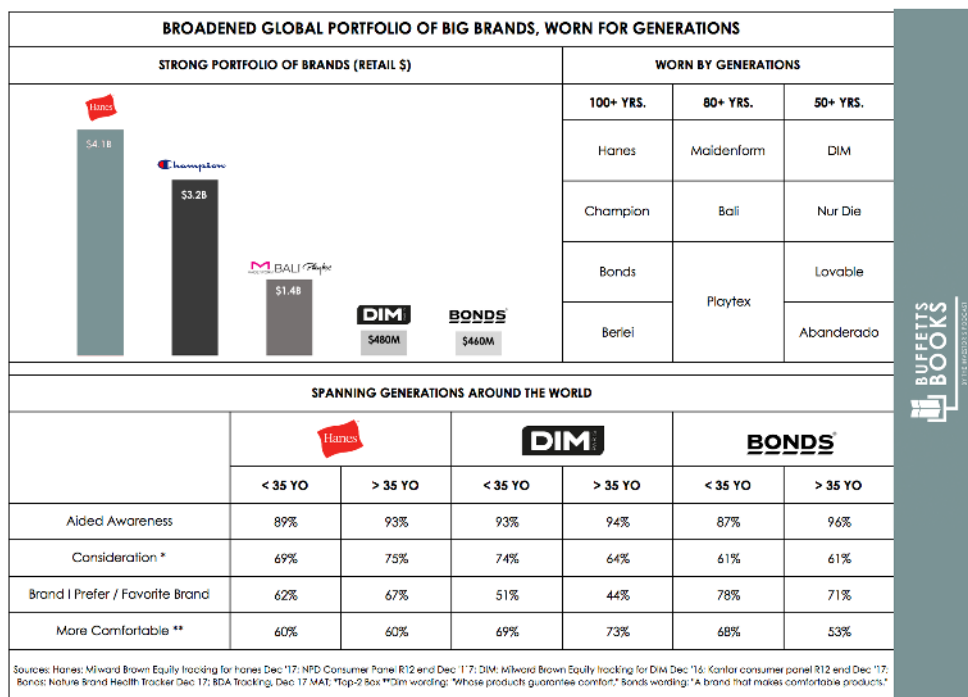


Figure 6: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

Despite the preceding advantages, one should acknowledge that Hanesbrands Inc.'d business has come under pressure as of late with the move away from brick-and-mortar retailers (retailers have been hit hard with bankruptcies, and many are reducing store counts) toward e-commerce sites like Amazon. Hanesbrands Inc.'s online sales amounted to only 11% of Hanesbrands Inc.'s revenue globally in 2017, but this number is growing. There are also risks stemming from changes in retailer private label strategies (which was demonstrated by Target's plan not to renew its exclusive contract for C9 by Champion line in 2020).

That being said, Hanesbrands Inc. may have a path back to sustained growth as it is distribution channel agnostic, and these trends (move away from brick-and-mortar to e-commerce and private label adoption) may only affect near-term results and the near-term stock price. This has perhaps created an attractive entry point for investors as the market tends to (at least in the short run) weigh near-term perception more than long-term prospects. The transition to e-commerce is proceeding well, with the online revenue growth rate hitting 22% in the fourth quarter of 2017. Online sales are expected to increase as a percentage of total revenue—specifically, analysts believe it can reach mid-teens percentage of total sales in 2018, up from 11% in 2017). A bright spot has been the company's Champion brand, which grew at a healthy 20 to 30% year-over-year clip in each of the past four quarters. Another bright spot has been its growth in international markets, which has grown from 11% of the company's business in 2013 to 32% in 2017.

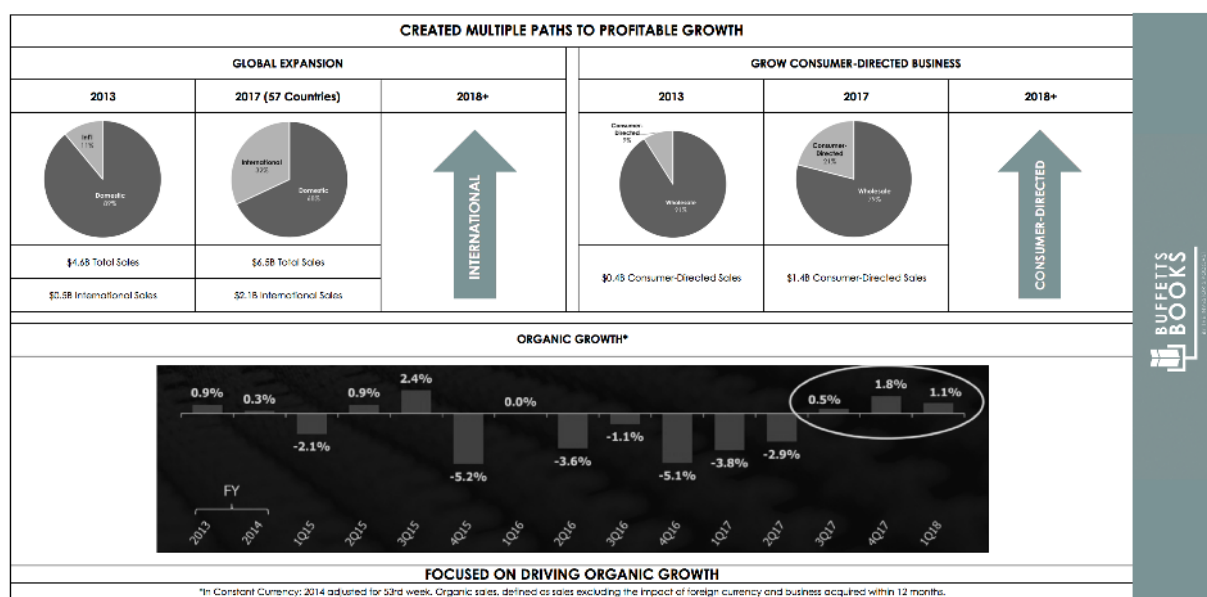


Figure 7: Source: Hanesbrands Inc. Investor Day slide deck presented on May 15, 2018.

With respect to shareholder friendliness, Hanesbrands Inc. has been returning value to shareholders in the form of dividends and share repurchases. In fact, Hanesbrands Inc. returned a total of \$1.9 billion in capital to shareholders in the form of dividends and share repurchases during the ten-year period between 2007 and 2017. Furthermore, over the past 2.5 years (from Q3 2015 through Q1 2018), the company has reduced its share count by 10% (from just over 400 million to about 360 million).

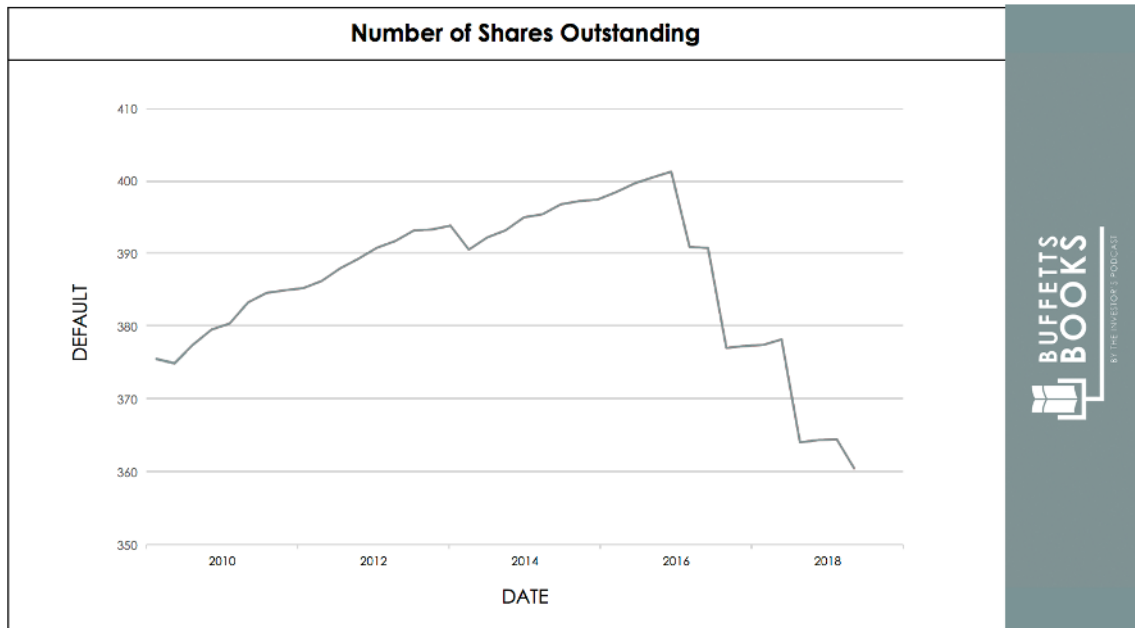
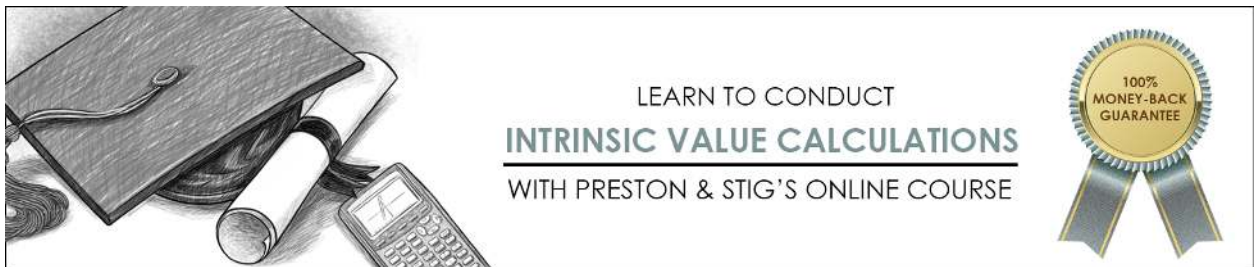


Figure 8: Source: Stockrow.com

In summary, Hanesbrands Inc. is a solid player in a fairly stable part of the apparel industry. Its shares are selling at a reasonable price based on its prospects for the future. Indeed, based on conservative assumptions we used in the free cash flow analysis above, Hanesbrands may return around 9.1% to shareholders annually if purchased the current market price of \$18.50.

Disclaimer: The author of this article is long HBI at the time of writing.



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