Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Honeywell Automation India

Q4 a blip; Outlook stays positive

Capital Goods	Sharekhan code: HONAUT	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 41,570**	
Price Target: **Rs. 52,407**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

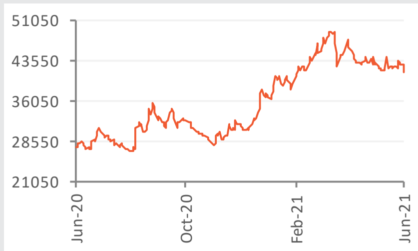
Company details

Market cap:	Rs. 36,754 cr
52-week high/low:	Rs. 49,805/26,556
NSE volume: (No of shares)	4,562
BSE code:	517174
NSE code:	HONAUT
Free float: (No of shares)	0.2 cr

Shareholding (%)

Promoters	75.0
FII	2.1
DII	12.7
Others	10.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4	2	31	50
Relative to Sensex	-10	-5	15	-6

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on Honeywell Automation India with a revised price target of Rs. 52,407 factoring a marginal reduction in revised estimates.
- Q4 results lagged estimates as revenue booking may have been affected by supply chain disruptions. However, OPM improved y-o-y despite pressure on gross margins.
- Honeywell is expected to benefit from parent's strong growth outlook for key segments, while domestic growth is expected to be driven by oil & gas, smart cities, airports and building solution segments.
- Company continues to generate strong cash flows, maintaining strong balance sheet.

Honeywell Automation India (Honeywell) reported weak results for Q4FY2021 led by lower-than-expected revenue booking. Revenues declined by 4.5% y-o-y to Rs. 673 crore (lower than estimates), which may have been on account of supply chain disruptions causing lower manufacturing output. However, the company has been able to improve OPM despite pressure on gross margins owing to rationalisation of costs, especially discretionary spends and by boosting employee productivity. Gross margins declined by 340 bps y-o-y to 50.6%, mainly led by a steep rise in key commodity prices. However, OPM improved by 95 bps y-o-y to 20.6% (lower than our estimates) on account of a decline in employee costs (down 7% y-o-y) and other expenses (down 27% y-o-y). Hence, operating profit remained almost flat y-o-y at Rs. 129 crore. Further, a 29.6% y-o-y drop in other income led to a 6.4% y-o-y dip in net profit at Rs. 104 crore. The company continued to generate strong operating cash flows of Rs. 364 crore in FY2021 as against Rs. 330 crore in FY2020. The parent company (Honeywell Automation) post Q1CY2021 results gave a favourable guidance for CY2021 improving marginally upon revenue guidance and maintaining operating margin guidance. The company is expected to benefit from its parent's strong growth outlook for segments like Safety & Productivity solutions (SPS) and Building Technologies. Domestically, Honeywell remains at the forefront to reap benefits from industrial software solutions, automation and AtmaNirbhar Bharat initiatives. After the pandemic, the company has been witnessing a greater level of automation/ digitisation demand from industries and expects further changes in industrial software solutions with a huge focus on towards industrial cyber security and is expecting orders for the same. Further, it is seeing opportunities in the oil & gas space, especially in gas (infrastructure for gas pipelines, equipment for storage and distribution being required), upcoming new airports and smart cities where Honeywell has a significant presence and expects to grow strongly. It also foresees new business opportunities in the building segment, wherein it expects infrastructure and capex for healthy buildings to grow, wherein solutions for maintaining social distancing, safety and security remain steady. We have marginally lowered our estimates for FY2022E-FY2023E. Going ahead, the company's focus on development of new products and services, forays into new industries apart from core industries and addressing the growing mass mid-market is expected to maintain healthy net earnings growth trend (23.5% CAGR likely over FY2021-FY2023E). Currently, the stock is trading at a P/E of 52.4x its FY2023E earnings, which we believe leaves room for a further upside considering its strong business fundamentals. Hence, we retain a Buy rating on the stock with a revised price target of Rs. 52,407.

Key positives

- OPM stayed in line with estimates due to cost rationalisation despite weak gross margins.
- Domestic opportunities strong led by government's focus on infrastructure investments.

Key negatives

- Revenues lower than estimates due to supply chain disruptions
- Gross margins and other income dips.

Our Call

Valuation –Retain Buy with a revised price target of Rs. 52,407: The company has multiple domestic growth levers such as government's infrastructure investments including smart cities, upcoming airports over the next five years, RERA, industrial internet of things (IIoT), AatmaNirbhar Bharat, etc, which we believe would help the company in maintain a healthy growth trend going ahead. An asset-light model (nil debt), strong cash position (almost Rs. 1,800 crore), strong free cash flow generation (over Rs. 1000 crores in FY2022E-FY2023E), strong return ratios and a consistent dividend paying record justify the stock's premium valuation. Currently, the stock is trading at a P/E of 52.4x its FY2023E earnings, which we believe leaves room for a further upside considering its strong business fundamentals. Hence, we retain Buy on the stock with a revised price target of Rs. 52,407.

Key risk

- A significant proportion of revenue and profits come from Honeywell International and its affiliates; and
- Softening of investments domestically as well as globally, increase in crude oil prices and volatility in foreign exchange rate would affect business operations.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	3,290	3,043	3,619	4,175
OPM (%)	19.3	19.4	20.5	21.8
Adjusted PAT	491	460	551	702
% Y-o-Y growth	*37.0*	*(6.4)*	*19.8*	*27.3*
Adjusted EPS (Rs.)	556.0	520.4	623.6	794.0
P/E (x)	74.8	79.9	66.7	52.4
P/B (x)	16.9	14.2	16.3	12.7
EV/EBIDTA (x)	55.4	59.3	47.9	38.1
RoNW (%)	25.0	19.3	22.8	27.2
RoCE (%)	31.4	23.3	28.9	33.6

Source: Company; Sharekhan estimates

Q4 results affected by lower revenue booking: Honeywell Automation India (Honeywell) reported weak results for Q4FY2021 led by lower-than-expected revenue booking. Revenues declined by 4.5% y-o-y to Rs. 673 crore (lagging estimates), which may have been on account of supply chain disruptions causing lower manufacturing output. However, the company has been able to improve OPM despite pressure on gross margins owing to rationalisation of costs, especially discretionary spends and by boosting employee productivity. Gross margins declined by 340 bps y-o-y to 50.6%, mainly led by a steep rise in key commodity prices. However, OPM improved by 95 bps y-o-y to 20.6% (lower than our estimates) on account of a decline in employee costs (down 7% y-o-y) and other expenses (down 27% y-o-y). Hence, operating profit remained almost flat y-o-y at Rs. 129 crore. Further, a 29.6% y-o-y drop in other income led to a 6.4% y-o-y dip in net profit at Rs. 104 crore. The company continued to generate strong operating cash flows of Rs. 364 crore in FY2021 as against Rs. 330 crore in FY2020.

Global parent's and domestic outlook remain positive: The parent company (Honeywell Automation) post Q1CY2021 results gave a favourable guidance for CY2021 improving marginally upon revenue guidance and maintaining operating margin guidance. The company is expected to benefit from its parent's strong growth outlook for segments like Safety & Productivity solutions (SPS) and Building Technologies. Domestically, Honeywell remains at the forefront to reap benefits from industrial software solutions, automation and AtmaNirbhar Bharat initiatives. After the pandemic, the company has been witnessing a greater level of automation/digitisation demand from industries and expects further changes in industrial software solutions with a huge focus on towards industrial cyber security and is expecting orders for the same. Further, it is seeing opportunities in the oil & gas space, especially in gas (infrastructure for gas pipelines, equipment for storage and distribution being required), upcoming new airports and smart cities where Honeywell has a significant presence and expects to grow strongly. It also foresees new business opportunities in the building segment, wherein it expects infrastructure and capex for healthy buildings to grow, wherein solutions for maintaining social distancing, safety and security remain steady.

Results (Standalone) Rs cr

Particulars	Q4FY21	Q4FY20	y-o-y (%)	Q3FY21	q-o-q (%)
Revenue	673	704	-4.5%	874	-23.0%
Operating profit	129	129	0.5%	188	-31.1%
Other Income	24	34	-29.6%	28	-16.6%
Interest	1.7	1.5	8.6%	1	25.0%
Depreciation	13	12	9.9%	13	2.4%
PBT	138	149	-7.2%	202	-31.6%
Tax	34	38	-9.4%	52	-34.3%
EO	-	-		-	
Reported PAT	104	111	-6.4%	150	-30.6%
Adj. PAT	104	111	-6.4%	150	-30.6%
Adj.EPS	118	126	-6.4%	170	-30.6%
Margin			BPS		BPS
OPM (%)	19.2	18.3	95	21.5	(225)
NPM (%)	15.5	15.8	(31.8)	17.1	(168)
Tax rate	24.8	25.4	-	25.8	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Multiple structural growth enablers to drive growth

India's focus on turning itself into a manufacturing hub through 'Make in India', huge investments in infrastructure across sub-sectors through the National Infrastructure Pipeline (NIP) over FY2020-FY2025 and ensuring energy security through increased share of renewable energy are key growth levers, which has positioned itself across various industries viz. oil & gas, chemical/petrochemicals, metals & mining, infrastructure and residential and commercial construction. The Indian ambition is tied with its increasing requirement of adopting automation technologies such as artificial intelligence (AI), IoT (connected devices), cloud services and industrial internet of things (IIoT) that can support and transform its existing and upcoming infrastructure and industrial projects. The COVID-19 pandemic has opened further opportunities in healthcare and pharmaceutical sectors through expected rise in capacity additions.

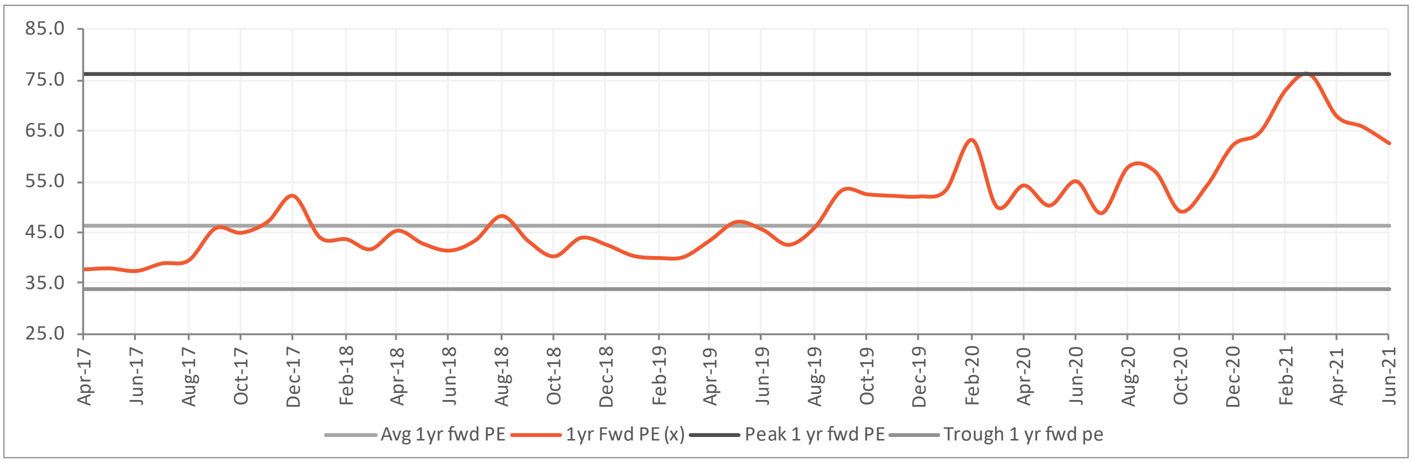
■ Company Outlook – Long term growth levers intact despite near term weak environment

Honeywell Automation India's focus on development of products & services, venturing into new industries apart from core industries and addressing the growing mass mid-market is expected to maintain healthy earnings growth trend. Further, the company is expected to benefit from domestic long-term growth levers such as smart city development, modernisation of railway stations, metro projects, airport expansions, RERA, GST, Industrial Internet of Things (IIoT) and 'Make in India" initiatives.

■ Valuation – Retain Buy with a revised price target of Rs. 52,407

The company has multiple domestic growth levers such as government's infrastructure investments including smart cities, upcoming airports over the next five years, RERA, industrial internet of things (IIoT), AatmaNirbhar Bharat, etc, which we believe would help the company in maintain a healthy growth trend going ahead. An asset-light model (nil debt), strong cash position (almost Rs. 1,800 crore), strong free cash flow generation (over Rs. 1000 crores in FY2022E-FY2023E), strong return ratios and a consistent dividend paying record justify the stock's premium valuation. Currently, the stock is trading at a P/E of 52.4x its FY2023E earnings, which we believe leaves room for a further upside considering its strong business fundamentals. Hence, we retain Buy on the stock with a revised price target of Rs. 52,407.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Honeywell Automation India Limited (HAIL) is a leader in providing integrated automation and software solutions, including process solutions and building solutions. It has a wide product portfolio in environmental and combustion controls, and sensing and control, and also provides engineering services in the field of automation and control to global clients. A Fortune India 500 company, HAIL has more than 3,000 employees based in nine offices across India – Pune, Baroda, Bangalore, Hyderabad, Mumbai, Chennai, Gurgaon, Kolkata, and Jamshedpur.

Investment theme

Honeywell Automation India Limited (Honeywell), a step down subsidiary of Honeywell International (a diversified technology and manufacturing company) is a leader in providing integrated automation and software solutions, including process solutions and building solutions. The company has positioned itself across various industries diversifying sector specific risk and to a greater extent shielding itself from economic downturn. The company's focus on development of new products and services, venturing into new industries apart from core industries and addressing the growing mass mid-market is expected to maintain its healthy earnings growth trend. The company's asset light model, strong cash position, strong cash flow generation, healthy return ratios, consistent dividend paying record are some of its salient features.

Key Risks

- Good percentage of revenue and profits come from Honeywell International and its affiliates
- Softening of investments domestically as well as globally, increase in crude oil prices and volatility in foreign exchange rate affects its business operations.

Additional Data

Key management personnel

Mr. Ashish Gaikwad	Executive Director-MD
Amit Kumar Tantia	Chief Financial Officer
Mr. Davies Walker	Director
Mr. Suresh Senapaty	Non-Executive - Independent Director-Chairperson

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Hail Mauritius	75.00
2	AdityaBrila Sun Life AMC	5.56
3	AdityaBrila Sun Life Trustee Co. Pvt Ltd	5.52
4	Reliance Capital Trustee Co. Pvt Ltd	4.03
5	Sundaram AMC	0.81
6	CanaraRobeco AMC /India	0.67
7	UTI Asset Management Company	0.58
8	Dimensional Fund Advisors	0.28
9	L&T Mutual Fund Trustee Ltd/India	0.26
10	Axis Asset Management Ltd	0.19

Source: Bloomberg; Note: Shareholding as of January 29, 2021

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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