Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Honeywell Automation India Ltd

Disappointing Q4; long-term prospects bright

Capital Goods	Sharekhan code: HONAUT	
Reco/View: Buy ↔	CMP: Rs. 32,377	Price Target: Rs. 41,200 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q4FY22 performance has been below our expectations on all fronts. Revenue declined by 0.7% y-o-y to Rs 668 crore (vs our expectations of Rs. 848 crore).
- Operating profit declined by 32% y-o-y to Rs 87 cr due to higher raw material cost, increase in staff cost as well as other expenses. Consequently, margin declined by 600 bps y-o-y to 13.1% (vs our estimate of 14%). Net profit fell by 30% y-o-y to ~Rs. 73 crore (versus our estimate of Rs 110 crore).
- The company remained debt free and cash & cash equivalents stood at Rs. 2,006 crore. The company generated Rs. 264 crore from cash from operations in FY22.
- We retain a Buy rating on the stock with a revised PT of Rs. 41,200, factoring a downward revision in estimates.

Q4FY22 performance has been below our expectations on all fronts. Revenue declined by 0.7% y-o-y to Rs 668cr (vs our expectations of Rs 848cr). Operating profit declined by 32% y-o-y to Rs 87 crore due to higher raw material cost, increase in staff cost as well as other expenses. Consequently, margin declined by 600 bps y-o-y to 13.1%. Net profit fell by 30% y-o-y to ~Rs 73 crore (vs our estimate of Rs 110 crore). On the brighter side, the company has strong cash position and asset-]light business with short working capital cycle. Despite weak numbers from past few quarters, the company remains at the forefront to reap benefits from industrial software solutions, automation and the AtmaNirbhar Bharat program. The company offers process solutions, building solutions, building management systems and advanced sensing technologies. Its business has a mix of domestic and exports thereby diversifying its revenue base.

Key positives

- The company has strong cash position of Rs 2,006 crore.

Key negatives

- Revenue growth was flattish, while operating profit declined sharply y-o-y and q-o-q.
- Net profit also declined y-o-y and q-o-q.

Revision in estimates – We have lowered our estimates for FY2022-FY2024, factoring lower revenue growth and margin compression.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 41,200: 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 a P/E ratio of ~49x its FY2024E earnings, which we believe leaves room for further upside, considering its strong business fundamentals and significant correction in the stock recently. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 41,200 factoring a 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, geo-political uncertainty and volatility in foreign exchange rate would affect business operations.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Sales	3,043	2,948	3,545	4,043
OPM (%)	19.4	14.7	17.3	18.3
Net Profit	460	339	477	589
EPS (Rs)	520.4	383.6	540.1	666.7
EPS Growth (%)	(6.4)	(26.3)	40.8	23.4
PER (x)	62.2	84.4	59.9	48.6
P/BV (x)	11.1	14.0	11.6	9.5
EV/EBITDA (x)	45.5	62.4	43.7	35.5
ROCE (%)	23.3	15.5	23.1	25.5
ROE (%)	19.3	12.5	18.0	21.5

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

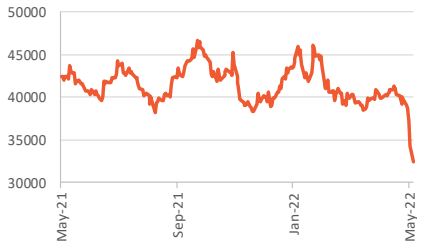
Company details

Market cap:	Rs. 28,621 cr
52-week high/low:	Rs. 47,276/32,050
NSE volume: (No of shares)	0.05 lakh
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	-19.0	-21.7	-22.3	-23.7
Relative to Sensex	-9.8	-13.0	-10.1	-30.5

Sharekhan Research, Bloomberg

Poor profitability due to cost pressures

Q4FY22 performance has been below our expectations on all fronts. Revenue declined by 0.7% y-o-y to Rs 668cr (vs our expectations of Rs 848 crore). Operating profit declined by 32% y-o-y to Rs. 87 crore due to higher raw material cost, increase in staff cost as well as other expenses. Consequently, margin declined by 600 bps y-o-y to 13.1% (versus our estimate of 14%). Net profit fell by 30% y-o-y to ~Rs 73 crore (Vs our estimate of Rs 110 crore). On the brighter side, the company remained debt free and cash & cash equivalents stood at Rs 2,006 crore.

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.

Results (Standalone) **Rs cr**

Particulars	Q4FY2022	Q4FY2021	Y-o-Y %	Q3FY2022	Q-o-Q %
Revenue	668	673	-0.7%	860	-22.3%
Operating profit	87	129	-32.4%	122	-28.4%
Other Income	25	24	6.3%	14	75.9%
Interest	1.2	1.7	-27.9%	1	10.2%
Depreciation	13	13	-1.9%	14	-6.3%
PBT	99	138	-28.7%	122	-18.9%
Tax	26	34	-24.2%	32	-18.6%
Adj. PAT	73	104	-30.1%	90	-19.0%
Adj.EPS	82	118	-30.1%	102	-19.0%
Margin			**BPS**		**BPS**
OPM (%)	13.1	19.2	(613)	14.2	(111)
NPM (%)	10.9	15.5	(458)	10.4	44
Tax rate	26.3	24.8	154	26.2	10

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – 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.

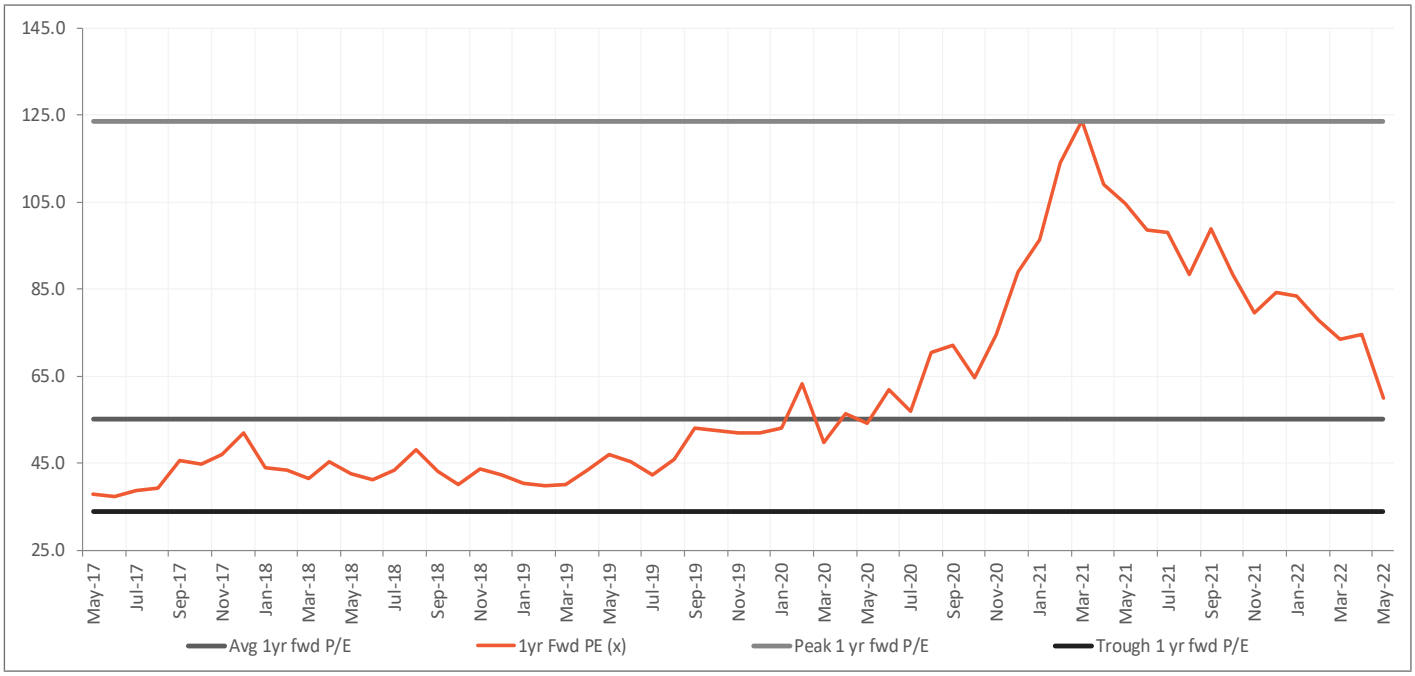
■ Company Outlook – Long-term growth levers intact despite near-term weakness

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. 41,200

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 a P/E ratio of ~49x its FY2024E earnings, which we believe leaves room for further upside, considering its strong business fundamentals and significant correction in the stock recently. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 41,200 factoring a downward revision in estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

About 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	75.00
2	Aditya Birla Sun Life AMC	5.56
3	Aditya Birla Sun Life Trustee Co. Pvt. Ltd.	4.82
4	Nippon Life India Trustee Ltd-a/c	2.34
5	Sundaram AMC	0.81
6	Canara Robeco 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

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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