H.B. Fuller (FUL)

Updated September 28th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	6.0%	**Volatility Percentile:**	37.8%
Fair Value Price:	$52	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	19.5%
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.2%	**Valuation Percentile:**	56.7%
Dividend Yield:	1.2%	**5 Year Price Target**	$67	**Total Return Percentile:**	32.0%

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 the $2.8 billion market cap of H.B Fuller, it is evident that its recent acquisition of Royal Adhesives & Sealants for $1.6 billion is paramount. 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 September, H.B. Fuller reported (9/26/18) its financial results for the third quarter of fiscal 2018. The company grew its organic sales by 5% thanks to growth in every segment, including double-digit growth in engineering adhesives, which generate about 1/6 of total revenues and earnings. Despite the rising cost of raw materials, the company grew its adjusted earnings per share by 32% thanks to its implementation of price hikes. 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. However, due to currency headwinds, management reduced its earnings-per-share guidance for this year from $3.15-$3.40 to $3.05-$3.20. As a result, the market punished the stock with a 7% plunge on the announcement of the results.

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	***$3.15***	***$4.02***
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***

Thanks to the solid performance of all its segments, its major acquisition and its reduced tax rate, we expect H.B. Fuller to grow its earnings per share to $3.15 this year. We have reduced our estimate by 3% since our last research report, in August, due to the above mentioned currency headwind. Moreover, thanks to the increasing synergies from the acquisition of Royal Adhesives & Sealants, management expects to double the EBITDA of the company by 2020.

There is a high degree of uncertainty in this business and hence investors should maintain conservative expectations in order to avoid negative surprises. While the company has grown its earnings per share at a 7.4% average annual rate in the last nine years, its 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 earnings-per-share growth for the next five years.

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	***16.8***	***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%***

In our previous research report, we mentioned that H.B Fuller was trading at a higher P/E ratio than its historical average of 16.6. Since then, its P/E ratio has come very close to its historical average, as it has dropped to 16.8. If the stock trades at its average P/E ratio in five years, it will incur a mild 0.2% annualized drag due to P/E contraction.

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	***2.5***	***5.0***
Payout	72.2%	15.9%	19.6%	16.8%	17.4%	20.6%	47.4%	30.2%	22.7%	52.2%	***19.7%***	***20.4%***
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%***

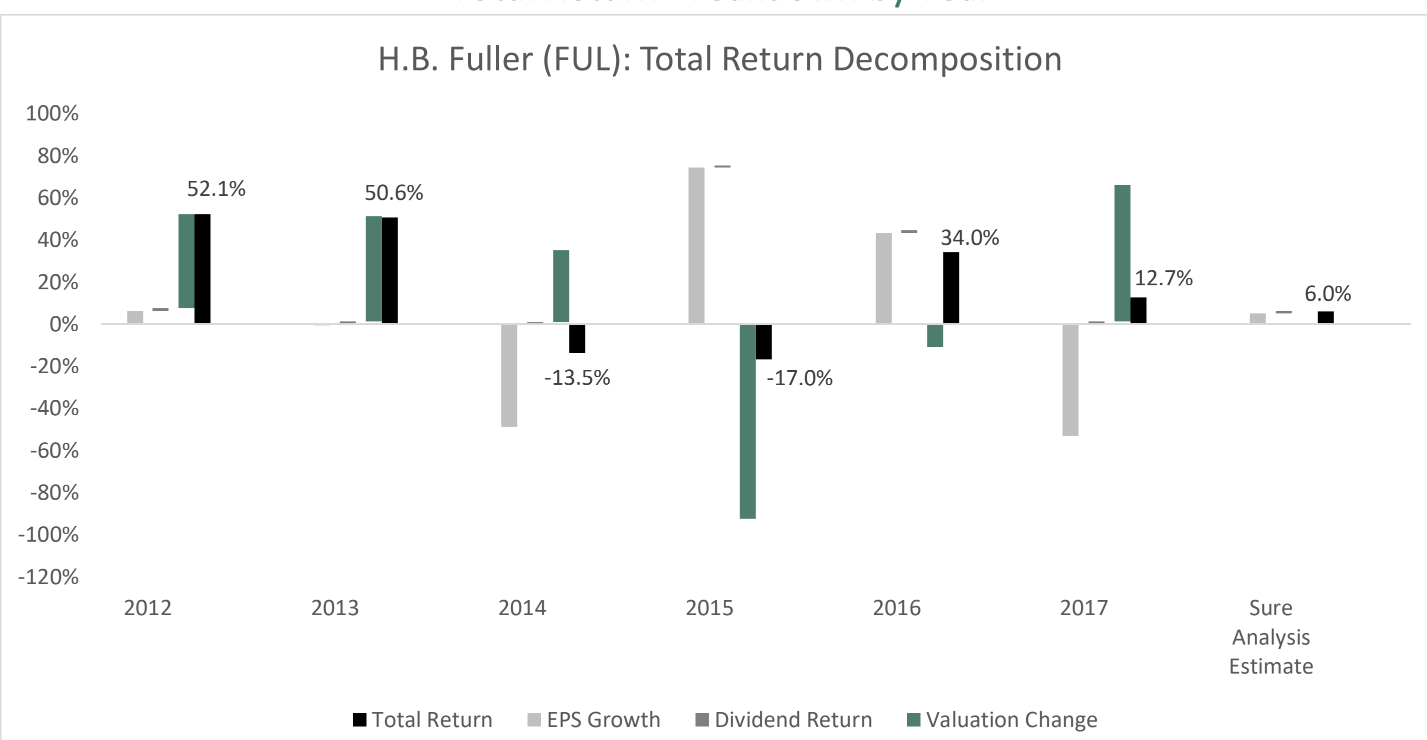
Due to the recent major acquisition, interest coverage has plunged to almost decade lows while the debt/assets ratio has greatly increased. However, management has repeatedly confirmed that it will be using a major portion of free cash flows to reduce debt. The company is on track to reduce its debt by $170 million this year and expects to reduce it by $600 million by 2020. As a result, the above 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 the underlying economic conditions. The company is highly vulnerable to recessions. During the Great Recession, its earnings per share 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 6.0% average annual return in the next five years, thanks to 5.0% earnings-per-share growth and a 1.2% dividend, which will be partly offset by a 0.2% annualized P/E contraction. While the company is executing well, investors should note its volatile earnings record and its vulnerability to economic downturns. Given the low dividend yield and the huge downside risk in the event of a recession, income-oriented investors should avoid the stock. Since our previous report, in which we advised investors to wait for a much more attractive entry point, the stock has become 7% cheaper. Nevertheless, we still advise investors to wait for a lower entry point unless they have great confidence in the U.S. economic growth over the next few years.

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.