H.B. Fuller (FUL)

Updated August 13th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$57	**5 Year CAGR Estimate:**	4.9%	**Volatility Percentile:**	42.0%
Fair Value Price:	$54	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	50.7%
% Fair Value:	106%	**5 Year Valuation Multiple Estimate:**	-1.2%	**Valuation Percentile:**	53.7%
Dividend Yield:	1.1%	**5 Year Price Target**	$69	**Total Return Percentile:**	29.4%

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 $2.9 billion, it is evident that its recent acquisition of Royal Adhesives & Sealants for $1.6 billion is important. This acquisition, which is the largest in the history of the company, is poised to boost its annual sales by $650 million (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, H.B. Fuller expects to double its EBITDA from about $300 million in 2017 to $600 million in 2020.

In late June, H.B. Fuller reported (6/28/18) its financial results for the second quarter of fiscal 2018. The company posted adjusted earnings of $46.4 million or $0.89 per share, which were 44% higher than those of Q2-2017 and $0.04 higher than the consensus. The great performance resulted from the 17% growth in engineering adhesives thanks to a series of customer wins and strong organic volume growth in Asia Pacific. Due to the strength in the oil price, the company continued to face high costs of raw materials but it offset these costs by raising its prices. Moreover, it remains on track to achieve $15 million of synergies from the integration of Royal this year and $35 million of synergies by 2020.

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	***$3.24***	***$4.14***
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 $3.24 this year. Furthermore, thanks to the increasing synergies from the acquisition of Royal Adhesives & Sealants, management expects to double the EBITDA of the company by 2020.

Nevertheless, there is a high degree of uncertainty in this business and hence investors should maintain more conservative expectations in order to avoid negative surprises. 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% annual EPS growth for the next five years. If this occurs, the company will grow its EPS from $3.24 this year to $4.14 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	***17.6***	***16.6***
Avg. Yld.	1.2%	1.6%	1.3%	1.4%	1.1%	1.0%	1.0%	1.3%	1.3%	1.1%	***1.1%***	***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 five 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 lower than the current P/E of 17.6. As it is reasonable to expect the stock to revert towards its average P/E ratio in the next five years, the stock is likely to incur a 1.2% annualized drag due to P/E contraction in this period.

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%	***74.0%***	***60.0%***
Int. Cov.	1.7	15.8	9.1	13.2	5.5	7.7	5.1	6.7	7.7	2.6	***3.0***	***5.0***
Payout	72.2%	15.9%	19.6%	16.8%	17.4%	20.6%	47.4%	30.2%	22.7%	52.2%	***19.1%***	***19.8%***
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%***

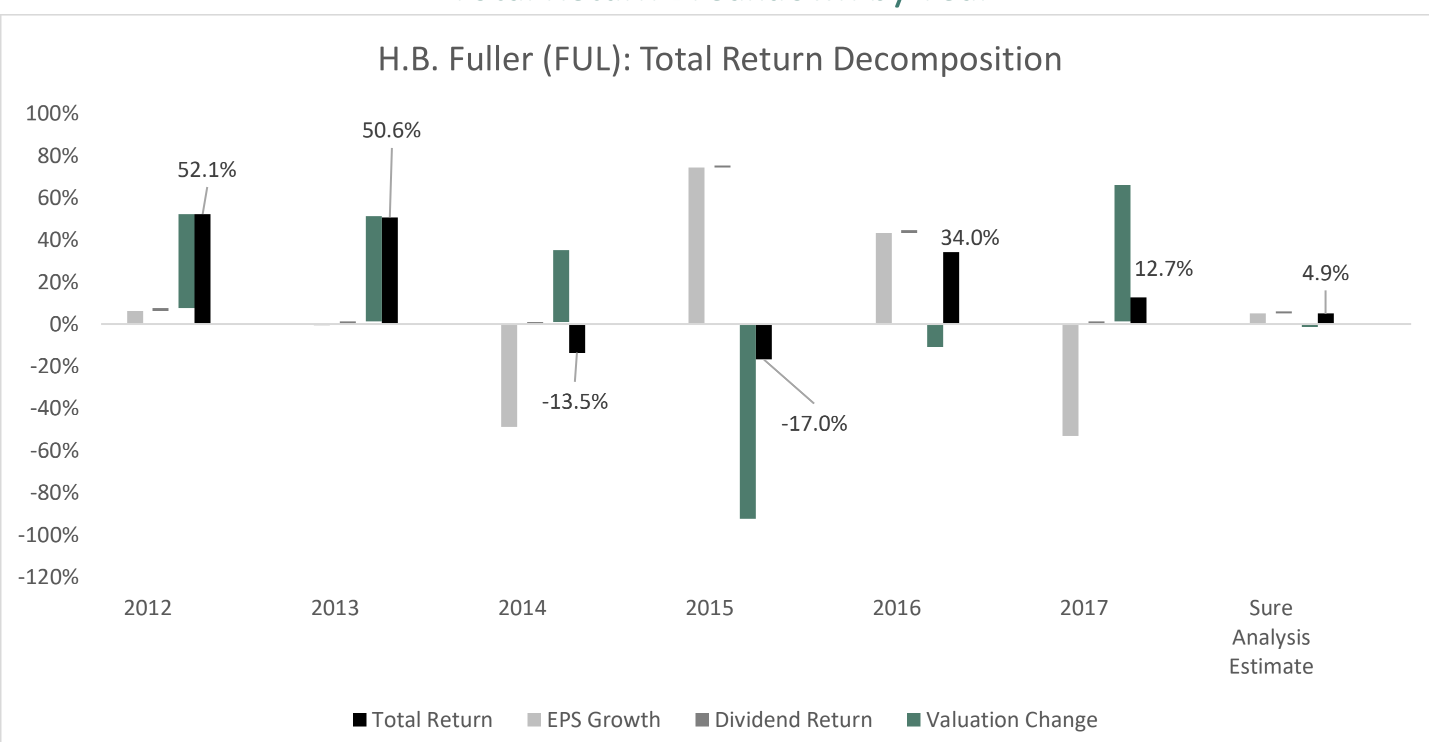
Due to the recent major acquisition, interest coverage has plunged while the debt/assets ratio has greatly increased. However, management recently confirmed that it will be using a major portion of free cash flows to reduce debt. As a result, these metrics are likely to revert towards their historical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

Final Thoughts & Recommendation

We expect H.B. Fuller to offer a 4.9% average annual return in the next five years, thanks to 5.0% annual EPS growth and a 1.1% dividend, which will be partly offset by a 1.2% annualized P/E contraction. While the company is executing well, investors should note its markedly volatile EPS record and its high vulnerability to economic downturns. Therefore, investors should wait for a more attractive 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, income-oriented investors should stay away from the stock.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.