H.B. Fuller (FUL)

Updated April 24th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$52	**5 Year CAGR Estimate:**	6.8%	**Quality Percentile:**	N/A
Fair Value Price:	$54	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	N/A
% Fair Value:	97%	**5 Year Valuation Multiple Estimate:**	0.6%	**Total Return Percentile:**	N/A
Dividend Yield:	1.2%	**5 Year Price Target**	$68	**Valuation Percentile:**	N/A

Overview & Current Events

H.B. Fuller is a leading global formulator, manufacturer and marketer of adhesives, sealants and other specialty chemical products. The category of industrial adhesives is the core product offering of the company.

Given that H.B Fuller has a market cap of $2.6 B, it is evident that its recent acquisition of Royal Adhesives & Sealants for $1.6 B is immense. This acquisition, which is the largest in the history of the company, is poised to boost its annual sales by $650 M or about 30% and enhance its reach to more highly specified adhesive segments. H.B. Fuller also acquired Adecol last year and thereby improved its growth potential in Brazil. Thanks to these acquisitions and their synergies, H.B. Fuller expects to double its EBITDA, from about $300 M in 2017 to $600 M in 2020.

In its Q1 earnings report, the company reported 7% adjusted, constant-currency revenue growth, driven by significant growth in all the segments. Nevertheless, while the company enjoyed strong trends in its markets, its gross margin decreased from 27.6% to 26.3%, mostly due to the rising cost of its raw materials. As the vast majority of its raw materials are derivatives of oil and natural gas, their cost has markedly increased due to the rally in the price of oil since last summer. In addition, as the price of oil is likely to remain strong for the foreseeable future thanks to the sustained efforts of OPEC and Russia, input costs are likely to continue to exert pressure on the company's margins.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.36	$1.70	$1.43	$1.79	$1.90	$1.89	$0.97	$1.69	$2.42	$1.13	***$3.22***	***$4.11***
DPS	$0.26	$0.27	$0.28	$0.30	$0.33	$0.39	$0.46	$0.51	$0.55	$0.59	***$0.62***	***$0.82***

H.B. Fuller will significantly benefit from the recent tax reform, as its tax rate will drop from the low 30s to about 26%. Moreover, thanks to the solid performance of all its segments, its management and the analysts expect its EPS to grow to $3.22 this year. Furthermore, thanks to the increasing synergies from the acquisition of Royal Adhesives & Sealants, the management expects to double the EBITDA of the company by 2020.

Nevertheless, it is critical to note that there is a high degree of uncertainty in this business and hence investors should maintain more conservative expectations in order to avoid negative surprises. First of all, the strength in the oil price is likely to continue to raise the input cost of the company in the upcoming years. In addition, while the company has grown its EPS at a 7.4% average annual rate in the last nine years, its EPS record has been markedly volatile. Moreover, H.B. Fuller is highly vulnerable to recessions and a recession has not shown up for nine consecutive years. Therefore, it is prudent to be somewhat conservative and assume 5.0% EPS growth for the next five years. If this occurs, the company will grow its EPS from $3.22 this year to $4.11 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	NMF	10.2	14.9	12.0	15.7	21.5	48.1	24.1	17.7	46.9	***16.1***	***16.6***
Avg. Yld.	1.2%	1.6%	1.3%	1.4%	1.1%	1.0%	1.0%	1.3%	1.3%	1.1%	***1.2%***	***1.2%***

Since the Great Recession, H.B. Fuller has traded at an average P/E of 23.5. However, in 2014 and 2017, its EPS were depressed and thus resulted in extreme P/E ratios. Therefore, as we have assumed a healthy growth pace for the next few years, it is reasonable to exclude these two years from the calculation of the average P/E ratio. In this case, the average P/E ratio becomes 16.6, which is very close to the current P/E of the stock. As it is reasonable to expect the stock to revert towards its average P/E ratio in the future, the stock is likely to enjoy a 0.6% annualized boost from P/E expansion in the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	33.7%	33.7%	31.1%	32.9%	29.0%	30.4%	28.5%	27.8%	29.7%	13.8%	***20.0%***	***25.0%***
Debt/A	50.5%	46.3%	45.2%	42.6%	56.4%	50.3%	52.4%	57.3%	54.4%	76.1%	***75.0%***	***60.0%***
Int. Cov.	1.7	15.8	9.1	13.2	5.5	7.7	5.1	6.7	7.7	2.6	***3.5***	***5.0***
Payout	72.2%	15.9%	19.6%	16.8%	17.4%	20.6%	47.4%	30.2%	22.7%	52.2%	***19.3%***	***20.0%***
Std. Dev.	71.0%	57.8%	33.3%	41.1%	26.2%	23.9%	27.1%	21.1%	25.2%	18.6%	***19.0%***	***20.0%***

Due to the recent major acquisition, interest coverage has plunged while the debt/assets ratio has spiked. However, management recently confirmed that it will be using a major portion of free cash flows to reduce debt. As a result, these metrics are likely to revert towards their historical values in the upcoming years.

As the customers of H.B. Fuller are manufacturers of a wide range of products, the performance of H.B. Fuller is closely tied to underlying economic conditions. The company is highly vulnerable to recessions. During the Great Recession, its EPS plunged 79%, from $1.68 in 2007 to $0.36 in 2008, and the stock lost 2/3 of its market cap in less than six months. As a recession has not shown up for nine consecutive years and interest rates are on a steady rise, investors should take this risk factor into account, especially given the company's higher leverage.

Final Thoughts & Recommendation

We expect H.B. Fuller to offer a 6.8% average annual return in the next five years, thanks to 5.0% annual EPS growth, a 1.2% dividend and a 0.6% annualized P/E expansion. However, there is high uncertainty over its future growth due to its enormous recent acquisition, its rising input cost and its markedly volatile EPS record. Moreover, the company is highly vulnerable to economic downturns. Therefore, investors should wait for a better entry point unless they have great confidence in the U.S. economic growth over the next few years. Given the low dividend yield and the huge downside risk in the event of a recession, retirees should stay away from the stock.

Total Return Breakdown by Year