

## Fortune Brands (FBHS)

**\$69.07** (As of 01/15/20)

Price Target (6-12 Months): **\$73.00**

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:B

Value: B

Growth: B

Momentum: D

## Summary

In the past three months, Fortune Brands' shares have outperformed the industry. We believe that it is poised to gain from the solid product portfolio and shareholder-friendly policies as well as strengthening Plumbing, and Doors & Security segments in the quarters ahead. Also, acquisitions, investments in product innovation and capacity expansion will likely be beneficial. In the past 60 days, the company's earnings estimates have been raised for 2019 (results are awaited) and 2020. For 2019, weakness in the Canada business and soft demand for building products in the United States remain concerning. Sales growth projection has been lowered to 5-6% from 5.5-6.5% mentioned earlier. Earnings are expected to be \$3.53-\$3.63 per share, down from \$3.53-\$3.67 stated previously. Also, inflation-related woes and high debts can hurt results.

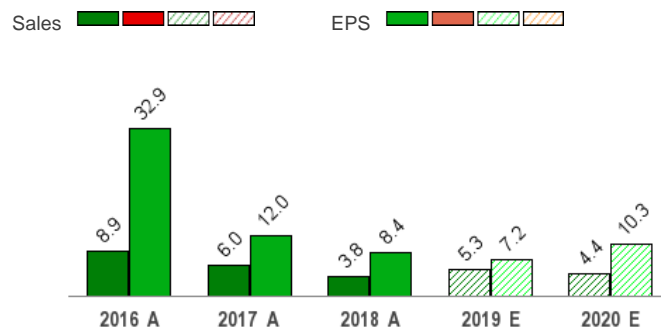
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	<b>\$70.16 - \$40.61</b>
20 Day Average Volume (sh)	<b>893,369</b>
Market Cap	<b>\$9.6 B</b>
YTD Price Change	<b>5.7%</b>
Beta	<b>1.53</b>
Dividend / Div Yld	<b>\$0.96 / 1.3%</b>
Industry	<b><a href="#">Security and Safety Services</a></b>
Zacks Industry Rank	<b>Bottom 32% (173 out of 254)</b>

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>-2.1%</b>
Last Sales Surprise	<b>-2.0%</b>
EPS F1 Est- 4 week change	<b>0.0%</b>
Expected Report Date	<b>01/29/2020</b>
Earnings ESP	<b>0.0%</b>
P/E TTM	<b>19.9</b>
P/E F1	<b>17.5</b>
PEG F1	<b>1.9</b>
P/S TTM	<b>1.7</b>

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,388 E	1,579 E	1,526 E	1,545 E	6,031 E
2019	1,328 A	1,507 A	1,459 A	1,481 E	5,775 E
2018	1,255 A	1,429 A	1,381 A	1,421 A	5,485 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.72 E	\$1.12 E	\$1.09 E	\$1.08 E	\$3.95 E
2019	\$0.63 A	\$1.03 A	\$0.95 A	\$0.97 E	\$3.58 E
2018	\$0.56 A	\$1.00 A	\$0.93 A	\$0.86 A	\$3.34 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 01/15/2020. The reports text is as of 01/16/2020.

## Overview

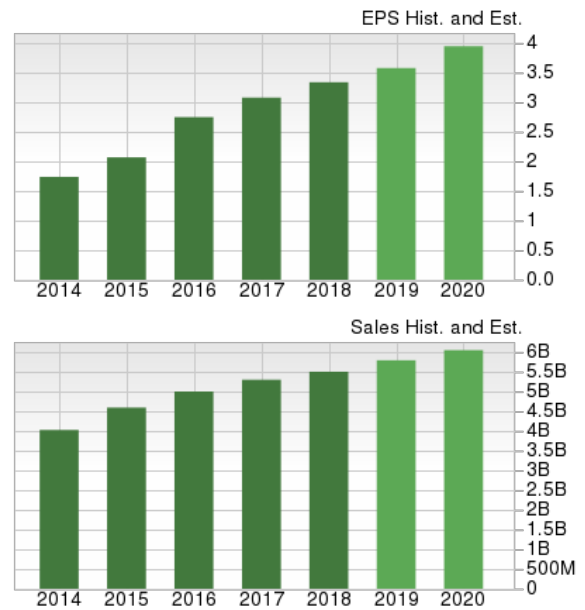
Headquartered in Deerfield, IL, Fortune Brands Home & Security, Inc. specializes in designing, manufacturing and selling home and security products, primarily used in the kitchen and bath cabinetry, plumbing and accessories, entry door systems, and security products applications.

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 (40.4% of third-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 (35.2%):** 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 (24.4%):** 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.



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## Reasons To Buy:

- ▲ In the past three months, Fortune Brands' shares have rallied 18.2% compared with the industry's growth of 5.1%. In the third quarter, the company's top line recorded an increase of 6% year over year on healthy Plumbing and Doors & Security segments. Continued strength in the United States and China markets coupled with product launches is likely to aid Fortune Brands' Plumbing revenues. Notably, for 2019, the company expects the Plumbing segment to grow in the mid to high-single-digit range. Also, strength across Master Lock and other businesses, supported by the company's incremental investments for product launches, is likely to keep boosting revenues of its Doors & Security segment. Notably, the company noted that it is on track to deliver mid-teen sales growth in the Doors & Security segment in 2019. Further, antidumping duties as well as investments in innovations will likely support results for the Cabinets segment. Fortune Brands anticipates the Cabinets segment's sales for 2019 to grow slightly in the United States. In the past 60 days, the company's earnings estimates have been revised up by 0.3% for 2019 and 0.8% for 2020.
- ▲ Fortune Brands is steadily improving its cash position. In the last five years (2014-2018), the company's free cash flow rose 29.6% (CAGR) to \$460 million. Notably, for 2019, the company expects to generate free cash flow of about \$480-\$500 million, with a cash conversion rate of at least 95%. Also, in the third quarter, Fortune Brands' cash and cash equivalents were up 27.9% from the end of the 2018. With increased liquidity, the company invests 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 2018, the company deployed close to \$1.3 billion over its business (including \$470 million on Fiberon buyout, \$695 million on share buyback and \$115 million on dividends). In addition, in the first nine months of 2019, the company bought back two million shares for \$100 million and paid out dividends worth \$92.3 million. Notably, Fortune Brands has the authorization to repurchase common stock worth \$314 million under its existing buyback program. Also, in December 2018, the company announced a 10% hike in its quarterly dividend rate.
- ▲ Fortune Brands 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 doors business and acquired the Fiberon business. Further, its distribution partnership with OrePac (inked in July 2019) will enable its Fiberon business to expand product offerings in the western region of the United States.

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

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## Reasons To Sell:

- ▼ On an EV/EBITDA (TTM) basis, Fortune Brands currently appears overvalued compared with the industry, with respective tallies of 13.02x and 11.76x. Also, the stock is presently trading above the industry's three-month highest multiple of 13.02x. This makes us cautious about the stock.
- ▼ In the third quarter of 2019, Fortune Brands delivered weaker-than-expected results, with earnings and sales lagging estimates by 2.06% and 2.04%, respectively. Cost of sales in the quarter rose 5% year over year while selling, general and administrative expenses increased 2%. Of late, material price inflation and rising freight charges have been increasing Fortune Brands' aggregate costs, with a hike of 7% recorded in costs of sales in both the first and second quarters of 2019. For 2019, the company expects weak Canada business and soft demand for building products in the United States to hurt results. Sales in the year are predicted to grow 5-6% compared with 5.5-6.5% rise mentioned earlier. Earnings before charges/gains are estimated to be \$3.53-\$3.63 per share, lower than the \$3.53-\$3.67 stated previously. Also, inflation (inclusive of commodity inflation, tariffs and logistics) might have adverse impact on results. However, anti-tariff actions will be a relief in the year.
- ▼ A highly leveraged balance sheet can inflate Fortune Brands' financial obligations, and subsequently hurt profitability. In the last five years (2014-2018), the company's long-term debt rose 22.9% (CAGR). Notably, at the end of third-quarter 2019, its total debt was \$1,949 million, reflecting an increase of 7.7% from the end of 2018. Interest expenses have escalated 41% to \$71.8 million in the first nine months of 2019. Also, the stock appears more leveraged compared with the industry, with long-term debt to capital ratio being 47.2% and 38.2%, respectively. For 2019, the company predicts interest expenses of \$94 million.
- ▼ Fortune Brands has significant operational presence for its Plumbing and Cabinet segments in Canada. Of late, it is experiencing softness in the construction market in Canada, which lowered sales of the Cabinets segment by 2% in the third quarter of 2019. Persistence of this headwind in the quarters ahead will adversely impact results. For 2019, Cabinet sales are predicted to be flat year over year.

Weakness in Canada operations, soft demand for building products in the United States, inflation-related woes, and high debts might continue to weigh over Fortune Brands' near-term profitability.

## Last Earnings Report

### Fortune Brands Q3 Earnings & Revenues Miss Estimates

Fortune Brands reported weaker-than-expected financial results for third-quarter 2019. Its earnings before charges/gains were 95 cents per share, missing the Zacks Consensus Estimate of 97 cents. Notably, on a year-over-year basis, the bottom line improved 2.2% on the back of sales growth.

The company's net sales were \$1,459 million, increasing 6% 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 \$1,489 million.

### Segmental Details

The company's segmental results are discussed below:

Cabinets segment's sales decreased 2% year over year to \$589.7 million. Growth in sales of value products was offset by weakness in premium and semi-custom.

Plumbing sales jumped 11% to \$514.1 million on the back of organic sales growth of about 12%.

Doors & Security segment's sales increased 11% to \$355.2 million, backed by gains from the buyout of Fiberon.

### Costs & Expenses

In the third quarter, Fortune Brands' cost of sales before charges/gains increased 5% year over year to \$934.8 million. It represented 64.1% of net sales compared with 64.2% in the year-ago quarter. Selling, general and administrative expenses jumped 2% to \$311.3 million, and represented 21.3% of the net sales compared with 22.1% a year ago.

Operating income before charges/gains increased 14% to \$168 million. Operating margin before charges/gains climbed 80 basis points to roughly 11.5%. Interest expenses increased 24% to \$23.6 million.

### Balance Sheet

Exiting the third quarter, Fortune Brands' cash and cash equivalents were \$336.2 million, up 27.9% from \$262.9 million at the end of the 2018. Its long-term debt increased 7.7% to \$1,949 million from the end of last year.

In the first nine months of 2019, net cash provided by operating activities were \$353.8 million, reflecting 2.9% increase year over year. Capital expenditure amounted to \$82.4 million, down from \$106.5 million.

### Outlook

Sales for 2019 are expected to increase in the range of 5-6% compared with 5.5-6.5% rise predicted earlier. Earnings before charges/gains are estimated to be \$3.53-\$3.63 per share, lower than the \$3.53-\$3.67 guided previously.

Quarter Ending **09/2019**

Report Date	Oct 23, 2019
Sales Surprise	-2.04%
EPS Surprise	-2.06%
Quarterly EPS	0.95
Annual EPS (TTM)	3.47

## 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 shares are up 63.6% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are up 25.3% and 16.1% over the past year.

The S&P 500 index has moved up 23.6% in the past year.

The stock is currently trading at 17.42x forward 12-month earnings per share, which compares to 18.68x for the Zacks sub-industry, 18.13x for the Zacks sector and 18.95x 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 19.02x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$73 price target reflects 18.29x 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	17.42	18.68	18.13	18.95
	5-Year High	22.95	20.29	19.9	19.34
	5-Year Low	9.34	10.93	12.59	15.17
	5-Year Median	19.02	16.5	16.54	17.44
EV/EBITDA F12M	Current	11.53	14.73	17.8	12.66
	5-Year High	13.29	21.68	18.2	12.66
	5-Year Low	7.66	5.81	10.68	9.08
	5-Year Median	11.54	9.45	14.01	10.78
EV/Sales F12M	Current	1.9	2.3	3.14	3.26
	5-Year High	2.18	2.99	3.14	3.37
	5-Year Low	1.24	1.49	1.76	2.3
	5-Year Median	1.8	2.02	2.28	2.78

As of 01/15/2020

## Industry Analysis Zacks Industry Rank: Bottom 32% (173 out of 254)



## 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
<b>VGM Score</b>	<b>B</b>	-	-	<b>B</b>	<b>A</b>	<b>A</b>
Market Cap	9.61 B	190.58 M	24.22 B	5.00 B	8.53 B	9.85 B
# of Analysts	7	2	13	4	9	8
Dividend Yield	1.27%	0.00%	1.75%	0.78%	1.65%	0.00%
<b>Value Score</b>	<b>B</b>	-	-	<b>C</b>	<b>A</b>	<b>B</b>
Cash/Price	0.04	0.08	0.04	0.02	0.11	0.01
EV/EBITDA	14.89	7.75	14.11	15.37	5.50	7.12
PEG Ratio	1.90	2.46	2.06	1.29	1.29	1.73
Price/Book (P/B)	4.11	3.45	3.34	13.62	1.86	1.27
Price/Cash Flow (P/CF)	15.25	17.50	13.57	18.90	6.28	7.07
P/E (F1)	17.51	23.47	18.90	20.11	10.00	13.00
Price/Sales (P/S)	1.68	1.79	2.65	4.85	0.84	0.99
Earnings Yield	5.72%	3.97%	5.29%	4.97%	10.00%	7.69%
Debt/Equity	0.89	0.04	0.72	1.77	0.36	0.22
Cash Flow (\$/share)	4.53	0.44	6.94	5.46	6.58	19.46
<b>Growth Score</b>	<b>B</b>	-	-	<b>B</b>	<b>B</b>	<b>C</b>
Hist. EPS Growth (3-5 yrs)	16.83%	14.96%	10.56%	16.19%	9.55%	6.83%
Proj. EPS Growth (F1/F0)	10.30%	12.43%	7.59%	12.32%	4.85%	6.11%
Curr. Cash Flow Growth	4.62%	8.13%	14.73%	7.22%	11.56%	-1.47%
Hist. Cash Flow Growth (3-5 yrs)	13.01%	8.20%	9.00%	3.47%	7.21%	13.07%
Current Ratio	1.39	2.29	1.24	2.09	1.58	1.52
Debt/Capital	47.20%	15.91%	42.99%	63.91%	26.56%	18.15%
Net Margin	7.23%	0.85%	11.14%	19.55%	7.43%	7.09%
Return on Equity	21.55%	5.42%	17.16%	78.13%	19.43%	9.82%
Sales/Assets	0.92	0.81	0.55	0.57	1.00	0.74
Proj. Sales Growth (F1/F0)	4.43%	4.43%	4.23%	6.41%	2.38%	1.08%
<b>Momentum Score</b>	<b>D</b>	-	-	<b>C</b>	<b>C</b>	<b>B</b>
Daily Price Chg	1.54%	0.00%	0.27%	1.67%	-1.05%	3.71%
1 Week Price Chg	2.40%	0.00%	0.39%	2.85%	-2.22%	-3.02%
4 Week Price Chg	5.07%	1.38%	2.17%	9.55%	-8.65%	1.08%
12 Week Price Chg	18.31%	2.74%	6.65%	5.21%	3.28%	7.00%
52 Week Price Chg	66.71%	9.29%	22.43%	63.58%	4.19%	11.70%
20 Day Average Volume	893,369	54,773	1,545,017	251,742	936,660	518,806
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.02%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.24%	-0.27%	0.00%
(F1) EPS Est 12 week change	-0.14%	-1.85%	-0.41%	0.15%	0.42%	-3.36%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-0.98%	0.00%

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### 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>B</b>
Growth Score	<b>B</b>
Momentum Score	<b>D</b>
VGM Score	<b>B</b>

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.

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### Disclosures

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