



H.B. Fuller (FUL)

Updated June 27th, 2019 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|---------------------------------|-------|
| Current Price: | \$42 | 5 Year CAGR Estimate: | 9.2% | Volatility Percentile: | 56.8% |
| Fair Value Price: | \$48 | 5 Year Growth Estimate: | 5.0% | Momentum Percentile: | 18.9% |
| % Fair Value: | 87% | 5 Year Valuation Multiple Estimate: | 2.7% | Growth Percentile: | 35.6% |
| Dividend Yield: | 1.5% | 5 Year Price Target | \$61 | Valuation Percentile: | 62.8% |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Total Return Percentile: | 37.5% |

Overview & Current Events

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

Given the \$2.2 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.

On June 11th, H.B. Fuller announced the sale of its surfactants, thickeners and dispersants for \$71 million. Thanks to this divestment, the company expects to reduce its debt load by \$250 million this year (instead of \$200 million previously expected).

In late June, H.B. Fuller reported (6/26/19) financial results for the second quarter of fiscal 2019. Revenues decreased 3.8% but currency-adjusted revenues increased 1%. While the company enjoyed strong growth in engineering adhesives, it was negatively affected by portfolio repositioning in construction adhesives towards more profitable product lines. Adjusted earnings-per-share fell from \$0.89 to \$0.88 and missed the analysts' consensus by \$0.01. Moreover, management lowered its guidance for adjusted earnings-per-share from \$3.15-\$3.45 to \$3.10-\$3.30 and adjusted EBITDA from \$465-\$485 million to \$455-\$465 million this year due to a \$0.05 per share charge from the above divestment and poor business trends in Europe and Asia Pacific. We have thus lowered our guidance for the earnings-per-share of this year by 3%, from \$3.30 to \$3.20.

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 | \$3.20 | \$4.08 |
| 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 | 52.4 | 55.0 |

There is a high degree of uncertainty in the business of H.B. Fuller 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 | 13.1 | 15.0 |
| Avg. Yld. | 1.6% | 1.3% | 1.4% | 1.1% | 1.0% | 1.0% | 1.3% | 1.3% | 1.1% | 1.2% | 1.5% | 1.4% |

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Since our last research report, in April, H.B. Fuller's stock has shed 16%. It is now trading at a price-to-earnings ratio of 13.1. While the historical average earnings multiple of the stock is 16.7, we assume a fair price-to-earnings ratio of 15.0 due to the challenges facing the business and the high cyclicality of the stock. If the stock reaches our fair valuation level over the next five years, it will enjoy a 2.7% annualized gain thanks to the expansion 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% | 20.0% | 20.6% |

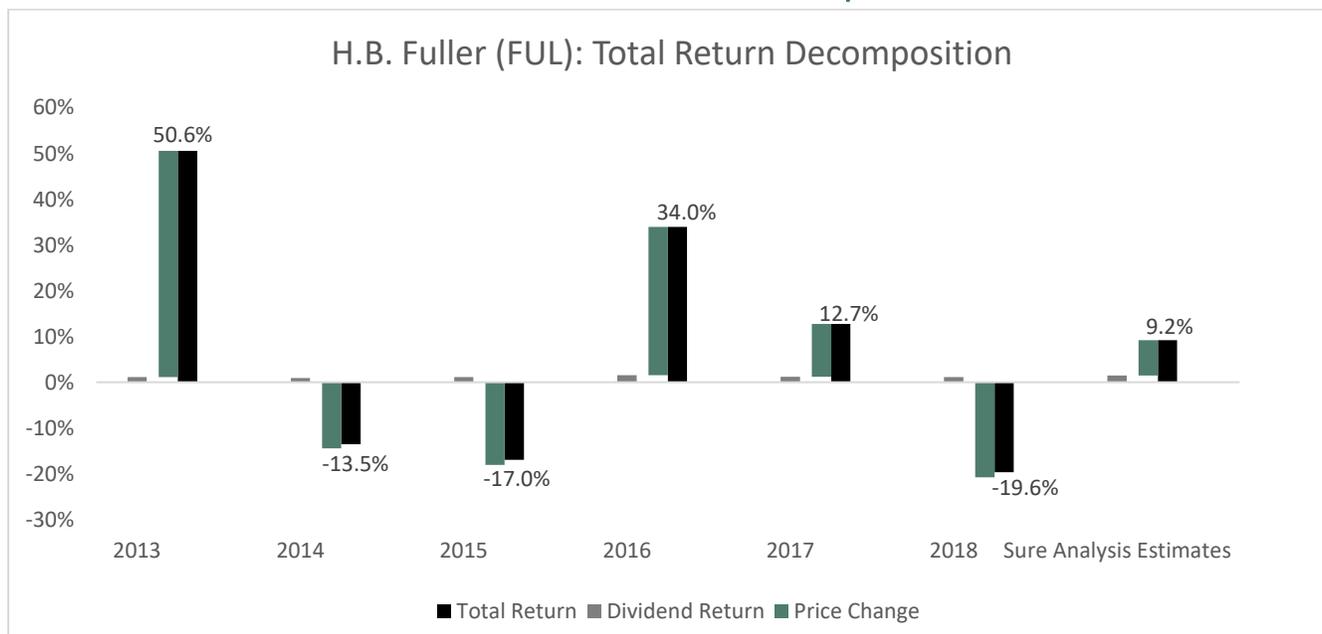
Due to the acquisition of Royal Adhesives & Sealants, interest coverage has plunged to an almost decade low of 2.2. However, management has repeatedly confirmed that it will be using a major portion of free cash flows to reduce debt. The company reduced its debt by \$204 million last year and is on track to reduce it by another \$250 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. Moreover, H.B. Fuller is highly leveraged to economic growth and hence the stock is likely to outperform the market in rallies and underperform the market in rough periods. The company is notably 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, 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 slumped 16%. Consequently, the stock has become more attractive and can now offer a 9.2% average annual return over the next five years. However, investors should note its volatile earnings record, its vulnerability to economic downturns and its lackluster business performance. The stock is currently trading at the same level it was five years ago whereas S&P is 50% higher. Given the low yield and downside risk in the event of a recession, income-oriented investors should pass here. We rate it as a hold for those not in need of the stock's income.

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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