



H.B. Fuller (FUL)

Updated April 13th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	\$50	5 Year CAGR Estimate:	6.0%	Volatility Percentile:	53.4%
Fair Value Price:	\$49	5 Year Growth Estimate:	5.0%	Momentum Percentile:	38.7%
% Fair Value:	101%	5 Year Valuation Multiple Estimate:	-0.3%	Growth Percentile:	35.2%
Dividend Yield:	1.3%	5 Year Price Target	\$63	Valuation Percentile:	52.4%
Dividend Risk Score:	A	Retirement Suitability Score:	B	Total Return Percentile:	29.5%

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 \$2.5 billion market cap of H.B Fuller, it is evident that its acquisition of Royal Adhesives & Sealants for \$1.6 billion is critically important. This acquisition, which is the largest in the history of the company, boosted its annual sales by \$735 million (32% growth) and enhanced its reach to more highly specialized adhesive segments. H.B. Fuller also acquired Adecos in late 2017 to improve its growth prospects 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 March, H.B. Fuller reported (3/27/19) its financial results for the first quarter of fiscal 2019. In the quarter, revenues decreased 5.6% and currency-adjusted revenues decreased 1%. While the company benefited from price hikes, low-single digit organic growth in American adhesives and strong growth in engineering adhesives, it was negatively affected by a slowdown in China and portfolio repositioning in construction adhesives. The company enhanced its gross margin from 26.1% to 27.0% thanks to price hikes and synergies from the integration of Royal Adhesives but its adjusted earnings-per-share came in line with analysts' consensus, at \$0.34, slightly lower than prior year's earnings-per-share of \$0.35.

Management reaffirmed its guidance for adjusted earnings-per-share of \$3.15-\$3.45 and adjusted EBITDA in the range of \$465 to \$485 million this year. The mid-point of the guidance implies 10% earnings-per-share growth over last year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.70	\$1.43	\$1.79	\$1.90	\$1.89	\$0.97	\$1.69	\$2.42	\$1.13	\$3.00	\$3.30	\$4.21
DPS	\$0.27	\$0.28	\$0.30	\$0.33	\$0.39	\$0.46	\$0.51	\$0.55	\$0.59	\$0.62	\$0.64	\$0.84
Shares	48.7	49.2	49.5	49.8	50.2	50.3	50.1	50.1	50.2	52.0	52.5	55.0

While H.B. Fuller met our expectations in the first quarter, this quarter is always the weakest of H.B. Fuller, mostly due to reduced activity in construction and engineering. We will thus have a better picture of this year's performance after the end of second quarter. With that said, there is a high degree of uncertainty in this business and investors should maintain conservative expectations in order to avoid negative surprises. While the company has grown its earnings-per-share at a 6.5% 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 a whole decade. 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	10.2	14.9	12.0	15.7	21.5	48.1	24.1	17.7	46.9	17.1	15.2	15.0
Avg. Yld.	1.6%	1.3%	1.4%	1.1%	1.0%	1.0%	1.3%	1.3%	1.1%	1.2%	1.3%	1.3%

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Since H.B. Fuller bottomed in the Christmas sell-off, it has rallied 25%. As a result, it is now trading at a price-to-earnings ratio of 15.2. While this is lower than its historical average of 16.7, we assume a fair price-to-earnings ratio of 15.0 for this stock due to the challenges facing the business and its high cyclicality. If the stock reaches our fair valuation level over the next five years, it will incur a mild 0.3% annualized drag due to the contraction of its earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	15.9%	19.6%	16.8%	17.4%	20.6%	47.4%	30.2%	22.7%	52.2%	20.7%	19.4%	20.0%

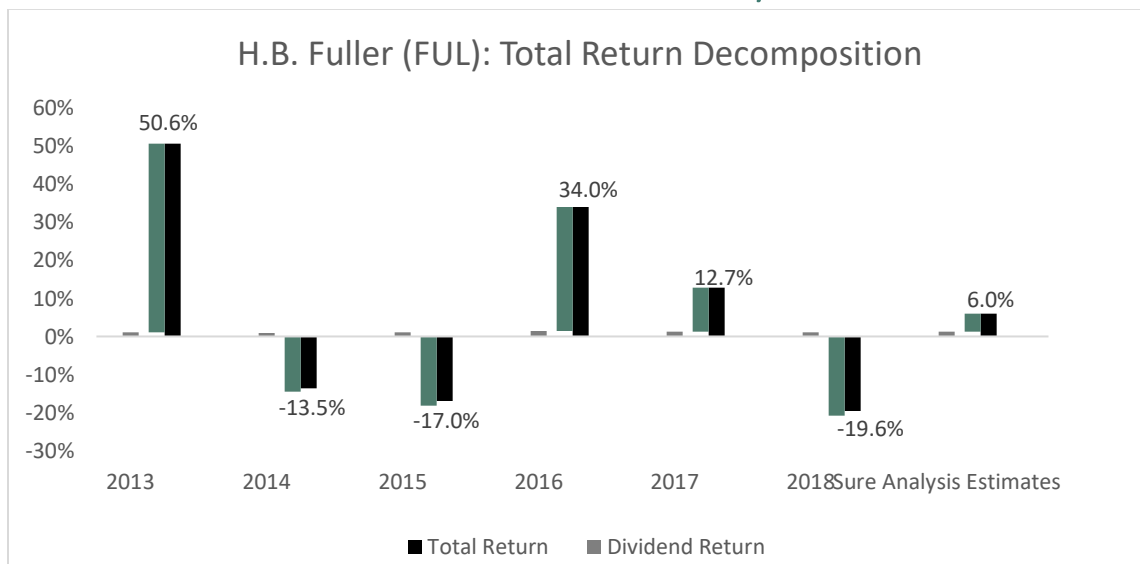
Due to the recent major acquisition, interest coverage has plunged to an almost decade low of 2.6. However, management has repeatedly confirmed that it will be using a major portion of free cash flows to reduce debt. The company reduced its debt by \$204 million last year and is on track to reduce it by another \$200 million this year. As a result, its interest coverage is likely to revert towards its 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 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 a decade and interest rates have risen in the last two years, investors should take this risk factor into account, especially given the company's increased leverage.

Final Thoughts & Recommendation

Since our last research report, H.B Fuller has posted an impressive 25% rally. Consequently, the stock has become much less attractive and now may offer just a 6.0% average annual return over the next five years. The recent rally was in-line with the broad market, which has strongly rebounded since the Christmas sell-off. As H.B. Fuller is highly leveraged to economic growth, the stock is likely to outperform the market in rallies and underperform the market in rough periods. Investors should note its volatile earnings record, its vulnerability to economic downturns and its lackluster business performance. Despite its recent rally, the stock is currently trading at the same level it was five years ago. Given the low dividend yield and the huge downside risk in the event of a recession, income-oriented investors should avoid the stock. We rate it as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1235	1257	1444	1886	2047	2104	2084	2095	2306	3041
Gross Profit	371	358	404	517	570	533	568	606	605	837
Gross Margin	30.1%	28.5%	28.0%	27.4%	27.9%	25.3%	27.3%	28.9%	26.2%	27.5%
SG&A Exp.	264	264	291	358	350	362	371	408	477	582
D&A Exp.	47	39	39	57	62	70	75	78	87	145
Operating Profit	107	95	113	138	196	150	170	198	128	255
Operating Margin	8.7%	7.5%	7.8%	7.3%	9.6%	7.1%	8.2%	9.5%	5.6%	8.4%
Net Profit	84	71	89	126	97	50	87	122	59	171
Net Margin	6.8%	5.6%	6.2%	6.7%	4.7%	2.4%	4.2%	5.8%	2.6%	5.6%
Free Cash Flow	49	40	55	73	6	-110	152	132	86	185
Income Tax	37	20	31	30	40	34	56	49	10	-6

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	1100	1153	1228	1786	1873	1869	2042	2056	4373	4175
Cash & Equivalents	100	133	155	200	155	78	119	142	194	151
Accounts Receivable	204	221	217	320	331	341	365	351	474	486
Inventories	117	122	116	209	222	251	249	247	372	356
Goodwill & Int. Ass.	245	240	242	488	483	452	567	572	2338	2213
Total Liabilities	506	519	518	1008	943	979	1169	1118	3321	3023
Accounts Payable	109	102	104	163	202	174	178	163	268	273
Long-Term Debt	214	251	232	520	493	575	723	703	2452	2248
Shareholder's Equity	591	632	705	778	930	890	873	938	1051	1152
D/E Ratio	0.36	0.40	0.33	0.67	0.53	0.65	0.83	0.75	2.33	1.95

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.7%	6.3%	7.5%	8.3%	5.3%	2.7%	4.4%	5.9%	1.8%	4.0%
Return on Equity	14.8%	11.6%	13.3%	16.9%	11.3%	5.5%	9.8%	13.4%	6.0%	15.5%
ROIC	10.5%	8.4%	9.8%	11.2%	7.1%	3.4%	5.7%	7.5%	2.3%	5.0%
Shares Out.	48.7	49.2	49.5	49.8	50.2	50.3	50.1	50.1	50.2	52.0
Revenue/Share	25.14	25.34	28.96	37.26	40.03	41.06	40.54	40.85	44.67	58.51
FCF/Share	0.99	0.80	1.11	1.44	0.12	-2.15	2.96	2.58	1.66	3.56

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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