

Fortune Brands (FBHS)

\$72.64 (As of 02/13/20)

Price Target (6-12 Months): **\$76.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/22/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: A

Summary

Fortune Brands' fourth-quarter 2019 earnings and revenues improved 16% and 4%, respectively, on a year-over-year basis. We believe that it is poised to gain from solid product portfolio and shareholder-friendly policies as well as segmental strength in the quarters ahead. Also, acquisitions, investments in product innovation and capacity expansion are likely to be beneficial. Over the past three months, the stock has outperformed the industry, but it looks comparatively overvalued. Also, rising costs of sales and expenses have been a concern over the past few quarters. Weakness in the Canada and Mexico markets and inflation-related woes can hurt 2020 results. Further, a highly leveraged balance sheet can inflate financial obligations and hurt profitability.

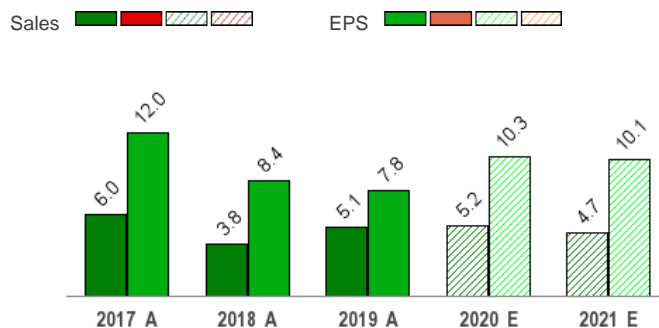
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$73.00 - \$44.79
20 Day Average Volume (sh)	1,417,897
Market Cap	\$10.1 B
YTD Price Change	11.2%
Beta	1.54
Dividend / Div Yld	\$0.96 / 1.2%
Industry	Security and Safety Services
Zacks Industry Rank	Top 34% (87 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.1%
Last Sales Surprise	-0.7%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	04/22/2020
Earnings ESP	1.6%
P/E TTM	20.1
P/E F1	18.3
PEG F1	2.0
P/S TTM	1.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,448 E	1,653 E	1,606 E	1,604 E	6,346 E
2020	1,390 E	1,587 E	1,537 E	1,549 E	6,064 E
2019	1,328 A	1,507 A	1,459 A	1,471 A	5,765 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.80 E	\$1.22 E	\$1.19 E	\$1.16 E	\$4.37 E
2020	\$0.75 E	\$1.11 E	\$1.07 E	\$1.08 E	\$3.97 E
2019	\$0.63 A	\$1.03 A	\$0.95 A	\$1.00 A	\$3.60 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/13/2020. The reports text is as of 02/14/2020.

Overview

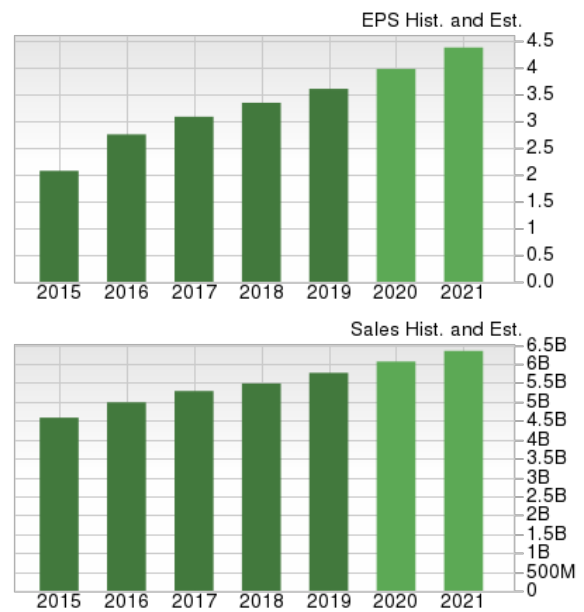
Headquartered in Deerfield, IL, Fortune Brands Home & Security, Inc. specializes in designing, manufacturing and selling home and security products, primarily used in the kitchen and bath cabinetry, plumbing and accessories, entry door systems, and security products applications.

It markets products through wholesalers, kitchen and bath dealers, locksmith distributors, industrial distributors, professional remodelers, retail outlets, and home centers.

In July 2018, the company reorganized its business segments by combining operations of Security and Doors segments into one segment. Effective from the quarter ended September 2018, Fortune Brands started reporting financial operations under three heads/segments — Cabinets, Plumbing, and Doors & Security.

A brief discussion on the company's business segments is given below:

- **Cabinets (40.2% of fourth-quarter 2019 revenues):** This segment deals with the production of custom, semi-custom and stock cabinetry and vanities for the kitchen, bath and other parts of the home. Operations are mainly carried out in North America. Key brands under the head are Aristokraft, Mid-Continent, Diamond, Kitchen Craft, Schrock, Omega, Homecrest, Decora, Kemper, StarMark and Ultracraft.
- **Plumbing (37.3%):** This segment produces and sells faucets, kitchen sinks, accessories and waste disposals. Operations are mainly carried out in the United States, Canada, China, South America, Mexico, Southeast Asia and Europe. Key brands include Moen, Riobel, ROHL, Perrin & Rowe, Victoria + Albert, and Shaws.
- **Doors & Security (22.5%):** This segment produces and sells fiberglass and steel entry door systems as well as urethane millwork products. Operations are principally carried out in the United States, Europe, Central America, Canada, Australia and Japan. Key brands include Therma-Tru and Fypon. Under the Security head, the segment also produces locks, safety and security devices, and electronic security products. It is also responsible for manufacturing fire resistant safes, security containers and commercial cabinets. Key brands include Master Lock, American Lock and SentrySafe.



Reasons To Buy:

- ▲ In the past three months, Fortune Brands' shares have rallied 15.2% compared with the industry's growth of 0.5%. In the fourth quarter, the company's top line recorded an increase of 4% year over year on healthy Plumbing and Doors & Security segments. For 2020, the company expects this segment to benefit from strength in the U.S. housing market supported by expected solid new construction growth, strength in China market and new product launches. Notably, for the year, the company expects the Plumbing segment to grow in the 5-7% range with operating margins of more than 21%. Also, solid demand for decking products along with strength in security business, supported by the company's incremental investments for product launches, is likely to keep boosting revenues of its Doors & Security segment. Notably, Fortune Brands expects to witness 4-7% sales growth in the Doors & Security segment, with operating margins of 13.5-14% for 2020. Further, strong demand for the company's value price point cabinetry products as well as investments in capacity expansion will likely support results for the Cabinets segment. Fortune Brands anticipates the Cabinets segment's sales for 2020 to grow 4-6%, with operating margins of above 10.5%. Overall sales for the year are expected to increase 5-6% from 2019.
- ▲ Along with solid growth opportunities across Fortune Brands' operating segments, the company's focus on optimizing cost structure through supply chain, manufacturing footprint optimization and other initiatives are likely to improve margins and its financial performance in 2020. Notably, earnings before charges/gains are estimated to be \$3.83-\$4.03 per share, reflecting year-over-year growth of 9.2% at the mid-point.
- ▲ Fortune Brands is steadily improving its cash position. Notably, in 2019, the company's free cash flow increased 13.3% year over year to \$526.9 million. For 2020, the company expects to generate free cash flow of about \$565-\$585 million, with a cash conversion rate of at least 95%. Also, in the fourth quarter, Fortune Brands' cash and cash equivalents were up 47.5% from the end of the 2018. Increased liquidity will allow the company to invest in product innovation and capacity expansion.
- ▲ Fortune Brands follows a sound capital-deployment strategy. It acquires lucrative businesses (explained in a separate point below), introduces share buyback programs and provides attractive dividends to shareholders. In 2019, the company repurchased shares worth \$100 million and paid out dividends worth \$123 million. Also, in December 2019, the company announced a 9% hike in its quarterly dividend rate. In addition, it remains focused on strengthening its competency on business acquisitions. In September 2018, the company completed the acquisition of Fiberon, LLC. The \$470-million buyout complements Fortune Brands' existing door brand — Therma-Tru — and enhances its growth opportunities in the outdoor living space. Of late, the company has been investing in capacity and product line expansion in the security business and the acquired Fiberon business. Further, its distribution partnership with OrePac (inked in July 2019) will enable Fiberon business to expand product offerings in the western region of the United States.

Fortune Brands is well positioned to benefit from strength in Plumbing and Doors & Security segments, inorganic growth strategies and the policy of rewarding shareholders.

Reasons To Sell:

- ▼ On an EV/EBITDA (TTM) basis, Fortune Brands currently appears overvalued compared with the industry, with respective tallies of 12.54x and 11.44x. Also, the stock is presently trading above the industry's three-month highest multiple of 12.07x. This makes us cautious about the stock.
- ▼ Rising costs and expenses have been an issue for Fortune Brands over the past few quarters. In the third and fourth quarters of 2019, Fortune Brands' cost of sales rose 5% and 2%, respectively, on a year-over-year basis. Also, in the third and fourth quarters, its selling, general and administrative expenses increased 2% and 1%, respectively. Of late, inflation (inclusive of commodity inflation, tariffs and logistics) has been increasing Fortune Brands' aggregate costs. As a matter of fact, for 2020, the company expects inflation to be in the range of \$40-\$50 million.
- ▼ A highly leveraged balance sheet can inflate Fortune Brands' financial obligations, and subsequently hurt profitability. In the last five years (2015-2019), the company's long-term debt rose 8.8% (CAGR). Notably, at the end of fourth-quarter 2019, its total debt was \$2,184.3 million, up 12.1% on a sequential basis. Interest expenses have escalated 26.4% to \$94.2 million in 2019. Also, the stock appears more leveraged compared with the industry, with long-term debt to capital ratio being 42.4% and 38.2%, respectively. For 2020, the company predicts interest expenses of \$85-\$90 million.
- ▼ Fortune Brands has significant operational presence for its Plumbing and Cabinet segments in Canada. Of late, it is experiencing continued market weakness in Canada and Mexico, which lowered sales of the Cabinets segment by 5% in the fourth quarter of 2019. Persistence of this headwind in the quarters ahead will adversely impact results.

Weakness in Canada & Mexico operations, inflation-related woes, and high debts might continue to weigh over Fortune Brands' near-term profitability.

Last Earnings Report

Fortune Brands' Earnings Beat, Revenues Miss in Q4

Fortune Brands reported fourth-quarter 2019 earnings before charges/gains of \$1 per share, surpassing the Zacks Consensus Estimate of 97 cents. On a year-over-year basis, the bottom line improved 16%, backed by sales growth.

In 2019, the company's earnings before charges/gains were \$3.60 per share, increasing 8% from the year-ago figure of \$3.34.

Fortune Brands' net sales were \$1,470.5 million, increasing 4% from the year-ago figure. The rise was driven by healthy growth in Plumbing and Doors & Security segments. However, the top line missed the consensus estimate of \$1,481 million.

Net sales in 2019 were \$5,764.6 million, increasing 5% year over year, driven by solid momentum in Plumbing and Doors & Security segments.

Segmental Details

Cabinets' sales decreased 5% year over year to \$590.8 million. Growth in sales of value products was offset by weakness in premium products.

Plumbing sales jumped 12% to \$548.4 million on the back of impressive performance in China and the United States.

Doors & Security's sales increased 8% to \$331.3 million, backed by robust sales growth of composite decking along with solid operating performance in security products.

Costs & Expenses

In the fourth quarter, Fortune Brands' cost of sales before charges/gains increased 2% year over year to \$938.7 million. It represented 63.8% of net sales compared with 64.7% in the year-ago quarter. Selling, general and administrative expenses jumped 1% to \$312.4 million, and represented 21.2% of the net sales compared with 21.7% a year ago.

Operating income before charges/gains increased 37% to \$192.5 million. Operating margin before charges/gains climbed 320 basis points to roughly 13.1%. Interest expenses decreased 4% to \$22.4 million.

Balance Sheet

Exiting the fourth quarter, Fortune Brands' cash and cash equivalents were \$387.9 million, up 47.5% from \$262.9 million at the end of the 2018. Its long-term debt decreased 1.3% to \$1,784.6 million.

In 2019, net cash provided by operating activities were \$637.2 million, reflecting 5.5% increase year over year. Capital expenditure amounted to \$131.8 million, down from \$150.1 million.

Outlook

For 2020, Fortune Brands anticipates moderate growth in markets while seeks to focus on operational improvements. The company expects the U.S. home products market to grow 4-6% in the year and the global market to grow 3-5%.

Sales for the year are expected to increase 5-6% from 2019. Earnings before charges/gains are estimated to be \$3.83-\$4.03 per share, reflecting year-over-year growth of 9.2% at the mid-point.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	-0.70%
EPS Surprise	3.09%
Quarterly EPS	1.00
Annual EPS (TTM)	3.61

Recent News

Dividend

On **Dec 10, 2019**, Fortune Brands' board of directors approved payment of a quarterly cash dividend of 24 cents per share to shareholders of record as of Feb 28, 2020. The payment will be made on Mar 18, 2020. This represents hike of 9% in the quarterly dividend, from 22 cents to 24 cents.

Valuation

Fortune Brands Home & Security shares are up 11.1% in the year-to-date period and 53.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are up 0.3% and 0.9% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 12.8% and 8.3% respectively.

The S&P 500 index is up 4.7% in the year-to-date period and 20.8% in the past year.

The stock is currently trading at 18.14x forward 12-month earnings per share, which compares to 17.88x for the Zacks sub-industry, 18.45x for the Zacks sector and 19.37x for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.95x and as low as 9.34x, with a 5-year median of 18.91x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$76 price target reflects 18.98x forward 12-month earnings per share.

The table below shows summary valuation data for FBHS.

Valuation Multiples - FBHS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.14	17.88	18.45	19.37
	5-Year High	22.95	20.18	19.89	19.37
	5-Year Low	9.34	10.95	12.6	15.18
	5-Year Median	18.91	16.5	16.62	17.47
EV/EBITDA F12M	Current	11.06	14.76	17.81	12.66
	5-Year High	13.21	21.49	18.2	12.66
	5-Year Low	7.08	5.75	10.68	9.08
	5-Year Median	11.42	9.41	14.03	10.79
EV/Sales F12M	Current	1.91	2.29	3.14	3.26
	5-Year High	2.18	2.96	3.14	3.37
	5-Year Low	1.24	1.49	1.76	2.3
	5-Year Median	1.81	1.99	2.28	2.79

As of 02/13/2020

Industry Analysis Zacks Industry Rank: Top 34% (87 out of 255)



Top Peers

Armstrong World Industries, Inc. (AWI)	Neutral
Brady Corporation (BRC)	Neutral
BorgWarner Inc. (BWA)	Neutral
Dover Corporation (DOV)	Neutral
Masco Corporation (MAS)	Neutral
Mohawk Industries, Inc. (MHK)	Neutral
RPM International Inc. (RPM)	Neutral
Stanley Black & Decker, Inc. (SWK)	Neutral

Industry Comparison Industry: Security And Safety Services				Industry Peers		
	FBHS Neutral	X Industry	S&P 500	AWI Neutral	BWA Neutral	MHK Neutral
VGM Score	A	-	-	B	A	B
Market Cap	10.11 B	184.95 M	24.56 B	4.95 B	7.24 B	9.50 B
# of Analysts	7	2	13	4	9	9
Dividend Yield	1.21%	0.00%	1.78%	0.78%	1.94%	0.00%
Value Score	B	-	-	C	A	A
Cash/Price	0.04	0.07	0.04	0.02	0.13	0.01
EV/EBITDA	13.99	6.64	14.00	15.24	4.74	6.90
PEG Ratio	1.99	2.46	2.10	1.65	1.13	1.68
Price/Book (P/B)	4.16	2.64	3.31	13.48	1.58	1.22
Price/Cash Flow (P/CF)	15.29	16.98	13.68	18.72	5.33	6.82
P/E (F1)	18.38	20.36	19.23	19.92	8.74	12.58
Price/Sales (P/S)	1.75	1.83	2.69	4.81	0.71	0.95
Earnings Yield	5.47%	4.00%	5.20%	5.02%	11.43%	7.95%
Debt/Equity	0.74	0.06	0.71	1.77	0.36	0.22
Cash Flow (\$/share)	4.75	0.44	6.92	5.46	6.58	19.46
Growth Score	B	-	-	B	B	C
Hist. EPS Growth (3-5 yrs)	15.99%	14.96%	10.85%	16.19%	9.55%	6.83%
Proj. EPS Growth (F1/F0)	10.32%	10.66%	7.17%	12.32%	-2.83%	5.05%
Curr. Cash Flow Growth	3.23%	8.52%	8.56%	7.22%	11.56%	-1.47%
Hist. Cash Flow Growth (3-5 yrs)	11.26%	7.21%	8.36%	3.47%	7.21%	13.07%
Current Ratio	1.35	2.52	1.23	2.09	1.58	1.52
Debt/Capital	42.37%	16.99%	42.91%	63.91%	26.56%	18.15%
Net Margin	7.49%	0.85%	11.81%	19.55%	7.34%	7.46%
Return on Equity	21.74%	3.20%	16.86%	78.13%	19.05%	9.39%
Sales/Assets	0.91	0.81	0.54	0.57	1.00	0.73
Proj. Sales Growth (F1/F0)	5.19%	4.54%	3.85%	6.41%	-0.63%	0.82%
Momentum Score	A	-	-	B	D	B
Daily Price Chg	0.22%	0.00%	0.00%	-0.02%	1.12%	-0.41%
1 Week Price Chg	2.97%	0.00%	2.47%	2.30%	-2.10%	-3.55%
4 Week Price Chg	4.37%	0.00%	0.56%	-0.36%	-16.24%	-5.70%
12 Week Price Chg	16.11%	6.87%	6.96%	9.06%	-17.28%	-4.45%
52 Week Price Chg	54.42%	6.74%	16.68%	48.83%	-13.89%	-4.44%
20 Day Average Volume	1,417,897	92,143	2,020,569	252,147	3,531,080	573,858
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.12%	0.00%	-0.05%	0.00%	-2.93%	-0.26%
(F1) EPS Est 12 week change	0.78%	0.00%	-0.17%	0.24%	-2.44%	-1.22%
(Q1) EPS Est Mthly Chg	5.13%	0.00%	-0.24%	0.00%	-4.29%	-0.70%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.