



# H.B. Fuller (FUL)

Updated September 24<sup>th</sup>, 2020 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$46	<b>5 Year CAGR Estimate:</b>	7.8%	<b>Market Cap:</b>	\$2.4 B
<b>Fair Value Price:</b>	\$38	<b>5 Year Growth Estimate:</b>	11.0%	<b>Ex-Dividend Date:</b>	10/14/20 <sup>1</sup>
<b>% Fair Value:</b>	123%	<b>5 Year Valuation Multiple Estimate:</b>	-4.0%	<b>Dividend Payment Date:</b>	10/29/20
<b>Dividend Yield:</b>	1.4%	<b>5 Year Price Target</b>	\$63	<b>Years Of Dividend Growth:</b>	51
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	1.6%

## 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 \$2.4 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 Adecoll in late 2017 to improve its growth prospects in Brazil.

In late September, H.B. Fuller reported (9/23/20) financial results for the third quarter of fiscal 2020. Revenues decreased -5% and organic revenues decreased -2.5%, primarily due to lower demand for construction adhesives and engineering adhesives, which has been caused by the coronavirus crisis. Adjusted gross margin shrank from 28.8% to 27.3% due to lower revenues and unfavorable business mix related to the pandemic effect and adjusted earnings-per-share fell from \$0.86 to \$0.76 but exceeded analysts' consensus by \$0.06.

Management provided guidance for a milder than -3% decrease in revenue in the fourth quarter over the prior year's quarter and flat EBITDA. Moreover, the recent 1.6% dividend hike is important, not for the increased distribution, but as a testament to management's confidence in a swift recovery of the company from the pandemic.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$1.43	\$1.79	\$1.90	\$1.89	\$0.97	\$1.69	\$2.42	\$1.13	\$3.00	\$2.96	<b>\$2.50</b>	<b>\$4.21</b>
<b>DPS</b>	\$0.28	\$0.30	\$0.33	\$0.39	\$0.46	\$0.51	\$0.55	\$0.59	\$0.62	\$0.64	<b>\$0.65</b>	<b>\$0.83</b>
<b>Shares<sup>2</sup></b>	49.2	49.5	49.8	50.2	50.3	50.1	50.1	50.2	52.0	52.4	<b>52.8</b>	<b>55.0</b>

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, the results of H.B. Fuller are highly sensitive to the global recession caused by the coronavirus. If the pandemic lasts longer than currently anticipated, H.B. Fuller will be significantly affected. On the other hand, we expect the pandemic to subside and the global economy to recover from next year. We thus expect H.B. Fuller to grow its earnings-per-share at an 11.0% average annual rate over the next five years off this year's low base.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
<b>Avg. P/E</b>	14.9	12.0	15.7	21.5	48.1	24.1	17.7	46.9	17.1	16.0	<b>18.4</b>	<b>15.0</b>
<b>Avg. Yld.</b>	1.3%	1.4%	1.1%	1.0%	1.0%	1.3%	1.3%	1.1%	1.2%	1.4%	<b>1.4%</b>	<b>1.3%</b>

<sup>1</sup> Estimated date.

<sup>2</sup> In millions

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H.B. Fuller is currently trading at a price-to-earnings ratio of 18.4. 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 cyclicality of the stock. If the stock trades at our fair valuation level in five years, it will incur a -4.0% 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%	26.0%	19.7%

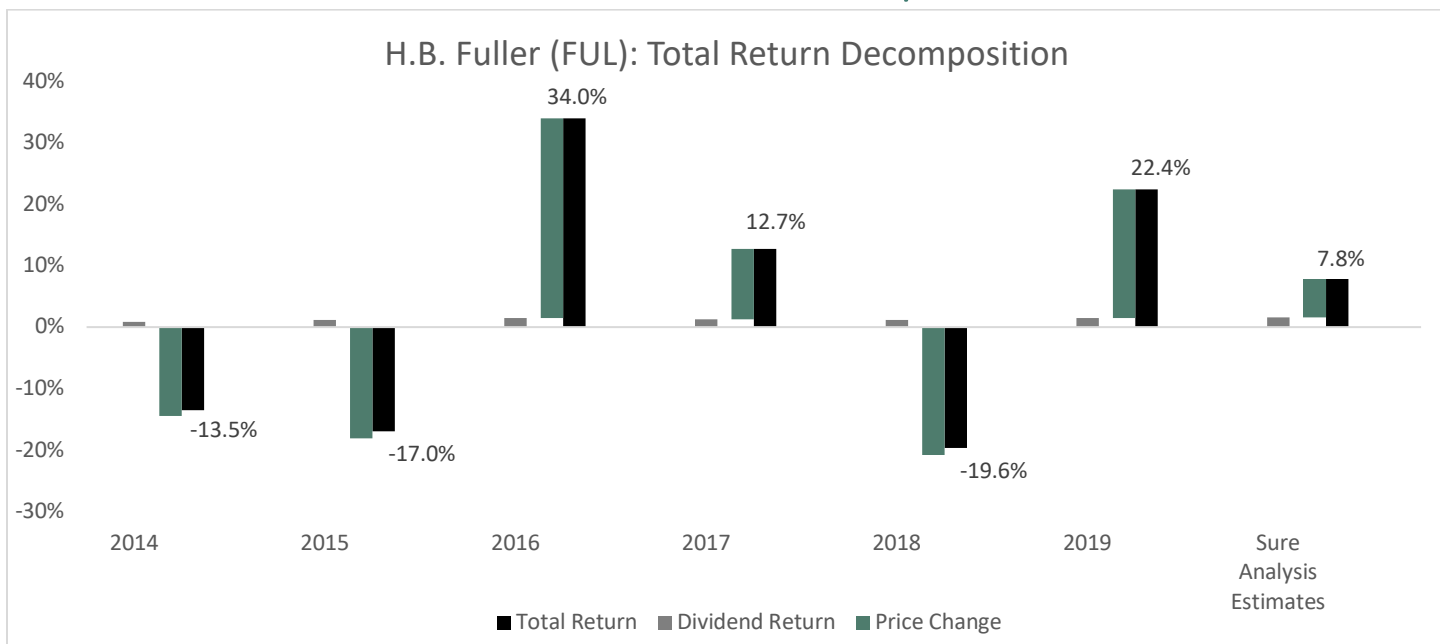
Due to the acquisition of Royal Adhesives & Sealants and the ongoing downturn, interest coverage has fallen to 3.0. However, management has repeatedly confirmed that it will be using a major portion of free cash flows to reduce debt. The company reduced its debt by \$268 million last year and is on track 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. Moreover, H.B. Fuller is highly leveraged to economic growth and hence the stock could 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. Given the severe recession caused by the coronavirus, 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 and it is vulnerable to economic downturns, such as the global recession caused by the coronavirus. As we expect a recovery of the global economy from next year, we expect the stock to offer a 7.8% average annual return over the next five years. On the other hand, if the recession lasts longer than expected, the stock will have significant downside risk, particularly given its full valuation. Given the low yield and the vulnerability to recessions, 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
<b>Revenue</b>	1257	1444	1886	2047	2104	2084	2095	2306	3041	2,897
<b>Gross Profit</b>	358	404	517	570	533	568	606	605	837	807
<b>Gross Margin</b>	28.5%	28.0%	27.4%	27.9%	25.3%	27.3%	28.9%	26.2%	27.5%	27.9%
<b>SG&amp;A Exp.</b>	264	291	358	350	362	371	408	477	582	581
<b>D&amp;A Exp.</b>	39	39	57	62	70	75	78	87	145	141
<b>Operating Profit</b>	95	113	138	196	150	170	198	128	255	226
<b>Operating Margin</b>	7.5%	7.8%	7.3%	9.6%	7.1%	8.2%	9.5%	5.6%	8.4%	7.8%
<b>Net Profit</b>	71	89	126	97	50	87	122	59	171	131
<b>Net Margin</b>	5.6%	6.2%	6.7%	4.7%	2.4%	4.2%	5.8%	2.6%	5.6%	4.5%
<b>Free Cash Flow</b>	40	55	73	6	-110	152	132	86	185	207
<b>Income Tax</b>	20	31	30	40	34	56	49	10	-6	49

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	1153	1228	1786	1873	1869	2042	2056	4373	4176	3,986
<b>Cash &amp; Equivalents</b>	133	155	200	155	78	119	142	194	151	112
<b>Accounts Receivable</b>	221	217	320	331	341	365	351	474	486	493
<b>Inventories</b>	122	116	209	222	251	249	247	372	356	337
<b>Goodwill &amp; Int. Ass.</b>	240	242	488	483	452	567	572	2338	2213	2,081
<b>Total Liabilities</b>	519	518	1008	943	979	1169	1118	3321	3023	2,763
<b>Accounts Payable</b>	102	104	163	202	174	178	163	268	273	299
<b>Long-Term Debt</b>	251	232	520	493	575	723	703	2452	2248	1,979
<b>Shareholder's Equity</b>	632	705	778	930	890	873	938	1051	1152	1,222
<b>D/E Ratio</b>	0.40	0.33	0.67	0.53	0.65	0.83	0.75	2.33	1.95	1.62

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	6.3%	7.5%	8.3%	5.3%	2.7%	4.4%	5.9%	1.8%	4.0%	3.2%
<b>Return on Equity</b>	11.6%	13.3%	16.9%	11.3%	5.5%	9.8%	13.4%	6.0%	15.5%	11.0%
<b>ROIC</b>	8.4%	9.8%	11.2%	7.1%	3.4%	5.7%	7.5%	2.3%	5.0%	4.0%
<b>Shares Out.</b>	49.2	49.5	49.8	50.2	50.3	50.1	50.1	50.2	52.0	52.4
<b>Revenue/Share</b>	25.34	28.96	37.26	40.03	41.06	40.54	40.85	44.67	58.51	55.73
<b>FCF/Share</b>	0.80	1.11	1.44	0.12	-2.15	2.96	2.58	1.66	3.56	3.99

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

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