Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Honeywell Automation India Ltd

Strong Q1; on the cusp of major upcycle

Capital Goods	Sharekhan code: HONAUT

Reco/View: Buy	↔	CMP: Rs. 42,503	Price Target: Rs. 49,750	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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 July 08, 2022

High Risk

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

Source: Morningstar

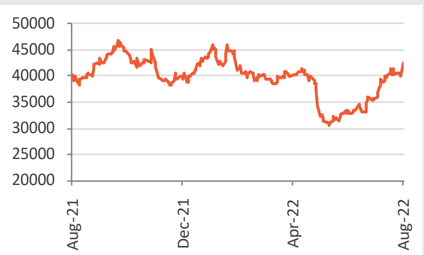
Company details

Market cap:	Rs. 37,573 cr
52-week high/low:	Rs. 47,276/32,050
NSE volume: (No of shares)	0.06 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	17.8	31.2	1.0	-2.6
Relative to Sensex	8.0	18.2	-2.4	-15.2

Sharekhan Research, Bloomberg

Summary

- Q1FY23 performance beat our expectations on all fronts. Revenue rose by ~15% y-o-y to Rs 786 crore (versus our estimate of Rs 744 crore).
- Operating profit growth was restricted to ~5% y-o-y to Rs 122 crore due to high input cost despite proportionate decline in staff cost and other expenses, Consequently, OPM declined by 157 bps y-o-y to 15.5% (versus our estimate of 14.5%). Net profit was up by 11% y-o-y to ~Rs. 102 crore (versus our estimate of Rs 87 crore).
- Supply chain disruptions faced by the industry especially for semi-conductor chip and electronics components are easing out. We believe this shall boost company's revenue and earnings growth going forward.
- We retain a Buy rating on the stock with a revised PT of Rs. 49,750 as improving growth prospects across end user industries, asset light business model, strong parentage, healthy balance sheet with cash & bank balance of Rs 2,006 crore (as on FY22) justify stock's premium valuation.

Q1FY23 performance was above estimates. Revenue was up by ~15% y-o-y to Rs 786cr (versus our expectations of Rs 744cr). Gross profit margins declined to 48.8% versus 52.3% in Q1FY22 due to higher raw material costs. As a result, operating profit growth was restricted to ~5% y-o-y to Rs 122 cr despite proportionate decline in staff cost and other expenses. OPM came in at 15.5%, lower by 157 bps (but higher than our estimate of 14.5%). Net profit increased by ~11% y-o-y to ~Rs. 102 crore (Vs our estimate of Rs 87 crore) supported by higher revenues and other income. The company has strong cash position and asset-light business model.

Key positives

- Revenue and net profit grew by ~15% and ~11% y-o-y respectively.
- Other income increased by ~34% y-o-y to Rs. 29 crore.

Key negatives

- GPM and OPM declined by 345/157 bps y-o-y to 48.8%/15.5%, respectively.

Revision in estimates – We have revised our estimates upwards for FY2022-FY2024E, factoring in better revenue and earnings growth.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 49,750: The company has multiple domestic growth levers such as the government's infrastructure investments, including smart cities, airports, metros, railways, ports, over the next five years as well as growing automation demand from metals, healthcare and cybersecurity segments. Continued government spending on the country's core infrastructure and development of large-scale data centers would help the company grow at a healthy pace going ahead. As per annual report, the company's external order book has increased 31% y-o-y and demand outlook remains robust for process and building solutions from all the key user industries. An asset-light model (nil debt), strong cash position, healthy free cash flow generation and promising long-term growth prospects in the automation space justify the stock's premium valuation. Further, supply chain disruptions faced by the industry especially for semi-conductor chips and electronic components is easing. This shall boost revenue and earnings growth. We expect Revenue/PAT CAGR of ~19%/37% over FY22-24E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 49,750 factoring upward revision in estimates.

Key Risks

- Significant proportion of revenue and profits come from Honeywell International and its affiliates.
- Softening of investments domestically as well as globally, 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	4,150
OPM (%)	19.4	14.7	16.5	17.9
Net Profit	460	339	487	637
EPS (Rs)	520.4	383.6	550.9	720.2
EPS Growth (%)	(6.4)	(26.3)	43.6	30.7
PER (x)	81.7	110.8	77.2	59.0
P/BV (x)	11.1	10.1	8.3	6.8
EV/EBITDA (x)	45.5	61.4	44.5	33.8
ROCE (%)	23.3	15.5	18.8	18.7
ROE (%)	19.3	12.5	15.9	17.1

Source: Company; Sharekhan estimates

Strong performance amid supply side challenges

Q1FY23 performance was above estimates. Revenue was up by ~15% y-o-y to Rs 786cr (versus our expectations of Rs 744cr). Gross profit margins declined to 48.8% versus 52.3% in Q1FY22 due to higher raw material costs. As a result, operating profit growth was restricted to ~5% y-o-y to Rs 122 cr despite proportionate decline in staff cost and other expenses. OPM came in at 15.5%, lower by 157 bps (but higher than our estimate of 14.5%). Net profit increased by ~11% y-o-y to ~Rs. 102 crore (Vs our estimate of Rs 87 crore) supported by higher revenues and other income. The company has strong cash position and asset-light business model.

FY22 Annual Report excerpts: Ample growth opportunities

The company witnessed healthy demand from various segments such as metals, healthcare, and cybersecurity in the country. External order booking in FY22 increased by 31% y-o-y. In order to tackle supply chain issues, the company is focusing on proactively identifying local manufacturers to avoid supply chain disruptions. Continued government spending on the country's core infrastructures such as airports, metros, railways, ports, smart cities and large-scale data centers, pharma and life sciences industry. Proportion of domestic sales increased to 62% as compared to 55% in the previous year.

The company's Automation and Control Systems business segment is divided into the following key business operations.

1. **Honeywell Process Solutions:** In this segment, the company witnessed strong traction with many of its strategic customers and EPCs with enhanced focus on remote operations and monitoring. The company expanded its reach in various underpenetrated geographies through channel partners and OEM engagements. This business will continue to stay focused on its core strategies and aggressively leverage the new growth levers of digitization, sustainability, and tailwinds across various industry segments like metals, life sciences, pharmaceuticals and gas, etc.
2. **Honeywell Building Solutions:** The business provides automation and control technologies that help make buildings green, safe, productive and smart in verticals like industrials, data centers, pharma and healthcare, energy, premium commercial, transport, infrastructure, etc. The company sees opportunities for value-added services such as analytics, energy optimization, and healthcare in the critical operator segment. In addition, the company is also positioned to drive growth in solutions like connected buildings and cybersecurity.
3. **Building management systems:** The company is a global leader in the building automation space and maintains pole position in India as well. The business will continue to stay focused on its core strategies through sales deployment, on-boarding, channel excellence, pipeline management, and new product offerings. The business will also be focusing on growing verticals like pharma, healthcare, data centers, etc.

Promising growth outlook

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 segments such as pharmaceuticals, life sciences industries, metals, oil & gas and upcoming new airports and smart cities where Honeywell has a significant presence. The company also foresees new business opportunities in the building management segment where it will continue to stay focused on its core strategies through sales deployment, on-boarding, channel excellence, pipeline management, and new product offerings.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	786	683	15.1	668	17.7
Operating profit	122	117	4.5	87	39.6
Other Income	29	22	33.9	25	15.7
Interest	1.3	1.8	-31.5	1	5.9
Depreciation	12	13	-4.2	13	-2.1
PBT	137	124	11.1	99	39.3
Tax	35	32	10.4	26	36.4
Adjusted PAT	102	92	11.4	73	40.3
Adjusted EPS (Rs.)	115	104	11.4	82	40.3
Margin (%)			**BPS**		**BPS**
OPM	15.5	17.1	(157)	13.1	243
NPM	13.0	13.4	(43)	10.9	209
Tax rate	25.8	25.9	(18)	26.3	(54)

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 up further opportunities in the healthcare and pharmaceutical sectors through an expected rise in capacity additions.

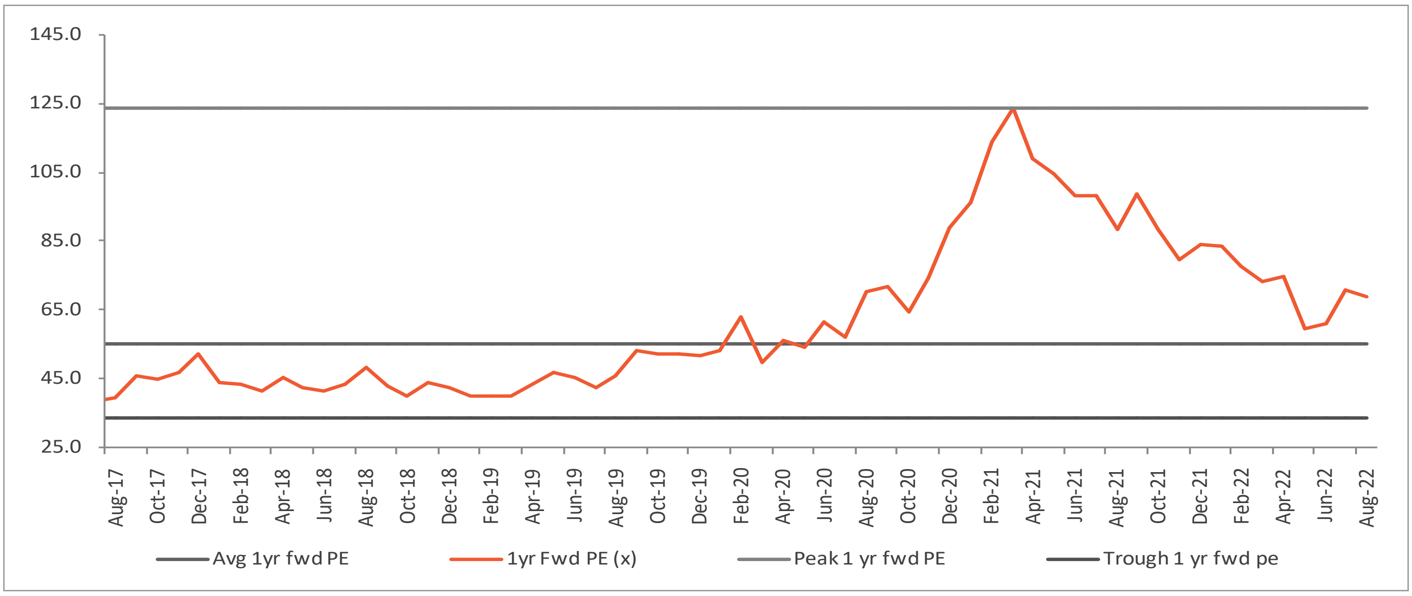
Company outlook - Long-term growth levers intact despite near-term weakness

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 rail projects, airport expansions, RERA, GST, IIoT and 'Make in India' initiatives.

Valuation - Retain Buy with a revised PT of Rs. 49,750

The company has multiple domestic growth levers such as the government's infrastructure investments, including smart cities, airports, metros, railways, ports, over the next five years as well as growing automation demand from metals, healthcare and cybersecurity segments. Continued government spending on the country's core infrastructure and development of large-scale data centers would help the company grow at a healthy pace going ahead. As per annual report, the company's external order book has increased 31% y-o-y and demand outlook remains robust for process and building solutions from all the key user industries. An asset-light model (nil debt), strong cash position, healthy free cash flow generation and promising long-term growth prospects in the automation space justify the stock's premium valuation. Further, supply chain disruptions faced by the industry especially for semi-conductor chips and electronic components is easing. This shall boost revenue and earnings growth. We expect Revenue/PAT CAGR of ~19%/37% over FY22-24E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 49,750 factoring upward 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 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
Dr. Ganesh Natarajan	Independent Director and Board Chairman

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Aditya Birla Sun Life Trustee Co. Pvt. Ltd.	3.94
2	Aditya Birla Sun Life AMC	3.83
3	Nippon Life India Asset Management	2.27
4	Life Insurance Corporation of India	1.84
5	Vanguard Group	0.91
6	Canara Robeco AMC /India	0.77
7	UTI Asset Management Company	0.57
8	Mirae Asset Global Investments Co.	0.50
9	Axis Asset Management Ltd	0.47
10	Tata Asset Management Ltd.	0.36

Source: Bloomberg, Capitaline

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Priya Sonavane; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.