



H.B. Fuller (FUL)

Updated January 23rd, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	\$49	5 Year CAGR Estimate:	7.6%	Market Cap:	\$2.5 B
Fair Value Price:	\$49	5 Year Growth Estimate:	6.5%	Ex-Dividend Date:	1/30/20
% Fair Value:	101%	5 Year Valuation Multiple Estimate:	-0.1%	Dividend Payment Date:	2/13/20
Dividend Yield:	1.3%	5 Year Price Target	\$67	Years Of Dividend Growth:	50
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	3.2%

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 \$2.5 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 Adecol in late 2017 to improve its growth prospects in Brazil. Thanks to these acquisitions, H.B. Fuller expects to grow its EBITDA by approximately 50%, from about \$300 million in 2017 to \$440-\$460 million in 2020.

In late January, H.B. Fuller reported (1/22/20) financial results for the fourth quarter of fiscal 2019. Revenues decreased -3.8% and organic revenues decreased -0.9% due to poor trends in construction adhesives and the economic slowdown in Europe, Middle East and Africa. The gross margin fell from 27.8% to 27.6% due to lower revenues while adjusted earnings-per-share fell from \$0.90 to \$0.88 and missed the analysts' consensus by \$0.04. H.B. Fuller has missed the analysts' earnings-per-share consensus in 7 of the last 10 quarters.

On the bright side, management provided positive guidance for this year. It expects \$20 million of cost savings thanks to increased synergies from recent acquisitions, organic revenue growth of 1%-2% and adjusted earnings-per-share of \$3.15-\$3.35, implying 9.8% growth at the mid-point.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.43	\$1.79	\$1.90	\$1.89	\$0.97	\$1.69	\$2.42	\$1.13	\$3.00	\$2.96	\$3.25	\$4.45
DPS	\$0.28	\$0.30	\$0.33	\$0.39	\$0.46	\$0.51	\$0.55	\$0.59	\$0.62	\$0.64	\$0.66	\$0.86
Shares¹	49.2	49.5	49.8	50.2	50.3	50.1	50.1	50.2	52.0	52.4	52.8	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 an 8.4% 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 a whole decade. Therefore, we prefer to be somewhat and assume 6.5% annual earnings-per-share growth for the next five years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.9	12.0	15.7	21.5	48.1	24.1	17.7	46.9	17.1	16.0	15.1	15.0
Avg. Yld.	1.3%	1.4%	1.1%	1.0%	1.0%	1.3%	1.3%	1.1%	1.2%	1.4%	1.3%	1.3%

H.B. Fuller is currently trading at a price-to-earnings ratio of 15.1. While the historical average earnings multiple of the stock is 16.5, we assume a fair price-to-earnings ratio of 15.0 due to the challenges facing the business and the high

¹ In millions

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cyclicality of the stock. If the stock trades at our fair valuation level in five years, it will incur a mild -0.1% annualized drag in its returns due to the contraction of its earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	19.6%	16.8%	17.4%	20.6%	47.4%	30.2%	22.7%	52.2%	20.7%	21.6%	20.3%	19.3%

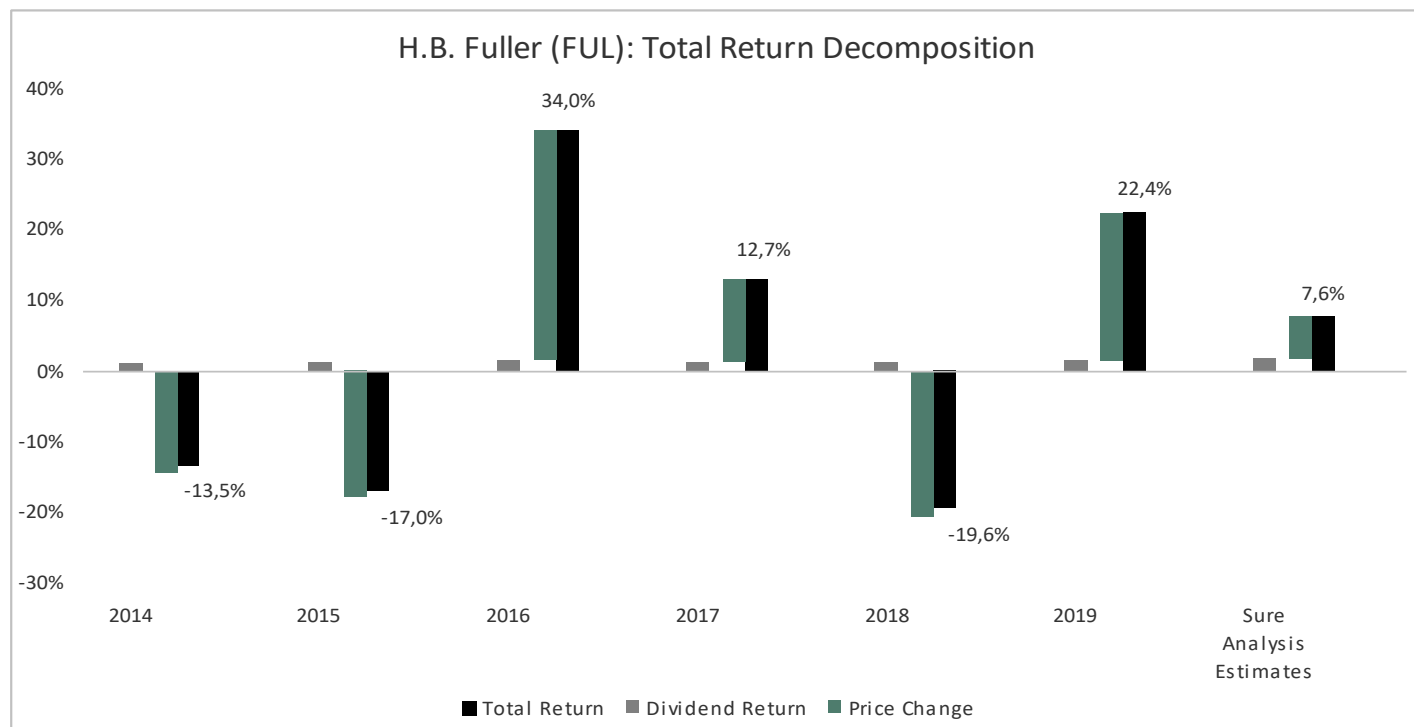
Due to the acquisition of Royal Adhesives & Sealants, interest coverage has plunged to an almost decade low of 2.2. However, management has repeatedly confirmed that it will be using a major portion of free cash flows to reduce debt. The company reduced its debt by \$268 million last year and expects 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. 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 two-thirds of its market cap in less than six months. As a recession has not occurred for a whole decade, investors should account for this risk factor, especially given the company's increased leverage.

Final Thoughts & Recommendation

H.B Fuller has a volatile earnings record; it is vulnerable to economic downturns and has lackluster business performance due to a slowdown in the industrial production in some regions. We expect the stock to offer a 7.6% average annual return over the next five years. Given the low yield and the downside risk in the event of a recession, the security is not attractive for income-oriented investors. We rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1257	1444	1886	2047	2104	2084	2095	2306	3041	
Gross Profit	358	404	517	570	533	568	606	605	837	
Gross Margin	28.5%	28.0%	27.4%	27.9%	25.3%	27.3%	28.9%	26.2%	27.5%	
SG&A Exp.	264	291	358	350	362	371	408	477	582	
D&A Exp.	39	39	57	62	70	75	78	87	145	
Operating Profit	95	113	138	196	150	170	198	128	255	
Operating Margin	7.5%	7.8%	7.3%	9.6%	7.1%	8.2%	9.5%	5.6%	8.4%	
Net Profit	71	89	126	97	50	87	122	59	171	
Net Margin	5.6%	6.2%	6.7%	4.7%	2.4%	4.2%	5.8%	2.6%	5.6%	
Free Cash Flow	40	55	73	6	-110	152	132	86	185	
Income Tax	20	31	30	40	34	56	49	10	-6	

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1153	1228	1786	1873	1869	2042	2056	4373	4175	
Cash & Equivalents	133	155	200	155	78	119	142	194	151	
Accounts Receivable	221	217	320	331	341	365	351	474	486	
Inventories	122	116	209	222	251	249	247	372	356	
Goodwill & Int. Ass.	240	242	488	483	452	567	572	2338	2213	
Total Liabilities	519	518	1008	943	979	1169	1118	3321	3023	
Accounts Payable	102	104	163	202	174	178	163	268	273	
Long-Term Debt	251	232	520	493	575	723	703	2452	2248	
Shareholder's Equity	632	705	778	930	890	873	938	1051	1152	
D/E Ratio	0.40	0.33	0.67	0.53	0.65	0.83	0.75	2.33	1.95	

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.3%	7.5%	8.3%	5.3%	2.7%	4.4%	5.9%	1.8%	4.0%	
Return on Equity	11.6%	13.3%	16.9%	11.3%	5.5%	9.8%	13.4%	6.0%	15.5%	
ROIC	8.4%	9.8%	11.2%	7.1%	3.4%	5.7%	7.5%	2.3%	5.0%	
Shares Out.	49.2	49.5	49.8	50.2	50.3	50.1	50.1	50.2	52.0	
Revenue/Share	25.34	28.96	37.26	40.03	41.06	40.54	40.85	44.67	58.51	
FCF/Share	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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