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EDITED TRANSCRIPT

FUL.N - Q2 2025 H.B. Fuller Company Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. My name is Christa, and I will be your conference operator today. At this time, I would like to welcome everyone to the H.B. Fuller second quarter 2025 investor conference call. (Operator Instructions)

And I would now like to turn the conference over to Steven Brazones, Vice President of Investor Relations.

You may begin.

Steven Brazones - *H.B. Fuller Company - Vice President of Investor Relations*

Thank you, operator. Welcome to H.B. Fuller's second quarter 2025 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 would now like to turn the call over to Celeste Mastin.

Celeste?

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Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Thank you, Stephen, and welcome, everyone. Our strong financial performance in the quarter is a testament to our team's disciplined execution in a highly dynamic environment. and we are performing better than the underlying markets. We remain nimble and focused on delivering positive organic revenue growth while managing costs in a deliberate manner and leveraging our global sourcing infrastructure to adeptly respond to geopolitical and market uncertainties.

Our EBITDA margin expansion highlights the success of the actions we are taking, which include an increased focus on pricing cost savings efforts and our active portfolio shift towards higher growth, higher margin markets.

While global economic activity remains subdued, we continue to perform well and are raising our full year outlook to reflect our strong execution. Looking at our consolidated results in the second quarter, our organic sales trend remained positive, driven by organic pricing growth of 0.7% during the quarter, partially offset by slightly negative volume. From a profitability perspective, we executed well and delivered strong results, driven in part by cost savings and targeted price actions.

Our ongoing portfolio transformation, including the strategic addition of higher-margin businesses and divestiture of the lower-margin flooring business drove most of the year-on-year margin increase in the quarter. We grew EBITDA 5% year-on-year to $166 million and expanded EBITDA margin by 130 basis points year-on-year to 18.4%.

Now let me move on to review the performance in each of our segments in the second quarter. In HHC, organic revenue increased 1.8% year-on-year driven by both positive volume and price. Strength in medical and flexible packaging was partially offset by weakness in end-of-line packaging and beverage labelling.

EBITDA margin of 15.6% was up nearly 300 basis points versus the first quarter, reflecting seasonally higher volume and increasing pricing momentum in the segment. EBITDA margin was down year-on-year in the second quarter as the favorable impact of organic growth and the contribution from the higher-margin medical acquisitions were offset by higher raw material costs.

In Engineering Adhesives, organic revenue decreased 0.4% in the second quarter, widespread strength in transportation-related end markets, particularly in automotive, was offset by continued weakness in solar. Excluding solar, EA organic growth was positive in the second quarter. EBITDA increased 24% in EA and EBITDA margin increased 310 basis points year-on-year to 22.9%. Favorable net pricing and raw material actions, cost savings and the contribution from acquisitions drove the increase in EBITDA margin.

In Building Adhesive Solutions, organic sales decreased 0.9% year-on-year as continued strength in roofing was offset by weakness in glass and wood, which are more closely tied to the residential construction market environment.

EBITDA for Building Adhesive Solutions increased 5% versus the second quarter of last year and EBITDA margin expanded 60 basis points to 16.7%. Favorable net pricing and raw material actions and cost savings drove the improvement in EBITDA margin year-on-year.

Geographically, Americas organic revenue was up 2% year-on-year in the second quarter, returning to positive organic growth. strength in roofing, flexible packaging and medical principally drove the sales growth in the region. In EIMEA, year-over-year organic revenue was down 2% and strong performance in our hygiene business was offset by weak demand in our construction-related end markets.

In Asia Pacific, organic revenue was up slightly year-on-year as strong performance in transportation-related markets was offset by slower results in solar and electronics. Looking ahead, we expect a continued challenging operating environment characterized by a high level of uncertainty and constrained demand. Also, while the dollar has recently weakened we expect currencies to remain unpredictable. As previously discussed, our strategy to produce in the same region where we sell to customers, not only results in optimal customer service but also reduces our exposure to tariffs. To the extent we have direct tariff exposure, we will continue to offset these impacts through sourcing mitigation and targeted pricing actions.

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In the event of share shifts between customers, the diversification of our customer base and our geographic footprint puts us in an advantaged position while the global economic impact of the uncertainty associated with the dynamic tariff situation is yet to be fully understood, our assumption is that volumes will be constrained for the remainder of the year.

As a result, our guidance reflects slightly weaker volume in the back half of the year. However, our pricing actions and raw material purchasing leverage will result in continued margin expansion and profit growth will accelerate in the second half.

Now let me turn the call over to John Corkrean to review our second quarter results in more detail and our updated outlook for 2025.

John Corkrean - *H.B. Fuller Company - Executive Vice President, Chief Financial Officer*

Thank you, Celeste.

I'll begin with some additional financial details on the second quarter. For the quarter, revenue was down 2.1% versus the same period last year. Adjusting for the flooring divestiture, net revenue was up 2.8% year-on-year. Currency had a negative impact of 1.2% and the net impact of acquisitions and divestitures decreased revenue by 1.3%.

Adjusting for those items, organic revenue was up 0.4% with pricing up 0.7% and volume down 0.3% year-on-year. Adjusted gross profit margin was 32.2%, up 110 basis points versus last year, driven by cost savings, the impact of acquisitions and divestitures and targeted pricing actions. Adjusted selling, general and administrative expense was up 2% year-on-year.

Adjusting for the net impact of acquisitions and divestitures, adjusted SG&A was flat year-on-year, reflecting strong expense management. Adjusted EBITDA for the quarter of $166 million was up 5% year-on-year, driven principally by targeted pricing actions, cost savings efforts and the net benefit from acquisitions and divestitures.

Adjusted earnings per share of $1.18 in was up 5% versus the second quarter of 2024 due to higher net income and lower shares outstanding. Second quarter operating cash flow of $111 million increased $29 million or 36% year-on-year.

Cash flow from operations was also up versus the first quarter, reflecting higher net income and a slight improvement in working capital. Net debt to adjusted EBITDA decreased sequentially from 3.5x to 3.4x at the end of the second quarter, reflecting growth in EBITDA as well as lower debt balances as a result of improved cash flow. We expect to continue to further reduce our leverage ratio in the second half.

During the second quarter, we repurchased 300,000 shares, bringing the year-to-date total to approximately 1 million shares. With that, let me now turn to our updated guidance for the 2025 fiscal year. As a result of our strong financial performance and the assumptions that Celeste laid out earlier, we are updating our previously communicated guidance for fiscal 2025 as follows: Net revenue is now expected to be down 2% to 3% year-on-year.

We still expect organic revenue to be flat to up 2% year-on-year and we now expect foreign exchange to adversely impact revenue by between 1% and 1.5% year-on-year. Adjusted EBITDA is now expected to be in the range of $615 million to $630 million, equating to growth of 4% to 6% year-on-year.

We now expect fully diluted shares outstanding for fiscal 2025 to be in the range of 55 million to 56 million shares. Combined, these assumptions now result in full year adjusted EPS in the range of $4.10 to $4.30, equating to year-on-year growth of between 7% and 12%. We continue to expect full year operating cash flow to be between $300 million and $325 million. Finally, we would expect third quarter EBITDA in the range of $165 million to $175 million.

Now let me turn the call back over to Celeste.

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Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Thank you, John. At H.B. Fuller, innovation isn't just about new products. It's about solving real-world challenges alongside our customers. We are privileged to work with a diverse and innovative group of customers.

And today, I am excited to highlight the winners of our second annual H.B. Fuller Customer Innovation Awards, which on our groundbreaking innovations that leverage adhesive technologies to improve the world around us.

CMC packaging automation was recognized for its revolutionary automated packaging technology, which creates right-sized packages on demand significantly reducing waste and inefficiencies driven by the rise of e-commerce. [Du] Xinyu was recognized for advancements in automotive lighting that improve visibility and road safety through better heat management ensuring long-lasting and efficient lighting systems. MITER Brands received an award for creating a triple pained glass insulating unit in collaboration with Corning Inc., that enhances thermal efficiency and reduces energy consumption while using the same frame dimensions as dual pain systems.

Georgia-Pacific was honored for its innovative use of water-based barrier coatings for protein-based packaging, which offer a sustainable alternative to traditional wax-based coatings. Congratulations again to these innovative companies. We are proud to celebrate your achievements and look forward to continuing our journey of innovation together.

At H.B. Fuller, sustainability is more than a commitment. It's a catalyst for innovation, operational excellence and positive impact. We're proud to share the progress we're making toward a more sustainable future and encourage you to learn more by checking out our newly released sustainability report, which launched on our website earlier this week. We're also thrilled to announce that Newsweek recently named H.B. Fuller as one of the world's greenest companies in 2025.

We appreciate this honor, which recognizes superior environmental sustainability performance. Finally, I would like to announce that Steven Brazones, our Vice President, Investor Relations has announced his intention to retire from H.B. Fuller this summer. Stephen has dedicated his deep finance background breadth of experience and strong reputation to enhancing and improving H.B. Fuller's Investor Relations approach.

We will miss Stephen's energy, professionalism and sense of humor, but he departs knowing that his work has helped make H.B. Fuller's IR program much stronger. To wrap up, we are pleased with our strong first half performance and the momentum we carry into the second half of the year. This is a reflection of the operational improvements we've made and continue to make throughout our business. Despite ongoing economic uncertainties, as we look forward to the second half of the year, we are optimistic and encouraged by our team's strong execution.

We continue to make sustained progress towards our 20% plus EBITDA margin target and are confident that we will meaningfully expand margins year-on-year again in 2025. As a reminder, we look forward to seeing you at our Investor Day on October 20, where we will provide an update on our strategic plan, including our successful M&A strategy transformational footprint optimization and road map to our greater than 20% EBITDA margin goal. That concludes our prepared remarks for today.

Operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions)

Ghansham Panjabi, Baird.

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Ghansham Panjabi - *Robert W. Baird & Co - Analyst*

Yeah, good morning. Thank you, operator. Good morning, everybody.

I guess, first off, big congrats on Steve on his retirement. Obviously, you'll be missed by our team. And congrats to Scott as well. I look forward to working with you. I guess -- so it's going back to the second quarter and the margin performance in EA, which seemed to be the outlier on the plus side, very strong margin performance.

Can you just give us a bit more color on that in context of some of the end markets being mixed and also solar being down, as you noted in your prepared comments.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Absolutely. So if you look at EA's performance in the second quarter, the really outstanding contribution there that was made was twofold. One was the N.D. Industries acquisition performed better than we anticipated. So we like to see that outperformance to the deal model. And secondly, that team, in addition to others across H.B. Fuller, but in particular, EA really showed very strong cost control. That led to the increased expansion in margins.

Now of course, we're seeing strength across that business in a number of their end markets if you look at the automotive business, actually anything transportation, particularly in Asia Pacific. Our team there has just done a fantastic job expanding our business from what has historically been more focused on interior trim to exterior trim applications to the powertrain to various other sealing applications and thermal management in not just batteries, but braking systems. And they've done an excellent job growing share.

Ghansham Panjabi - *Robert W. Baird & Co - Analyst*

Okay. And then for my follow-up, as you think about value velocity across your different business units, how did fiscal 2Q compared to the previous couple of quarters? And then just related to that, in terms of solar, what is the reasonable time line for Chinese solar to inflect positively year-over-year in context of comps coming up?

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. So we'll start to see less of an impact from the solar space toward the end of this year. And when I say that I'm referring to the top line, the team has already taken steps to reposition that business and to mitigate the EBITDA margin impact of that particular business on their results. So if you look at the impact of the solar space, Q2 of last year on margins in EA. It was about 120 basis points.

This quarter, they reduced that to a negative 80 basis point improvement or a negative 80 basis points. So they've improved margins, and they continue to work on doing that by shifting the business into more differentiated applications and spaces. As far as volume velocity across the business, are you asking about across EA in particular, Ghansham across all the end users and applications.

Ghansham Panjabi - *Robert W. Baird & Co - Analyst*

Yeah, sorry to clarify across the portfolio to the whole company.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Across the portfolio Yeah. So John, do you want to jump in on this one?

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John Corkrean - *H.B. Fuller Company - Executive Vice President, Chief Financial Officer*

Sure. So if you look at a total company level, the volume trends are pretty similar. We were up about 2% and on organic volume in Q1, it was flat in Q2. I would say we saw some positive momentum in places like automotive, which is actually was very strong in Q1, but had a slightly stronger flexible packaging actually probably saw a little bit of acceleration in medical.

I would say those are the places, Seeing a little bit of slowing as we highlighted in some of the construction-related markets, particularly those that have a bigger exposure to residential.

But overall -- and we -- one of the things we do is we measure how many of our end markets are showing acceleration how many are showing deceleration. About half were showing acceleration half we're showing some level of deceleration.

So it's a little bit softer volume in Q2. I think it's predominantly related to some of the residential construction softness. Most of the rest of the portfolio was pretty similar in terms of volume from Q1 to Q2.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. The one other area I would add there, Ghansham, is that in China, we also saw a temporary -- I'll call it a -- what I think is a temporary pause in export markets in China in Q2, our electronics business, for example, is one that has done well and has continued to take share.

We really saw that cool off given the underlying market for electronics exports in China in Q2, but we are -- we feel very strongly about that business and its ability to overcome that in the second half of the year because they have taken share and they have become parts of new products being developed and introduced in the second half that we'll see volume from upcoming.

Ghansham Panjabi - *Robert W. Baird & Co - Analyst*

Thank you both.

Operator

Patrick Cunningham, Citi.

Patrick Cunningham - *Citi Investment Research - Analyst*

Hi, good morning, and I'd like to echo congratulations for Stephen. It's been a pleasure working with him and looking forward to continuing the partnership with Scott. But I guess, first of all, I mean, maybe just digging into that weakness in electronics a bit more. It seems to be a deviation from prior quarters, and I think you hinted at some export weakness and trade uncertainty. But I mean what are you seeing in terms of just underlying market?

What gives you confidence that this is sort of normalizes back to your sort of consistent growth rate there because I just look surprising just in terms of that's been one of the strongest categories, but you obviously still had quite a strong quarter with an Engineering Adhesives. So just any additional commentary would be helpful.

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Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. We had a very good quarter in electronics in the US took some exciting new business there. We had wins in aerospace and defense, in particular, in radar assembly in pressure sensors and tires, in fighter jet fiber optic communications, really good growth in our US electronics market.

And we've taken good positions in growing end markets like electronics for medical devices for example, glucose monitoring systems as well as automotive electronics because there's a lot more electronics in an automobile today.

So those are good examples of ways that we've expanded our electronics business into faster-growing electronics applications and also taking share in those new applications. And as I highlighted, Yes, we saw a pause in electronics in Asia Pacific this quarter, which is unusual.

However, what we recognize is that that underlying export market for electronics was weaker in Q2 coming out of China. But again, we've taken some new business with some of the new designs being introduced in the second half with multinationals there, in particular, that we'll see the benefit from upcoming in the remainder of the year.

So I feel that we're in a good position in the electronics business. It was just notable that it was slower this quarter than it has been in previous quarters. And we are very pleased that our EA business was able to deliver on so many other segments and overcome that challenge.

Patrick Cunningham - *Citi Investment Research - Analyst*

Very helpful. And then how should we think about the progression of price cost and margin profile, specifically for HHC given what appears to be you're getting strong price there, you've got some high-margin acquisitions starting to have an impact. I guess if the underlying volume environment stays relatively stable should we start to see more significant year-on-year margin expansion within that segment?

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. In fact, Patrick, the -- what I highlighted during the last call, and we included in the script is just recall this reference to $55 million, call it, spread benefit in 2025 that you will see. So that's benefits from raw material cost reductions and from pricing.

So today, through Q2, raw material cost was higher than it was the previous year. But the benefits that we've highlighted you're going to see really back-end loaded here in the remainder of this year.

A lot of that will happen in the HHC business. And the HHC business is performing very well. we've seen this medical adhesive business growing successfully there. That's contributing to a stronger margin profile. Also in flexible packaging, we've taken a significant amount of share basically with our ability to develop and enable our customers a solution that solves global regulatory compliance challenges and that really simplifies their product profile given the supply chain challenges that are happening at this point in time.

But even more interesting to me is the HHC's team's ability to really address some of these what you would think would be slower-growing legacy markets, tissue towel is a great example, we'll call it, the premiumization of toilet paper and paper towels is happening as multiple plies are being used, that increases the amount of adhesive required and actually oftentimes even requires a higher performing, more differentiated adhesive to meet the challenge.

So there's a lot going on in that space, and the team is executing well, growing margins and bringing new product ranges, new product lines out to solve new problems in the space.

Patrick Cunningham - *Citi Investment Research - Analyst*

Very helpful. Thank you.

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Operator

Kevin McCarthy, Vertical Research Partners.

Kevin McCarthy - *Vertical Research Partners - Analyst*

Thank you very much. Good morning, Celeste and Stephen, I'll add my congratulations on your retirement. You will definitely be missed. And Scott look forward to talking with you even more frequently. I wanted to ask Celeste about your view of the quarterly cadence of EPS that's embedded in your new range of $4.10 to $4.30.

If I look back at history, it seems that it's often the case your November quarter is stronger than the fiscal third quarter, but that was not the case last year.

So maybe you can kind of talk through how you're thinking about the flow-through given the comparisons that you had last year?

John Corkrean - *H.B. Fuller Company - Executive Vice President, Chief Financial Officer*

Hey, Kevin, it's John. I'll try to field this one. So I think this year will look more like kind of a normal H.B. Fuller year in terms of the cadence of the quarters. So you're correct.

Last year, I would say it was an anomaly. We had a number of headwinds in the fourth quarter, which resulted in lower EBITDA, lower EPS. And I think we view this year as being more similar to maybe if you went back two years to 2023, where you'll see a modest step-up in EBITDA and EPS in Q3.

We gave the guidance on where we think that range should be and then likely a further step up. So that's mostly a reflection of volume being a little bit higher in Q4 than Q3, but we also expect this pricing and raw material momentum to show up a little bit bigger in Q4 than Q3.

Kevin McCarthy - *Vertical Research Partners - Analyst*

I see. Very helpful.

And then, John, just wondering if you could comment or elaborate on your view of the capital expenditure trajectory, you're kind enough to give us a pretty full cash flow statement with the release. As I look at the first half, I guess you spent maybe $65 million versus $90 million in the first half of last year. So that's running down quite a bit.

What are your thoughts on the back half and the full year. And then I guess related to that, my recollection is, if we look ahead to '26 and beyond at some point, maybe you have a step down related to your SAP project. So perhaps an update on that aspect of it would be helpful.

John Corkrean - *H.B. Fuller Company - Executive Vice President, Chief Financial Officer*

Yeah. So yeah, I would say we're a little bit behind in terms of capital spending year-to-date versus our budget. I would expect we'll close that gap back half of the year. We guided to $150 million of CapEx for the full year. I think we'll get there.

I think there's a little bit of risk. There are some large chunky projects that will happen in the back half of the year. Looking forward, we talked about the fact that with this footprint consolidation, we're going to have about $50 million, $40 million, I guess, is the number of incremental CapEx this year, probably a similar number next year. But you are right, we will start to come to the end of our SAP deployment at the end of next year. We probably have about $20 million of capital associated with that project on an annual basis.

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So it doesn't mean there won't be any capital, but that will step down significantly. And we also expect, as we go from roughly 80 manufacturing facilities down to 55 that will reduce maintenance capital. So we don't really have a new updated assumption for, let's say, beyond 2026. But I would say that we would hope to see that step down a little bit as we go forward.

Kevin McCarthy - *Vertical Research Partners - Analyst*

Perfect, thank you so much.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Thanks, Kevin.

Operator

Jeff Zekauskas, JP Morgan.

Jeff Zekauskas - *JP Morgan - Analyst*

Hi, good morning. Maybe for some housekeeping question. Your acquisition project cost were $3.6 million in the quarter, but I don't think that you bought anything. So why the $3.6 million in spending? And does that drop off in the second half? And what was your pension income in the quarter?

John Corkrean - *H.B. Fuller Company - Executive Vice President, Chief Financial Officer*

So, yeah, so the acquisition costs in the second quarter, primarily related to some lingering costs associated with the flooring divestiture. So I would anticipate that those will tail off in the second half of the year. We do have some ongoing deal evaluation-related costs that will continue through the year, but I think we should see a little bit of a step down. Pension income in the quarter was about $5.7 million, and that compares to about $4 million last year in Q2.

Jeff Zekauskas - *JP Morgan - Analyst*

And then is it the case that your raw materials are sequentially declining? And as far as demand goes, you cited some slowness in domestic home construction. Is it fair to say that outside of that business is pretty steady across the geographies?

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. If you're referencing the US in particular, Jeff, true, we are seeing a decline in some volumes as a consequence of lower residential activity. Now only less than 6% of H.B. Fuller's revenue comes from residential construction.

So we're not going to see that that's not going to cause a very big swing. In the US, in particular, our construction business overall remained good with roofing in particular, strong this quarter. And Yeah, I mean, if you look at pricing in all of our GBUs in the US we performed better in the second quarter. EA and HHC both showed better volume growth in the US in the second quarter, albeit not great volume growth. it was pretty stable and demand is pretty consistent there.

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You asked about raw materials, raw materials do continue to decline. As I mentioned, they're still up year-on-year. But we've taken some actions to reallocate raw materials to different suppliers in Q1 that will have an impact on our overall raw material cost throughout the course of the second half.

Jeff Zekauskas - *JP Morgan - Analyst*

Okay, great. Thank you so much.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

You bet.

Operator

(Operator Instructions)

Michael Harrison, Seaport Global Securities.

Michael Harrison - *Seaport Global Securities - Analyst*

Hi, good morning. Thanks for taking my question. I want to say my congrats to Scott and best wishes to Stephen on your retirement. It has been really nice work with you over the years. Wanted -- Celesta, I wanted to see if you could talk at all about overall volume trends as you looked from kind of March, April, May and then into June so far. And I'm kind of curious, when exactly did the pause in China exports happen? Like was there a specific month when you saw that?

And have you seen recovering here in June?

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. So if you look throughout month by month throughout the second quarter, overall, what we experienced was really just slightly negative to flat volume throughout. There was not a big differentiation between -- from one month to the next.

Now the only caveat I would make there is that in our BAS business, we did see more weakening in volume performance in P6, so in May than in the previous two months. And again, as we look out to the second half, our guidance includes an impact of a slower construction market as a consequence.

As it relates to China, in particular, I can't point to a particular month. I don't have that level of precision to really do that. But what I would say is that later in the quarter, we experienced more of this pause in the electronics market.

I think you'll see that extend for a couple more months before the actual improvement in volumes in Electronics in Asia, picks up because of the new designs that we have that we've become a part of. So again, temporary kind of, call it, later second quarter and probably will continue a month or two more.

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Michael Harrison - *Seaport Global Securities - Analyst*

All right. That's very helpful. And then I wanted to dig in a little bit on some of your comments on packaging within the HHC business, I was on a plane yesterday and someone sitting near me with eating crackers out of a what was a flexible package that would, I think, would have traditionally been a cardboard box.

And so I'm curious if some of the end-of-line weakness that you're seeing and the strength in Flex Pack is maybe some shift away from traditional cardboard packaging and growth in a Flex Pack that might have like a resealable opening on it. Is that happening?

And is that -- how is that benefiting your business?

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. So that's a viable hypothesis, Mike. Flex Pack in particular, is growing in some of the more developing nations in the world faster like Latin America, India, parts of Asia but still growing. Is it growing faster than typical cardboard and aligned packaging? Yeah, it is.

That said, the strong outperformance that we've had in the Flex Pack market has really been more a function of share gains than the market growth -- there's not a lot of differential in these like European or US markets over the last two or three years in flexible packaging growth rates.

So I believe it is more so the solutions we're bringing to customers and the shifting that's happening around regulations, the increasing demands on customers due to supply chain disruption and our ability to provide simpler solutions that have broader applicability that that's really driving our growth rate there.

Michael Harrison - *Seaport Global Securities - Analyst*

In terms of the adhesive that's used in a Flex Pack though, that is a more differentiated and I guess, more qualified, higher end adhesive than what you use in a cardboard package. Is that correct?

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. It's definitely a more demanding application. That's absolutely correct.

Michael Harrison - *Seaport Global Securities - Analyst*

All right. Thank you very much.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Thanks a lot, Mike.

Operator

Rosemarie Morbelli, Gabelli.

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Rosemarie Morbelli - *Gabelli & Company, Inc - Analyst*

Good morning. Thank you, everyone, and best of luck to Stephen on his next chapter. You will be thoroughly missed. And Scott, you will be very capable, but you have big shoes to fill. I look forward to talking with you going forward. Now most of my questions have been answered, but I was wondering, Celeste, even though you talked about the difficulty of estimating the impact from tariffs, if we assume, which, of course, is anybody's guess that the level is going to be whatever has been announced to date.

What would be the impact on the direct and indirect impact and which categories would be more affected than others.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Yeah. So recall, Rosemarie, that on average, 97% of what we sell in a region, we may can source there. In the United States, that's 99%. And in China, that's 96%. So from a direct tariff impact, there's a limited effect that we, by default, will feel.

Now there are actions that the team has taken. I don't want to minimize this because they're doing great work, throughout April meeting twice a day to ensure that as they understand the tariff implication at present that they're able to offset the direct impact of that through either sourcing solutions, maybe reallocating product to a different supplier or renegotiating with current supplier or putting through targeted pricing actions to offset. So from a direct impact, we won't see an impact because of the work that's being done by dedicated people across H.B. Fuller.

From an indirect perspective, we addressed in the script this concept of share shifting, I think we're going to see that. We're going to see some business shifting between customers in any given region. We're well positioned to manage that as well. As you know, we have a global footprint. So if product needs are shifting from one region to another.

The likelihood is that we'll be working with a customer in a different region that picks up the business or if there's a shift within a region, again, it's highly likely given the thousands and thousands of customers that we work with that we will be able to pick up the business from another angle through another customer.

The biggest question, I think, Rosemarie, and it's what we all have as businesses is what will be the ultimate volume impact of tariffs globally once there is some certainty around a tariff program. And that's hard to know.

So the way we look at that is we need to be prepared for potentially lower volumes given potentially more constrained economies. And you saw the impact in this quarter of the cost reduction efforts we've taken in advance of that to try to get ahead of it.

And again, the work that we have started already to drive cost reduction efforts throughout our raw material base will also be more evident and something we'll use to mitigate lower volumes in the second half should they come to pass.

Rosemarie Morbelli - *Gabelli & Company, Inc - Analyst*

Thanks. That is very helpful. And I was -- you mentioned something in your prepared remarks, Celeste, regarding your work with different categories I had not focused on, which would be the defense area. You mentioned adhesives for radars and so on.

Could you give us a better feel for how big that business is. And obviously, we are in a world where there is going to be a need for more defense.

So what could we see from your end?

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Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Well, Rosemarie, that this business of ours is so diversified that there's no single market segment region combination that represents more than 5% of sales. And so Aerospace is another good example of a differentiated, fast-growing, high-margin space within our overall network.

It is growing quickly, and we anticipate that will still -- that will continue to be the case. Will it have an outsized material impact ultimately on H.B. Fuller, maybe in a decade.

But in the near term, that growth is well fast still on a smaller base.

Rosemarie Morbelli - *Gabelli & Company, Inc - Analyst*

Thank you very much.

Operator

And that concludes our question-and-answer session. And I will now turn the conference back over to Celeste Mastin for closing comments.

Celeste Mastin - *H.B. Fuller Company - President and Chief Executive Officer*

Thanks, everyone, for joining this morning. We look forward to speaking with you again next quarter.

Operator

And ladies and gentlemen, this does conclude today's conference call. Thank you for your participation, and you may now disconnect.

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