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FUL.N - Q2 2023 H.B. Fuller Company Earnings Call

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PRESENTATION

Operator

Good morning. My name is David, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the H.B. Fuller Q2 2023 Earnings Conference Call. Today's conference is being recorded. (Operator Instructions).

Steven Brazones, you may begin your conference.

Steven E. Brazones - *H.B. Fuller Company - VP of IR*

Thank you, operator. Welcome to H.B. Fuller's Second Quarter 2023 Investor Conference Call. Presenting today are Celeste Mastin, President and Chief Executive Officer; and John Corkrean, Executive Vice President and Chief Financial Officer. After our prepared remarks, we will have a question-and-answer session.

Before we begin, let me remind everyone that our comments today will include references to certain non-GAAP financial measures. These measures are supplemental to the results determined in accordance with GAAP. We believe that these measures are useful to investors in understanding our operating performance and to compare our performance with other companies. Reconciliation of non-GAAP measures to the nearest GAAP measure are included in our earnings release. Unless otherwise noted, comments about revenue refer to organic revenue and comments about EPS, EBITDA and profit margins refer to adjusted non-GAAP measures.

We will also be making forward-looking statements during this call. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially from these expectations due to factors covered in our earnings release, comments made during this call and the risk factors detailed in our filings with the Securities and Exchange Commission, all of which are available on our website at investors.hbfuller.com.

I will now turn the call over to Celeste Mastin. Celeste?

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Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Thank you, Steven, and welcome, everyone. Our second quarter profit performance was strong and in line with our expectations despite adverse customer destocking actions and slower industrial demand. Our ability to successfully manage changing price and raw material dynamics while scaling production cost is delivering EBITDA growth and significant margin improvement, and we remain on track to deliver strong growth in adjusted EBITDA in fiscal 2023.

Global industrial activity has slowed, but underlying demand across the portfolio remains much stronger than our second quarter volume performance implies due to the effect of customer destocking, which is significant but not unique to us or our industry. This destocking activity is currently tapering over a large portion of our portfolio with Q2 representing an inflection point, and we expect our year-on-year and sequential volume comparisons to be stronger in the second half of the year.

As for our consolidated results in the second quarter, organic revenue declined 8.3% year-on-year with all GBUs experiencing declining organic sales and challenging volume conditions. However, the decline in organic sales for CA improved significantly on a sequential basis from down 26% year-on-year in Q1 to down 14% year-on-year in Q2.

The improvement in the organic sales trend for CA was better than we were expecting, while the deterioration in organic sales for both HHC and EA driven principally from heavier-than-expected customer destocking activities was more adverse than we anticipated. Organic sales for HHC and EA declined year-on-year by 5.5% and by 9%, respectively, in the second quarter. From a profitability perspective, we performed very well and at the midpoint of our EBITDA guidance. We are very pleased with the progression in profit improvement that the team's actions continue to drive for the business.

On a year-over-year basis, adjusted EBITDA was up 3% in the second quarter despite net revenue declining 10% and volume declining 14% versus the prior year. As a result, adjusted EBITDA margin increased 190 basis points year-over-year and 230 basis points sequentially from Q1 to 15.9%. The combined effort of our sales, manufacturing and supply chain organizations helped deliver a significant portion of this margin improvement.

Our sales organization through collaboration with our customers are continually implementing win-win product substitutions to enable our customers to receive lower costs while maintaining or improving our margins. At the same time, our manufacturing and supply chain group is appropriately leveraging our market position to not only improve the availability of supply, but to also procure raw materials and convert them at a lower cost. I'm very proud of the execution by our team and their ability to adjust to the changing market dynamics.

As a result, we continue to remain very confident in our ability to achieve between $130 million to $160 million in net year-on-year benefit from price and raw material cost management in fiscal 2023, consistent with our previous guidance.

Also, we continue to expect approximately $80 million in year-on-year headwinds from lower volume, wage and other inflation, offset by cost savings actions and the impact from acquisitions. Although volume development will be a larger headwind for the year than we anticipated, at the end of the first quarter, we believe we will be able to largely offset this impact by more aggressively managing costs and continuing to grow the business through acquisitions.

Now let me move on to review the performance in each of our segments in the second quarter. In HHC, organic revenue was down 5.5% year-on-year, driven principally by unusually high and broad-based destocking activity by HHC's consumer product goods customers. Although underlying consumer demand for HHC's customers remain stable as one would expect, destocking activity led to double-digit declines in volume for HHC in the second quarter.

The packaging and beverage labeling markets experienced more pronounced destocking impacts while the hygiene and tissue and towel market segments were less affected. Adjusted EBITDA for HHC increased 13% year-on-year to $65 million and adjusted EBITDA margin increased 290 basis points to 16.1%. Favorable price and raw material cost management as well as good expense control drove the improvement year-on-year.

In Engineering Adhesives, organic revenue declined 9% in the second quarter due to lower volume in the construction and durable goods related markets. This more than offset continued strong growth in the automotive, bus, truck and rail and aerospace market segments. Adjusted EBITDA

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in EA increased 3% year-on-year and adjusted EBITDA margin increased 210 basis points year-on-year to 16.8%. The improvement in profitability for EA was also driven by favorable price and raw material cost actions and disciplined cost management.

In Construction Adhesives, organic sales declined 14.2% year-on-year. CA volume continued to be negatively impacted by customer destocking activity, particularly in the roofing market segment. However, this began to taper throughout the second quarter, improving each month and resulting in better year-on-year organic sales development compared to the first quarter. CA was our first GBU to experience significant customer destocking activity starting in the fourth quarter of last year, and it will be the first to complete the progression through this macro level destocking phase. We believe customer destocking activity for CA has largely run its course.

Adjusted EBITDA for Construction Adhesives in the second quarter improved considerably on a sequential basis, with adjusted EBITDA margin increasing 11 percentage points to 14.1%, significantly ahead of our expectations for this business to return to mid-teens EBITDA margins. This extraordinarily quick turnaround in profitability was driven by restructuring actions and diligent cost management by the CA team, which demonstrated great courage in expeditiously reducing costs, driving significant volume leverage and greatly improving profitability.

Geographically, Americas' organic growth was down 9.7% year-on-year and EIMEA was down 6.3% as the impact of customer destocking moderated in CA, but accelerated in HHC and EA. In Asia Pacific, organic revenues decreased 5.5% year-on-year. Demand in China improved versus the first quarter as the country navigated through the challenges of reopening following their COVID lockdown restrictions. With that said, organic sales in China still declined year-on-year during the quarter.

While sequential demand in China has improved and we expect that trend to continue in the second half of the year, we are now expecting a longer and slower recovery as opposed to a sharp rebound. From a global economic standpoint, industrial demand continues to slow, particularly in construction and durable goods related markets. We are planning for demand levels to remain weak for the rest of this year and into next year, but improve from current levels as destocking impacts abate.

Overall, our market share position remains strong and unchanged. We believe true customer demand in our markets is down modestly and that the significant impact of customer destocking is driving the majority of the volume declines in the marketplace today.

Now I'd like to talk about our M&A strategy. M&A continues to be a strategic focus for us and a valuable tool to accelerate the realization of many of our growth opportunities. We are keenly concentrated on the pursuit of strategic tuck-in acquisitions that drive meaningful synergies and carry relatively low execution and integration risk. We have a robust pipeline of proprietary deals which enable us to acquire businesses at post-synergy EBITDA multiples well below our current trading multiple. These transactions are accretive to EBITDA and often deleveraging to the balance sheet as synergies are realized.

We are committed to drive-in our net debt-to-EBITDA ratio below 3x. Our strong cash flow profile allows us to allocate $200 million to $300 million in capital annually for smaller strategic tuck-in acquisitions that are highly synergistic while still accomplishing this capital structure objective. During the second quarter, we acquired Beardow Adams, a U.K. headquartered adhesives company with a strong presence in the packaging and labeling market segments. This is an industry consolidation acquisition with significant cost synergies expected through capacity optimization and supply chain leverage. This transaction will accelerate growth and profitability in HHC by enhancing our market position and distribution network.

Also this month, we closed 2 strategic acquisitions, XCHEM and Adhezion, both of which will enable the realization of two of our most strategic growth initiatives, building a business of scale in the medical market and globally diversifying our highly specified Construction Adhesives portfolio. XCHEM is an adhesives manufacturer based in the United Arab Emirates that offers a wide range of specialty adhesives and coatings for industrial and infrastructure applications in the fast-growing Middle East, North Africa region.

The acquisition expands CA's manufacturing capacity outside the United States for its flagship Fosters brand and broadened CA's portfolio of products for highly specified applications. This acquisition directly supports CA's strategy to diversify and grow the Construction Adhesives business geographically and improve its mix of countercyclical market exposure.

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Adhezion is a U.S.-based medical adhesives company with customers in more than 40 countries, more than 35 global certifications and 105 patents. It manufactures and distributes advanced adhesives for use in wound care for a broad range of health care disciplines. The acquisition adds to the capabilities acquired in the company's purchase of tissue seal in 2021 and decisively positions H.B. Fuller for expansion in the medical adhesives industry. This creates a solid unique platform from which to scale and innovate in the highly profitable $8 billion health care adhesives space.

Since the beginning of this fiscal year, we've completed 5 transactions. In aggregate, the 2023 collection of tuck-in acquisitions are expected to contribute approximately $100 million in sales and about $8 million in adjusted EBITDA in fiscal 2023, and $200 million in sales and $50 million in adjusted EBITDA by fiscal 2025. The combined purchase price for the 2023 collection is approximately $200 million and equates to a post-synergy multiple of less than 5x EBITDA and excluding the Adhezion transaction, a purchase price multiple that is less than our current net debt-to-EBITDA multiple.

We are very pleased for these companies to become part of H.B. Fuller, the largest pure-play adhesives company in the world, and we are excited to welcome our new team members to the H.B. Fuller family.

Now let me turn the call over to John Corkrean to review our second quarter results in more detail and our outlook for 2023.

John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

Thank you, Celeste. I'll begin on Slide 9 with some additional financial details of the second quarter. For the quarter, revenue was down 9.6% versus the same period last year. Currency had a negative impact of 3.4% and acquisitions positively impacted net revenue by 2.1%. Adjusting for those items organic revenue was down 8.3%, with pricing having a favorable impact of 5.9% year-on-year in the quarter and volume down 14.2%, reflecting a continuation in customer destocking across all GBUs and a general slowdown in industrial demand.

Adjusted gross profit margin was 29%, up 330 basis points versus last year, as the net effect of pricing and raw material cost actions more than offset the impact of lower volume. Adjusted Selling, General and administrative expense was essentially flat year-on-year. Good cost management, initial restructuring benefits, lower variable compensation and favorable foreign currency impacts offset inflation in wages and other costs.

Adjusted EBITDA for the quarter of $143 million was at the midpoint of our guidance range and up 3% year-on-year. This reflects actions on pricing and raw material costs as well as restructuring and cost savings, which more than offset lower volume and favorable foreign exchange and wage and other inflation during the quarter. On a constant currency basis, adjusted EBITDA was up approximately 7% year-on-year.

Adjusted earnings per share of $0.93 was down versus the second quarter of 2022, as expected, driven by significantly higher interest expense and unfavorable foreign currency. Higher interest expense and unfavorable foreign exchange negatively impacted adjusted EPS in the second quarter by approximately $0.19 and $0.07, respectively.

Operating cash flow in the quarter improved significantly year-on-year as improving margins and lower net working capital requirements more than offset the impacts of lower volume, higher interest expense and unfavorable foreign currency translation. Second quarter and year-to-date cash flow from operations increased year-on-year by $94 million and $118 million, respectively. With that, let me now turn to our guidance for the 2023 fiscal year.

We now expect full year net revenue and organic revenue to be down 3% to 5% versus 2022. This reflects lower than expected volume in the second quarter, a decreasing level of destocking activity in the second half of the year as well as slightly weaker industrial demand expectations for the full year. The combined impact of FX, acquisitions and the extra week in fiscal 2022 are expected to be effectively neutral versus fiscal 2023.

Additionally, we continue to expect adjusted EBITDA to be between $580 million to $610 million, representing a 9% to 15% year-on-year increase. This reflects lower organic revenue expectations, offset by contributions from additional cost reductions as well as the value-creating acquisitions discussed earlier.

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Net interest expense is now expected to be in the range of $125 million to $135 million and depreciation and amortization expense is expected to be approximately $160 million, reflecting a recent acquisition activity and higher interest rates.

Combined, these assumptions result in full year adjusted earnings per share in the range of $3.80 to $4.20. We now expect full year operating cash flow to be between $325 million and $375 million, up between 26% and 46% year-on-year, reflecting our expectations of more robust reductions in net working capital through the end of the year.

Finally, based on the seasonality of our business and the timing of pricing and raw material actions over the course of the year, we expect to realize between $155 million and $165 million of EBITDA in the third quarter of the year.

Now let me turn the call back over to Celeste to wrap this up.

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Thank you, John. I am extremely proud of the performance and execution our team has demonstrated in the current environment. We continue to provide our customers with exceptional service and greatly value our partnership with them to bring new innovations to the marketplace. These innovations are centered on the goal of helping our customers do more with less, to use drops not trucks and to improve the value and sustainability of their products.

Our innovative partnership approach is a key competitive differentiator for H.B. Fuller. We continually collaborate with our customers to address their innovation challenges and to assist them in capturing the opportunities associated with current megatrends such as sustainability, e-commerce and labor availability. I would like to highlight for you just a couple of examples of our recent innovations that are changing the world and capturing significant attention.

First, H.B. Fuller's EA team was the proud winner of the 2023 Adhesive and Sealing Council Innovation Award for our new product, EV Protect, a lightweight encapsulant for lithium-ion batteries used in the production of electric vehicles. EV Protect is a game-changing innovation that when exposed to a thermal event significantly reduces or delays thermal propagation.

The semi-structural properties of EV Protect also provide noise, vibration and harshness mitigation benefits to the battery system by unitizing the battery module and absorbing external environmental impacts. This new patent protected innovation greatly improves the safety of EV battery systems and will enable us to capture more market share and continue to significantly grow our EV business.

Second, HHC is leading the industry in innovating and enabling sustainability in the global hygiene market. Recently, one of our customers, Niine, a leading manufacturer of feminine care products in India, unveiled an incredible innovation in feminine hygiene, creating one of the industry's first biodegradable sanitary napkins. HHC's new bio-based adhesive technology, the Full Care 900 Series, which generates 90% lower carbon emissions compared to standard petrochemical-based adhesives was critical to their new product design. Through collaborative partnering with our customers, H.B. Fuller is leading the way in creating game-changing, sustainable solutions across industries to reduce waste and improve the environment.

Now as I conclude my prepared remarks, I would like to provide an overall perspective. We are well positioned in the marketplace and continue to expect strong growth in adjusted EBITDA and operating cash flow in fiscal 2023, our diverse portfolio and robust innovation pipeline engender continual product line upgrades, enabling strong profit growth in almost any economic environment.

Our confidence remains high in a stronger second half performance as we expect customer destocking activities to fade, EBITDA margins to continue to expand due to price and raw material cost actions, demand in China to improve, foreign currency comparisons to be favorable year-on-year and restructuring benefits ramp through the end of the year, delivering another strong year of EBITDA growth and setting us up to continue that trend in 2024.

That concludes our prepared remarks for today.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Mike Harrison with Seaport Research Partners.

Michael Joseph Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

Celeste, a lot of companies are saying that this ongoing destocking is making it difficult to know what underlying demand looks like and saying that visibility is very poor right now. You seem to be indicating that underlying demand is pretty solid. Is that based on what you're seeing in order patterns or on customer conversations? Or what -- can you help us understand what's giving you confidence while other companies are pointing to more limited visibility?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Sure. Thanks, Mike. So when you look at our underlying demand, we have a lot of anecdotal information, and we also have a view into our P7 which is this month. And what we really see is in the CA business, we had -- we saw really strong destocking month-over-month during the quarter. We're seeing that lighten up significantly by about half, in fact, in P7.

In the EA business, we've just seen this progression month-over-month of improving volumes. And now we're at the point where it looks like the EA business is down sort of low single digits as it relates to volume -- which I think is really indicative of the underlying demand, kind of low single-digit comparison. And then HHC. HHC was the last one, the last business we have that has become involved in this destocking phenomena. And they're going to be the last one to pull out of it.

So what we're seeing in that business, which, as you know, is dominated by a lot of large consumer products, businesses and companies is that we're seeing ongoing low demand in that particular area. And it's very hard to say exactly what the underlying demand is because it's still so mired in destocking. But -- like my intuition would say that overall, we're going to see demand settle out around 3% or 4% lower than a typical year.

Michael Joseph Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

Well, and that makes sense because that tends to be a more defensive category. Question on M&A strategy. If we looked at your pipeline of deals, and I'm looking at Slide 7 here, where you have this matrix or kind of 4 different buckets -- of categories for acquisitions. How would that pipeline kind of split roughly among those 4 buckets? And how do you think about the risks and value creation opportunities as you think about new technologies and new geographies versus something that's more of a low-risk consolidation play?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. I think this is -- what you see for this year is going to be a very typical dispersion of those acquisitions within the pipeline. By very nature of the strategies that we have in our 30 different market segments, there tends to be more of a drive to the need for adding new technologies in existing regions or to expand the technology we have into new regions. That's where we see -- really our best opportunities for growth. However, there are certainly opportunities that we found in the tissue seal deal or the Adhezion dealer are examples of this, where it makes sense to step out into an adjacent space and to build a capability like we're building in the Medical Adhesives business.

So to your point on risk, right? I mean finding the right platform in those areas on that left-hand side of the matrix is what's so critical, so when you look at the Adhezion deal, the reason we just loved that acquisition was because they have great technology. You can see how many products

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they have certified, all the FDA clearance they have, really robust technology. In fact, it's an extension of our cyanoacrylate, it's an octyl based version, which gives us a lot more -- which is a lot more applicable in a broader part of that space.

But what they didn't have was a good channel to market, which is why they weren't generating a lot of EBITDA and in a very challenging situation. We have that channel to market. So while it's on the left-hand side of the matrix, and it looks like there's a little more risk, there's always reasons we're looking at things that are in that part of the 4 box and it's typically because we bring a lot of capability that derisks the opportunity.

Michael Joseph Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

Excellent. And then the last question I had is on the really nice margin improvement you saw in Construction Adhesives. It sounds like a lot of that was related to cost actions, but can you maybe walk through the pieces, how much was volume leverage? How much was price cost improvement -- and I guess as we look at this sort of mid-teens EBITDA margin level, is that sustainable as we look into the second half and maybe into fiscal '24?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. So remember, the Construction Adhesives business is a highly specified business. And that is a business that sustainably over time will be in that mid-teens to high teens EBITDA margin level. As we grow the business, that's what we're targeting. And what you're seeing in that particular -- in that CA turnaround is -- we made a decision back in January that we knew we had to lower the breakeven point of that business.

There's -- we recognize the building product space is more volatile than the other businesses that we're in. And in order to be able to buffer that extreme movement and demand, we decided we wanted to put in place a lower cost structure. So the team has been working on it over the course of the year, I know it looks like a quick turnaround, but they've done a tremendous amount of work, and you really have made a difference.

And then the other thing I would point out before, and I'll turn it over to John to talk about how that breaks out by savings type -- but the other thing I would point out is, for this portfolio overall and the sustainability of our margins, this is a very recession-resistant business. We are in a position that we help our customers lower their cost.

We can help them at a time like this, use lower-cost substrates or we can bring a lower cost adhesive. But all of these actions that we can take at this point in time really reinforces our pricing value while at the same time, because of general low global demand, we have a lot of volume that we can use as leverage with suppliers. So that ability to expand EBITDA margins at a time like this really fits nicely with our portfolio. And I think the team has done a nice job adding cost reductions on top of that to be able to buffer this extremely low demand that we're experiencing.

John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

Mike, and I'll just add a couple of comments on the progression of the margins in CA. So obviously, this is the most kind of seasonal of our businesses and Q1 is always the lowest because of the fact that the weather results in less activity in the first quarter. So you always do see a step-up from Q1 to Q2. Last year, it was probably up a couple of hundred basis points from Q1 to Q2, that's about normal.

This year, if you look at the volume progression, the volume progression from Q1 to Q2 this year was actually a little more than last year, which is a sign also of not only the seasonality, but the recovering markets. So some of it is certainly driven by seasonality. Maybe we're talking 300 to 400 basis points, but I'd say the majority of it is around the restructuring of the business and taking cost out.

Operator

Next, we'll go to Ghansham Panjabi with Baird.

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Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I guess going back to the -- kind of the destocking question. Looks like you and others are experiencing some level of phase destocking, right, depending on the category and so on and so forth. Celeste, as you kind of think back, which category started to get destocked first. How are the volumes trending in those categories? And are there any sort of green shoots that are starting to appear as it relates to specific quantification related to destocking versus the anecdote that you cited?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. So we started seeing this destocking first in CA. And really to, as you can see, a very extreme degree. So the Construction Adhesives business, both our roofing and flooring businesses, in particular, have taken the brunt of that, but also the construction-related businesses that we have in our EA division. Wood working, for example, lowered quickly, and then insulated glass has now followed along.

So it wasn't first within the construction trades, but later in the construction trades to feel that pinch. And we have some -- a very innovative product in 4SG that we've introduced in the insulated glass industry. So I think that kind of -- that innovation was taking share and buffering some of the destocking we saw. But even now, we are seeing that in that space. So we're seeing that progression occur. CA was first -- then I would say we started really feeling it more so in EA just this quarter.

Now in EA, we're starting to see the green shoots because China -- our China business is starting to pull out of that low volume funk that they were in, in Q1. In fact, Ghansham, if you look at China, we were down, volume was down -- it was almost flat, frankly, volume was almost flat in China and EA benefits a lot from that. So we're going to see a pull out of destocking in the EA business as well as CA, I believe, very fast. And again, we're seeing some green shoots.

HHC is a different story, right? They were the last ones to fall into this destocking mode. And I think we're going to see on into Q3 impacts of that at a pretty significant level. They also have done a nice job of being able to buffer volume with their pricing performance. They're bringing a lot of value to their customers through innovation, which is helping. And that will help sort of mitigate some of the impact to this.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Perfect. And as it relates to the volume trend line, I know each month gets choppy, there's base effect issues, et cetera. But what's your sense as to how June is tracking from a volume standpoint on a year-over-year basis relative to the 14% decline that you saw in the second quarter?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. So when we look at our volumes over the last 4 months, we were kind of P4 down 17%, P5 down 14%, P6 down 10%. So that's for the business in total. And what we're seeing in P7 is high single digits decline in volume. So it does continue to get steadily better.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. Perfect. And then just last one for me. As it relates to the consolidated volume trend line that's baked into your guidance for the back half of the year, maybe a question for John. what are you baking in as your base case upper volumes in the back half of the year? And then also, could you bridge the EPS differential between your original guidance and your vision as it relates to all the moving parts?

John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

Sure, Ghansham. So on the first question, we're projecting the volume will still be down in the second half of the year, and that's organic volume. Remember, last year, we had the extra week. So when we talk about organic volume, we exclude the impact of the extra week last year, which is

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additional drag. So even absent that, we expect volume to be down in the second half of the year, down about 6% to 7% for the full year is what we're now projecting and probably down a similar number in Q3. So Q4, we expect to get to sort of flattish to modest volume growth, and that's what our full year kind of down 3% to 5% guidance range is based on.

On the question on bridging the EPS. So two things. One is interest expense is expected to be kind of at the midpoint of our guidance, about $10 million higher than it was coming into Q2. The majority of that is driven by the acquisitions that Celeste talked about, that's probably driving $7 million or $8 million of that increase and the rest is the fact that interest rates can kind of continue to tick up. And then the other driver of the change in EPS guidance is depreciation and amortization, which is about $10 million higher than we had expected at the beginning of the year. And again, that's all acquisition-driven.

Operator

Next, we'll go to Vince Anderson with Stifel.

Vincent Alwardt Anderson - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

So Mike brought up Adhezion, but I want to kind of dig into it just a little bit more. And really just skin bonding adhesives more generally because at first glance to a layman, Cyberbond tissue seal, now Adhezion have fairly similar chemistry sets. So what to you -- does a proper medical adhesive business look like when you talk about creating a growth platform and market leadership? Is it just about having the best products available to scale through? Or are we missing something else?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Thanks, Vincent. So we're looking at this $8 billion medical adhesive space to include 4 different components. One is, as you mentioned, the wound closure market, which often deploys the cyanoacrylate and that's -- we're tackling that through Adhezion, Cyberbond and tissue seal as you referenced. There are two other very large spaces in the medical adhesives industry.

One is the medical device adhesive space. And when you think about it, that's a lot like what we do in engineered adhesives. So we feel we have a right to succeed in our product line to succeed in the medical device space as well. And then the third, the bigger category in the space is stick-to-skin. And clearly, we have the technology to pursue stick-to-skin bonding, and we are doing more of that with some of our existing customers.

So we look at that as a platform some total that we're pursuing, again, an $8 billion market with a high growth rate and a very high EBITDA margin. 20% to 30% plus EBITDA margins. And as I look at this opportunity, I really feel like this is one way we can transform this portfolio. We made a big shift in the portfolio when we added the Engineered Adhesives business, and we've grown that successfully, ICE growing in the medical adhesive space quite similarly. And again, that will be a big aid in helping us drive the overall portfolio to those high teens EBITDA margins.

Vincent Alwardt Anderson - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Okay. That's helpful. I guess then -- if I think about that more broadly, given you already play at least in a lot of these chemistry sets, but it's never quite coalesce to a major business unit for you up until now. What has been preventing kind of the broader adhesive industry from creating kind of a market leader in that. Is there something very distinctly different in the commercialization strategy that you were lacking?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

So it's a good question. The -- my belief is that as the biggest pure-play adhesive company in the world, we are one of the few that would have the scale and the capital to pursue this market. And because adhesives is what we do and only what we do, we also have the focus to pursue this.

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So I guess it's a question for others, not me, because I feel like there are certainly opportunities for us to expand here. It is largely going to be a market where we're going to have to acquire because having the certifications and the qualifications due to the regulations is very rate limiting. So growing it is -- would be -- would take a very long time. I think acquiring companies like Adhezion to enter the space are going to be the most expedient way for us to do this.

Vincent Alwardt Anderson - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Okay. That's helpful. I appreciate it. And actually, if we could stay on the topic of M&A. Celeste, I just wanted to get kind of your philosophy on setting at least the public post-synergy expectations. I mean I assume some of these portfolios have fat to trim on the product line. So I'm not sure how you balance that against commercial synergies, if you include any at all? And then maybe specifically on a consolidation acquisition, how much restructuring benefit is included in your synergy expectations relative to just kind of your normal SG&A and procurement type cost outs?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

And so for the -- so for the consolidation synergies -- sorry, can you repeat your question just real quickly, Vincent, just to make sure I got it.

Vincent Alwardt Anderson - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Yes, if you think about what you set for fiscal '25 and what you're comfortable bucketing in that from kind of day 1 and giving the market as a target? Does that include things like commercial synergies? Does that include things like larger asset restructuring? Or is that initial target really based more on the low-hanging fruit, procurement, and back office and then really there's (inaudible).

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

So the target, as we define it, is what we can -- the synergies we can drive in a 3-year period. So for the 2023 collection, for example, I'll just give you some examples, our -- when you look at the 2023 collection and exclude Adhezion, because it is a very different kind of a deal, but let's just look at the other 4 acquisitions. We are acquiring those for a pre-synergy multiple of around 9x and the post-synergy multiple of around 3x. So in getting from 9x to 3x, there are raw material synergies, there are facilities synergies. Again, we have facilities over the world.

Oftentimes, especially with larger acquisitions, there'll be facility consolidation or capacity rationalization. As far as the back office goes, yes, you're right. In fact, we don't have a back office in every country of the world. We have shared services centers, which make it very easy for us to move back-office work from companies we acquire into our existing workload. And of course, the raw material synergies definitely dominate this.

When you look at these consolidation acquisitions, if you look at just like XCHEM and Beardow, the SKU overlap that we had between those companies was on the order of about 50% of the SKUs they bought. And when you take it a step further, what you find is that we are -- we look at our price paid on those SKUs compared to theirs. And in every case where we brought more volume, we had a lower price which we then get the opportunity to leverage to the acquired companies spend.

And there were 2 or 3 cases where the acquired company bought more of something. And again, it works the other way around. We're able to leverage their cost to our SKU base. So really, the synergies come most heavily from raw material spend and then, I would say, facilities we can take out within 3 years as well as, of course, back office.

John, do you want to elaborate?

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John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

Yes. So yes, and you kind of parse that apart. If you think about that getting to the $50 million by 2025, most of that comes from the synergies, some of it's organic growth. But the synergies that we're projecting, Vincent, about 80% of them are cost synergies. So exactly what Celeste explained and maybe 20% are commercial synergies.

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. In fact, if you look at the 2023 collection, the commercial synergies were largely just associated with Adhezion was de minimis other than that. So we are trying not to bake in revenue synergies unless we really, really know it's a true synergy. We don't include the growth rate, which is the synergy. And Adhezion is a great example, right, because we were able to bring the channel to market which is what enabled the company to grow -- will enable the business to grow quickly.

Operator

Next, we'll go to Jeffrey Zekauskas with JPMorgan.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

In the quarter, sequentially, did prices go up meaningfully in any area or did prices go down meaningfully in any area?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

So if you look at Q2 versus Q1, Jeff, we saw more carryover price as a percent of the total pricing value in this quarter versus last quarter. They haven't gone meaningfully down in any area. Certainly, it is -- there is more price competition in the market now as volumes are declining. But again, our customers aren't going to save a lot of money by getting price reductions on glue. They save more money when they use us to enable them to use lower-cost substrates or to change their line speeds or something that has much more impact.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Where is there a little bit of price competition -- in what subsector?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

So you see the price competition in, for example, the solar market in China. In fact, we've seen more in China, more price competition than in other parts -- and I would say in the -- kind of in the underlying packaging part of the business, there have been -- there's business we've walked away from. In fact, because of that. And in fact, if you look at sort of this overall -- if you look at our 14% decline, you sort of try to parse it out between market share, destocking and underlying demand. And it relates to market share, we have a very sophisticated model that helps us use predictive analytics on customers' orders to determine what kind of business we've lost or how many customers we've lost and which ones. And our estimate is that we've probably walked away from about 1% market share that had pricing that we were not willing to meet.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Okay. Good. In terms of your nonrecurring charges, I think last year, maybe your nonrecurring charges are about $40 million after tax. And I think this year, maybe they're running $20 million for the first half. Order of magnitude are the nonrecurring charges going to be about level with last year?

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John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

I think the answer is yes, Jeff. I mean the restructuring charges are -- have been largely recorded at least the ones we know so far in Q2. I'm trying to think about the kind of noncash one-off items that hit last year in the second half. I don't think there were much. So I think that's a pretty good estimate that they'll be pretty level because there will be some continuing restructuring charges in the second half.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

And then in terms of your cash flow, do you expect your accounts payable by the end of the year to be flat with what they were last year, roughly? And can you talk about what's going on in deferred taxes and why there is a use of cash of I think about $16 million for the first half in deferred tax.

John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

Yes. So I'd say on accounts payable, yes, I would think that it would be flat to up slightly. We are working on a project to look at vendor terms, and we would expect that to bear some fruit in the second half of the year. So the cash flow for this quarter was obviously driven by improvements in working capital, and we would expect those to continue and actually be a little bit bigger in the second half of the year.

On taxes, the overall, I'd say taxes are kind of a drag on cash flow in a relatively modest way. Just primarily related to settling old tax audits. So I think if you look at the tax payable line and the deferred tax line, it's a negative, negative $10 million roughly, and that's more or less in line with old tax audits that we've settled in the last 6 months.

Operator

Next, we'll go to David Begleiter with Deutsche Bank.

Yifei Huang - *Deutsche Bank AG, Research Division - Research Associate*

This is David Huang here for Dave. I guess, first on the $130 million to $160 million price cost tailwind and then the $80 million headwind. How much of those have been realized or occurred in first half? And how should we think about the split between Q3 and Q4 on those three numbers?

John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

Yes. So I'll -- at a high level, I think if you look at the impact of pricing in the first 2 quarters, it was roughly $130 million, right? So just pricing alone is at the bottom end of that range. But on a year-on-year basis, raw material costs were up year-on-year, more so in Q1 than Q2. So I couldn't give you an exact number, but we haven't realized $130 million, but we've realized probably closer to $80 million to $100 million.

And -- in the second half of the year, that raw material benefit will accelerate, but pricing will become less of a benefit. So I would say we're definitely kind of realizing half of it, maybe a little bit more. And that's kind of what I would think given the way this year is going to play out, given that the pricing carryover will be much more of a benefit in the first half, much less in the second half and then vice versa for raw materials.

Yifei Huang - *Deutsche Bank AG, Research Division - Research Associate*

Okay. And then I guess back to the guidance, is it fair to say that it's more realistic that you would achieve the lower half of the range. If not, I guess, what could still drive the higher end of that guidance range for the year.

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Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. If you look at the higher end of the range, it's certainly bolstered by the acquisitions we've done. Also a more dramatic upturn in volume would push us more so towards the higher end of the range. The lower end of the range, we preserved with cost restructuring, and we're going to continue to drive restructuring actions throughout the business.

Yifei Huang - *Deutsche Bank AG, Research Division - Research Associate*

Maybe lastly, I think you noted some improvement in China. Can you talk about that? Where are you seeing that improvement? And I guess in your guidance, what type of volume growth are you embedding in your guidance on the lower half on China?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

So I'll talk a little bit about China, and then John, maybe you can speak to the guidance there. So I actually just returned from China, I was there in May. And while I was there in May, in front page of the China Daily, the government essentially was announcing that they are going to be incentivizing more domestic spending. So I believe we are benefiting from that, particularly because our volumes have lift near neutral. So that's one source of improvement that we're seeing there.

The other area is in the electronics business interestingly enough. So actually, the -- some of the larger electronics producers in China are anticipating their volumes to be down 50% versus 2021. And some of the multinationals would cite numbers more like down 20%, but we are doing well. And it is because we have been able to innovate and take share in that electronics space. And there's some favorable trends happening in electronics for adhesives versus, for example, tapes.

A tape is not something that can be applied as quickly as an adhesive in, say, a touch panel screen. That's where liquid adhesives are really much more beneficial. And even as you see phones and other electronic devices get thinner, it's more difficult to use the traditional taping method to construct those and adhesive is just a much better material to create a bond in a situation like that. So I think we're doing well in electronics to your question in China, just through innovative share take more so than actual underlying volume in that space.

John J. Corkrean - *H.B. Fuller Company - Executive VP & CFO*

And just on the progression in terms of volume development. So first quarter, China was down -- volume was down nearly 10%. It was down a couple of percent in Q2. I think the last reference is earlier. We think that volume will be up in the second half of the year, but not up dramatically. I think we will have easier comparisons when you think about timing of the lockdowns in China last year. So we're optimistic that we'll see growth but not robust. If there is significant investment in China in terms of government investments to stimulate the economy, that could be an upside.

Operator

Next, we'll go to Rosemarie Morbelli with Gabelli Funds.

Rosemarie Jeanne Morbelli - *G.research, LLC - Former Research Analyst*

Good morning, everyone. You have given us a lot of information, Celeste, and I really appreciate it. I was wondering if you could talk about the competition -- the existing competition in the medical adhesives space. I presume that you are not the only one. We have all used those bandages, sticky bandages. So who else is in that space? And how are you going to compete as a small entrant?

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Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. So in the -- let's start with the kind of wound closure market. J&J is really the biggest participant in that part of the space with their Dermabond product. But other than that, it's -- Adhezion was really I think, second or third largest in that industry. So they already had a strong position, and that's not a very large market, in particular in medical adhesives, but we do feel the technology is applicable to other places.

In the medical device space, again, you see a lot of fragmentation, a lot of really actually midsized companies are participating in that space. And then stick to skin -- of course, there are a number of large players that can compete in that market. But we have tremendous technology as it relates to PSAs that is relevant to skin bonding, and we'll have the ability to have a strong position there. We already told for some companies in that space today.

Rosemarie Jeanne Morbelli - *G.research, LLC - Former Research Analyst*

Celeste, if you look at that $8 billion space, and you talked about the 3 major categories, can you split that $8 billion between those 3?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. So the biggest part -- yes, the biggest part of the $8 billion is, let's call it, $7 billion of the $8 billion is split between medical devices and stick to skin. And then the remainder is wound closure. However, the wound closure market, while it's smaller, is really growing fast. I think there's been some recognition that there is a technological advantage to bonding wounds closed rather than using sutures, for example. And there's a lot of reasons from an infection prevention perspective to use adhesive rather than sutures as well. So wound closure is smaller, but it is really growing rapidly that's, I'll call it, about a $1 billion market as well.

Rosemarie Jeanne Morbelli - *G.research, LLC - Former Research Analyst*

That is very helpful. Then you mentioned in your prepared remarks, product substitution. So usually, in this kind of an environment, companies will substitute to something cheaper -- and I was wondering if you could give us a better feel for what you are substituting or your customers are substituting and their impact on your operations?

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Yes. When we talk about product substitution, what we really should be saying is lower cost formulations of the same product. It's really substituting our raw materials, one for another. So when we formulate our adhesives, there's multiple inputs that go into the -- into a finished adhesive. And oftentimes, especially once we get to know our customers better and we understand their line speeds in depth and just see -- they change substrates, see what kind of substrates they're working with.

Oftentimes, we'll be able to offer either a lower cost adhesive, lower cost to the customer, but the margin preserving for us or we'll be able to switch out a raw material within adhesive that makes the overall formulation less expensive and both the customer gets the cost savings and we preserve our margin. And that's one of the things we do.

And again, However, in a time like this, where we add even greater value for our customers is by being able to help them switch out their substrates that usually requires a different type of an adhesive and adhesive that's formulated specifically to those substrates and their line conditions. And by being able to change a substrate a customer or run a line faster, a customer will save a lot more money than just saving pennies on qualifying a new adhesive formulation that we can provide.

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Operator

And we've reached our allotted time. At this time, I'll turn the call back over to Celeste Mastin for any additional or closing remarks.

Celeste Beeks Mastin - *H.B. Fuller Company - President, CEO & Director*

Thanks, everyone, for your participation today. We're proud of our second quarter results. I think what you saw was great execution, coupled with an effective business model, allowing us to drive a 3% EBITDA improvement despite 14% volume decline and we're going to deliver more of that. So thanks very much.

Operator

And this concludes today's conference call. You may now disconnect.

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