



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

Updated Oct 08, 2022

37.89

High Risk

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

Source: Morningstar

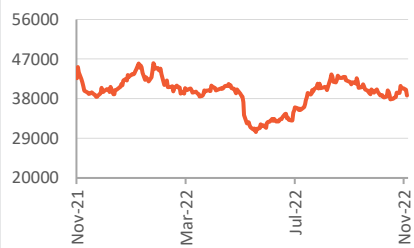
Company details

| | |
|-------------------------------|---------------------|
| Market cap: | Rs. 34,119 cr |
| 52-week high/low: | Rs. 46,398 / 30,185 |
| NSE volume: (No of shares) | 5,948 |
| BSE code: | 517174 |
| NSE code: | HONAUT |
| Free float: (No of shares) | 0.2 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 75.0 |
| FII | 2.9 |
| DII | 12.5 |
| Others | 9.7 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|------|------|-------|-------|
| Absolute | 1.4 | -0.8 | -0.6 | -9.7 |
| Relative to Sensex | -3.8 | -5.6 | -11.0 | -10.6 |

Sharekhan Research, Bloomberg

Honeywell Automation India Ltd

Strong Q2; Growth momentum to continue

Capital Goods

Sharekhan code: HONAUT

Reco/View: Buy



CMP: Rs. 38,596

Price Target: Rs. 49,750



Upgrade



Maintain



Downgrade

Summary

- Q2FY2023 performance was ahead of our expectations on the profit front, while it missed the mark on the revenue front. Revenue rose by 7.7% y-o-y to Rs. 794 crore (versus our estimate of Rs 855 crore).
- Operating profit increased by 19% y-o-y to Rs. 128 crore (in-line with estimate) due to a proportionate decline in RM cost and other expenses. Consequently, OPM improved by 152 bps y-o-y to 16.1% (versus our estimate of 15.7%). Net profit was up 38% y-o-y to ~Rs. 118 crore (versus our estimate of Rs. 114 crore).
- Supply-chain disruptions have not been completely resolved; however, they are improving gradually, which bodes well for growth.
- We retain our Buy rating on the stock with an unchanged PT of Rs. 49,750, as improving growth prospects across end-user industries, asset-light business model, strong parentage, and healthy balance sheet with cash and bank balance of Rs. 2,096 crore (as on Q2FY23) justify the stock's premium valuation.

Honeywell's Q2FY2023 performance has been above our estimates, particularly on the profitability front. Revenue increased by 7.7% y-o-y to Rs. 794 cr (vs. our expectations of Rs. 855 crore). Gross profit margin rose to 49.1% (vs. 47% in Q2FY2022 and 48.8% in Q1FY2023) due to proportionately lower raw-material cost. Operating profit increased by 19% y-o-y to Rs. 128 crore, as the company was able to curtail its other expenses. Operating profit margin (OPM) came in at 16.1%, higher by 152 bps/58 bps y-o-y and q-o-q (beating our estimate of 15.7%). Net profit increased by 38% y-o-y to ~Rs. 118 crore (vs. our estimate of Rs. 114 crore) as a result of good operating performance and higher other income, given strong cash and bank balance.

Key positives

- OPM exceeded our expectations and came in at 16.1%, up 152 bps y-o-y/58 bps q-o-q.
- Net profit grew by ~38% y-o-y to Rs. 118 crore.
- Other income increased by ~114% y-o-y to Rs. 45 crore on account of strong cash balance.
- Working capital cycle has improved due to the decline in debtor days to 78 days vs. 103 days (as of March 2022).

Key negatives

- Sales were lower than our expectation of Rs. 855 crore.

Revision in estimates – We have maintained our estimates for FY2022-FY2024E.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 49,750: Honeywell has multiple domestic growth levers such as the government's infrastructure investments, including smart cities, airports, metros, railways, and 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 centres would help the company grow at a healthy pace going ahead. As per the 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, are expected to ease. This shall boost revenue and earnings growth. We expect Revenue/PAT CAGR of ~19%/37% over FY2022-FY2024E. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 49,750.

Key Risks

- Significant proportion of revenue and profits come from Honeywell International and its affiliates.
- Softening of investments domestically as well as globally and geopolitical uncertainty would affect business operations.

Valuation

| 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 | 486 | 635 |
| EPS (Rs) | 520.4 | 383.6 | 550.1 | 718.2 |
| EPS Growth (%) | (6.4) | (26.3) | 43.4 | 30.6 |
| PER (x) | 74.2 | 100.6 | 70.2 | 53.7 |
| 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 | 17.0 |

Source: Company; Sharekhan estimates

Healthy performance, margins surprise positively

Honeywell's Q2FY2023 performance has been above our estimates, particularly on the profitability front. Revenue increased by 7.7% y-o-y to Rs. 794 crore (vs. our expectation of Rs. 855 crore). Gross profit margin rose to 49.1% (vs. 47% in Q2FY2022 and 48.8% in Q1FY2023) due to proportionately lower raw-material cost. Operating profit increased by 19% y-o-y to Rs. 128 crore as the company was able to curtail its other expenses. OPM came in at 16.1%, higher by 152 bps/58 bps y-o-y and q-o-q (beating our estimate of 15.7%). Net profit increased by 38% y-o-y to ~Rs. 118 crore (vs. our estimate of Rs. 114 crore) as a result of good operating performance and higher other income. Working capital cycle has improved due to the decline in debtor days to 78 days vs. 103 days (as of March 2022).

Stellar performance and upward revision in guidance by the parent post Q3CY2023 results

Honeywell's US-based parent, Honeywell International, has reported stellar Q3CY2023, exceeding the street's expectations. The company has also raised the low end of its full-year organic growth, adjusted its EPS guidance range, and raised its full-year segment margin guidance range. Despite ongoing challenges across supply chains, the company's sales were up by 6% on a reported basis and 9% organically. There was double-digit organic sales growth in segments such as Honeywell Building Technologies, Performance Materials, and Technologies and Aerospace. OPM expanded by 90 bps to 19.5%. The company also has a strong order backlog of US\$29.1 billion (+9% y-o-y). Hence, strong earnings performance and guidance improvement by parent bode well for Honeywell as it indicates that supply-side constraints are being managed well.

Promising growth outlook

We believe 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, the company sees opportunities in segments such as pharmaceuticals, life sciences industries, metals, and oil and 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)

| Particulars | Q2FY23 | Q2FY22 | Y-o-Y % | Q1FY23 | Q-o-Q % |
|-------------------------|------------|------------|-------------|------------|-------------|
| Total Revenue | 794 | 737 | 7.7 | 786 | 1.0 |
| Operating Profit | 128 | 107 | 19.0 | 122 | 4.8 |
| Other Income | 45 | 21 | 114.0 | 29 | 53.7 |
| Interest | 1 | 1 | -14.5 | 1 | -6.3 |
| Depreciation | 13 | 13 | -2.6 | 12 | 2.6 |
| PBT | 159 | 114 | 39.4 | 137 | 15.5 |
| Tax | 41 | 29 | 42.3 | 35 | 15.0 |
| Reported PAT | 118 | 85 | 38.4 | 102 | 15.7 |
| Adj. PAT | 118 | 85 | 38.4 | 102 | 15.7 |
| Adj. EPS (Rs.) | 133.4 | 96.4 | 38.4 | 115.4 | 15.7 |
| Margin (%) | | | BPS | | BPS |
| OPM | 16.1 | 14.6 | 152 | 15.5 | 58 |
| NPM | 14.8 | 11.6 | 329 | 13.0 | 188 |
| Tax rate | 25.7 | 25.1 | 52 | 25.8 | (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, which 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.

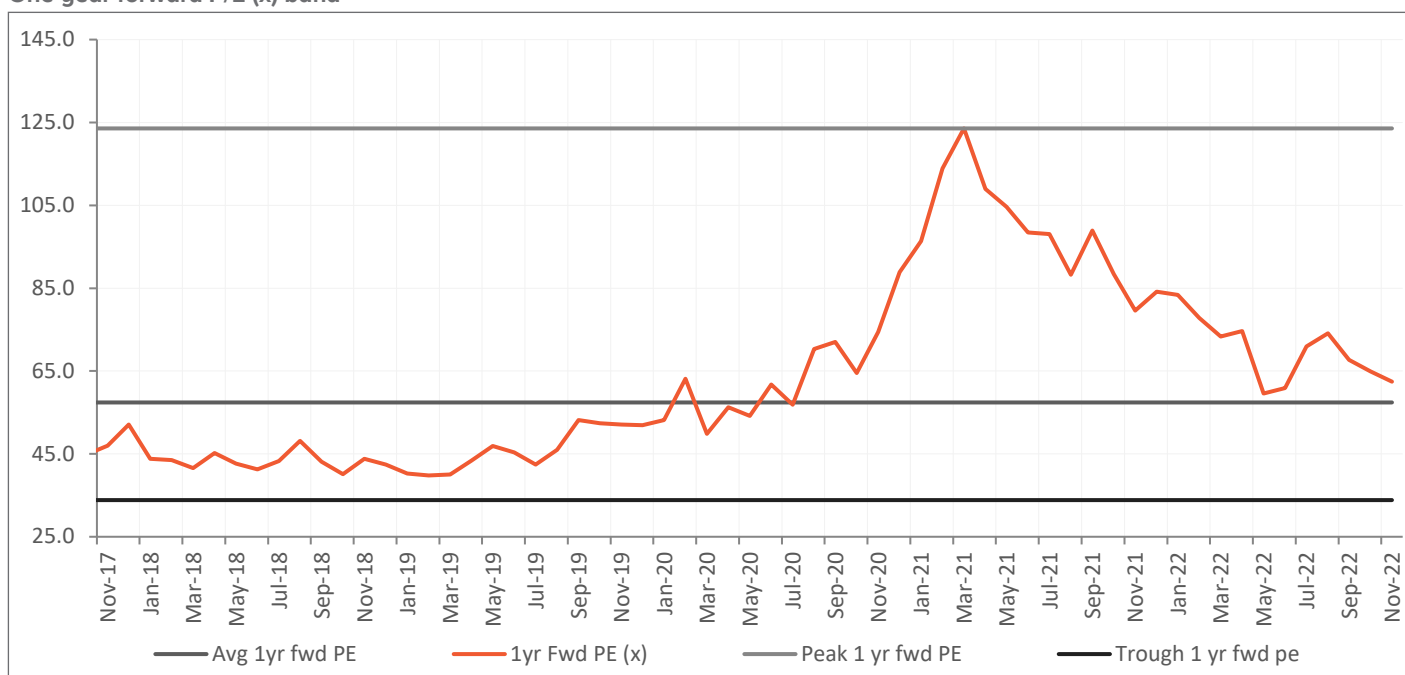
■ Company outlook – Long-term growth levers intact despite near-term weakness

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 an unchanged PT of Rs. 49,750

Honeywell has multiple domestic growth levers such as the government's infrastructure investments, including smart cities, airports, metros, railways, and 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 centres would help the company grow at a healthy pace going ahead. As per the 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, are expected to ease. This shall boost revenue and earnings growth. We expect Revenue/PAT CAGR of ~19%/37% over FY2022-FY2024E. We retain our Buy rating on the stock with an unchanged PT of Rs. 49,750.

One-year forward P/E (x) band



Source: Company, 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 the 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, robust 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 can affect its business operations.

Additional Data

Key management personnel

| | |
|----------------------|---|
| Mr. Ashish Gaikwad | Executive Director-MD |
| Mr. Pulkrit Goyal | Chief Financial Officer |
| Dr. Ganesh Natarajan | Independent Director and Board Chairman |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|---|-------------|
| 1 | Aditya Birla Sun Life Asset Management Co. Ltd. | 3.83 |
| 2 | Aditya Birla Sun Life AMC | 3.83 |
| 3 | Nippon Life India Asset Management | 2.19 |
| 4 | Life Insurance Corporation of India | 1.36 |
| 5 | Vanguard Group | 0.91 |
| 6 | Canara Robeco AMC /India | 0.77 |
| 7 | Mirae Asset Global Investments Co. | 0.58 |
| 8 | UTI Asset Management Company | 0.57 |
| 9 | Axis Asset Management Ltd | 0.47 |
| 10 | Kotak Mahindra Life Insurance Co. | 0.40 |

Source: Bloomberg

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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 deteriorating 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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