Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Honeywell Automation India Ltd

Margins stay stressed in Q3; growth prospects bright

Capital Goods	Sharekhan code: HONAUT

Reco/View: Buy	↔	CMP: Rs. 40,568	Price Target: Rs. 48,600	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Honeywell Automation India Limited (Honeywell) reported slightly better-than-expected revenues although OPM remained under pressure due to weak gross margins for Q3FY2022.
- Despite stressed OPM for the past two quarters, the company is expected to benefit from investments in oil and gas, smart cities, airports, and building solutions segments going ahead.
- The company continues to generate strong cash flows and maintains a robust balance sheet.
- We retain a Buy rating on the stock with a revised PT of Rs. 48,600, factoring downward revision in estimates.

Honeywell Automation India Limited (Honeywell) reported marginally higher than estimated revenue at Rs. 860 crore (-1.6% y-o-y) for Q3FY2022, led by lower execution which is likely on account of continued supply chain disruptions faced by the industry especially on semi-conductor and electronics components. OPM, at 14.2% (-728 bps y-o-y) came in much lower than our estimate of 17.5% as gross margins continued to remain under pressure (down 429 bps y-o-y at 43%). Consequently, operating profit declined by 35% y-o-y to Rs. 122 crore. Weak operating margins along with lower other income (down 50% y-o-y) led to standalone net profit decline of 40% y-o-y at Rs. 90 crore. Despite weak execution, the company remains at the forefront to reap benefits from industrial software solutions, automation and the AtmaNirbhar Bharat program.

Key positives

- Revenues at Rs. 860 crore was marginally higher than our expectation.

Key negatives

- Gross margin pressure continued, dragging down OPM y-o-y.

Revision in estimates – We have downwardly revised our estimates for FY2022-FY2024, factoring lower OPM.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 48,600: 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), and AtmaNirbhar Bharat, which we believe would help the company grow at a healthy pace going ahead. An asset-light model (nil debt), strong cash position, strong free cash flow generation, strong return ratios, and a consistent dividend paying record justify the stock's premium valuation. Currently, the stock is trading at P/E of 52x its FY2024E earnings, which we believe leaves room for further upside, considering its strong business fundamentals. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 48,600 factoring downward revision in estimates.

Key Risks

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

Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net Sales	3,043	3,128	3,609	4,168
OPM (%)	19.4	14.9	19.4	21.0
Net Profit	460	357	544	692
y-o-y growth	(6.4)	(22.4)	52.4	27.3
EPS (Rs.)	520.4	403.8	615.4	783.4
PER (x)	78.0	100.5	65.9	51.8
P/BV (x)	13.9	17.4	14.1	11.2
EV/EBITDA (x)	57.8	73.7	48.5	38.3
ROCE (%)	23.3	18.2	28.7	29.0
ROE (%)	19.3	15.4	23.6	24.1

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 37.89

Updated Jan 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

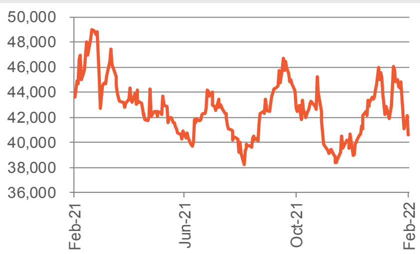
Company details

Market cap:	Rs. 35,868 cr
52-week high/low:	Rs. 49,805 / 3,8147
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	2.6
DII	12.4
Others	10.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-11.0	3.0	3.7	-7.0
Relative to Sensex	-7.2	4.1	-0.8	-20.6

Sharekhan Research, Bloomberg

OPM continued to stay stressed

Honeywell reported 1.6% y-o-y decline in standalone revenues at Rs. 860 crore which was marginally higher than our estimate. OPM at 14.2% (-728 bps y-o-y, -38 bps q-o-q) was much lower than our estimate of 17.5%. Weak OPM was on account of lower gross margins which were down 429 bps y-o-y (-399 bps q-o-q) at 43% along with higher employee and other expenses. Hence, operating profit declined by 35% y-o-y to Rs. 122 crore (much lower than our estimate). Weak operational performance led to 40% y-o-y dip (+5% q-o-q) in standalone net profit at Rs. 89.7 crore, which was significantly lower than our estimates.

Growth outlook bright

Honeywell remains at the forefront to reap benefits from industrial software solutions, automation, and AtmaNirbhar Bharat initiatives. Post the pandemic, the company has been witnessing greater demand for automation/digitisation from industries and expects further changes in the industrial software solutions space with a huge focus on industrial cyber security and is expecting orders for the same. Further, it sees opportunities in the oil & gas space (especially in infrastructure for gas pipelines and equipment for storage and distribution), upcoming new airports and smart cities where Honeywell has a significant presence. The company also foresees new business opportunities in the building segment, in which it expects infrastructure and capex for healthy buildings to grow, wherein solutions for maintaining social distancing, safety and security remain steady.

Financials (Standalone) — Rs cr

Particulars	Q3FY2022	Q3FY2021	YoY	Q2FY2022	q-o-q
Total Income	**860**	**874**	**-1.6%**	**737**	**16.7%**
EBITDA	**122**	**188**	**-35.0%**	**107**	**13.6%**
Other Income	14	28	-49.6%	21	-31.6%
Interest	1.1	1.3	-18.2%	1	-21.7%
Depreciation	14	13	7.3%	13	3.5%
PBT	**122**	**202**	**-39.8%**	**114**	**6.8%**
Total Tax	32	52	-38.9%	29	11.4%
Reported PAT	90	150	-40.1%	85	5.3%
Adjusted PAT	**90**	**150**	**-40.1%**	**85**	**5.3%**
Adjusted EPS (Rs.)	102	170	-40.1%	96	5.3%
Margin			**BPS**		**BPS**
OPM	14.2	21.5	*(728)*	14.6	*(38)*
PAT Margin	10.4	17.1	*(671)*	11.6	*(112)*
Tax Rate	26.2	25.8	*41*	25.1	*107*

Source: Company; Sharekhan Research

Outlook and Valuation

Sector outlook – Multiple structural 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. The company has positioned itself across various industries viz. oil and gas, chemical/petrochemicals, metals and mining, infrastructure and residential and commercial construction. India's aim is tied to its rising requirement for automation technologies such as artificial intelligence (AI), IoT (connected devices), cloud services, and IIoT that can support and transform its existing and upcoming infrastructure and industrial projects. The COVID-19 pandemic has opened further opportunities in the healthcare and pharmaceutical sectors through an expected rise in capacity additions.

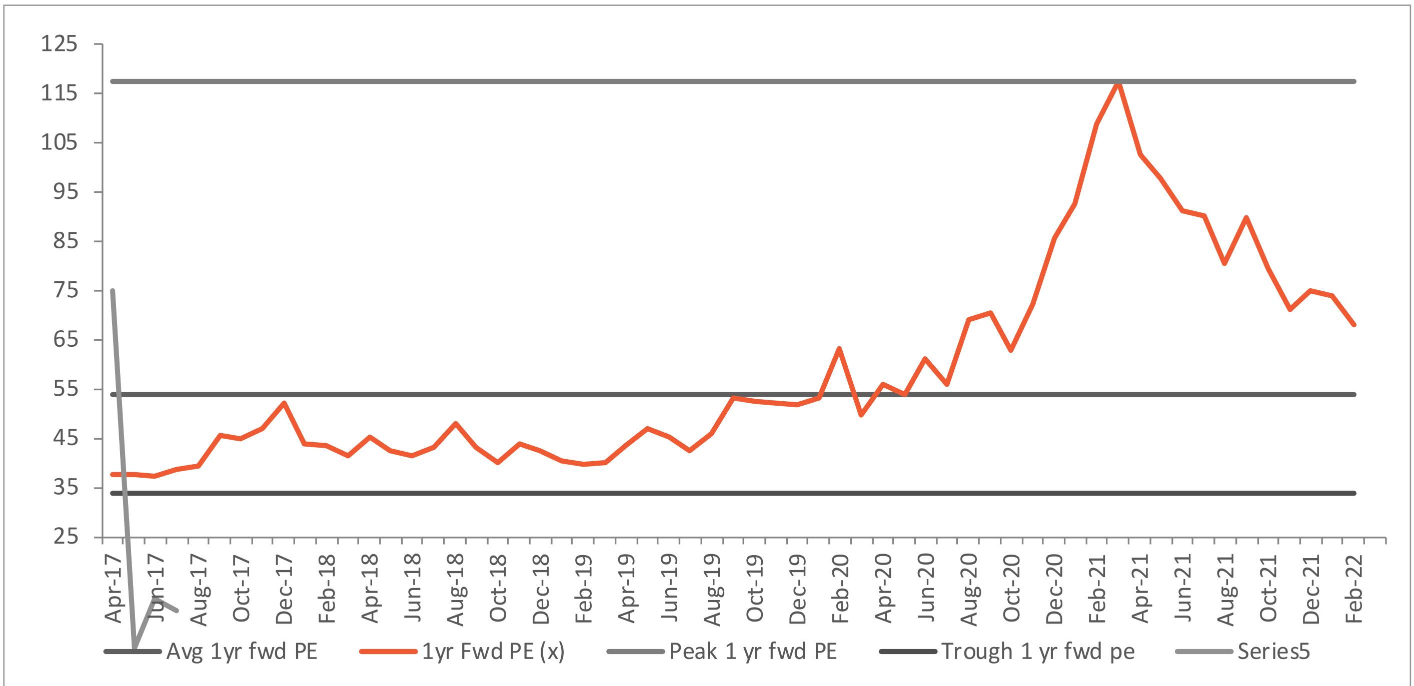
Company outlook – Long-term growth levers intact despite near-term weakness

Honeywell's focus on development of products and services, foray into new areas besides core industries, and addressing a growing mass mid-market are expected to help it maintain a 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, IIoT and 'Make in India' initiatives.

Valuation – Retain Buy with a revised PT of Rs. 48,600

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), and AtmaNirbhar Bharat, which we believe would help the company grow at a healthy pace going ahead. An asset-light model (nil debt), strong cash position, strong free cash flow generation, strong return ratios, and a consistent dividend paying record justify the stock's premium valuation. Currently, the stock is trading at P/E of 52x its FY2024E earnings, which we believe leaves room for further upside, considering its strong business fundamentals. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 48,600 the factoring downward revision in estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

About the company

Honeywell is a leader in providing integrated automation and software solutions, including process solutions and building solutions. The company has a wide product portfolio in environmental and combustion controls, and sensing and control. The company also provides engineering services in the field of automation and control to global clients. A Fortune India 500 company, Honeywell 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, 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 the 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 are expected to maintain its healthy earnings growth trend. The company's asset-light model, strong cash position, strong cash flow generation, healthy return ratios, and 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, increased crude oil prices, and volatility in foreign exchange rate affect its business operations.

Additional Data

Key management personnel

Mr. Ashish Gaikwad	Executive Director-MD
Mr. Pulkit Goyal	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	75.0
2	Aditya Birla Sun Life AMC	5.6
3	Aditya Birla Sun Life Trustee Co. Pvt. Ltd.	5.5
4	Reliance Capital Trustee Co. Pvt. Ltd.	4.0
5	Sundaram AMC	0.8
6	Canara Robeco AMC /India	0.7
7	UTI Asset Management Company	0.6
8	Dimensional Fund Advisors	0.3
9	L&T Mutual Fund Trustee Ltd./India	0.3
10	Axis Asset Management Ltd.	0.2

Source: Bloomberg

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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