Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Honeywell Automation India Ltd

Mixed bag Q3, yet long-term outlook stays bright

Capital Goods	Sharekhan code: HONAUT
Reco/View: Buy ↔	CMP: Rs. 38,079
	Price Target: Rs. 45,000 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q3FY23 performance was a mixed bag, wherein sales were above estimates but operating profitability lagged estimates. Revenue increased by 18.3% y-o-y to Rs. 1,017 crore (versus our estimate of Rs. 957 crore).
- Operating profit increased at a slower pace of 6.8% y-o-y to Rs. 130 crore (below our estimate of Rs. 167 crore) due to increase in raw material cost despite drop in staff cost. Consequently, OPM plunged 138 bps y-o-y to 12.8% (versus our estimate of 17.5%). Net profit was up 18% y-o-y to ~Rs. 106 crore (versus our estimate of Rs. 113 crore).
- As per company's last media interaction, it expects uptick in execution and growth in top line as there are bright spots and opportunities in the global markets. Further, margins are expected to inch up as supply chains ease going forward.
- We retain our Buy rating on the stock with a revised PT of Rs. 45,000, as improving growth prospects across end-user industries, asset-light business model, strong parentage, and a healthy balance sheet justify the stock's premium valuation.

Q3FY23 numbers were a mixed bag, wherein revenue beat estimates, but profitability lagged expectations. Revenue grew by 18.3% y-o-y to Rs. 1,017 crore. Gross profit margin declined to 41.5% (vs 43% in Q3FY22 and 49.1% in Q2FY3) due to higher raw material cost. As a result, operating profit increased at a slower pace of 6.8% y-o-y to Rs. 130 crore. OPM came in at 12.8%, lower by 138 bps/328 bps y-o-y/q-o-q (below our estimate of 17.5%). Net profit increased by 18% y-o-y to ~Rs. 106 crore (Vs our estimate of Rs. 113 crore) mainly as a result of higher other income, which grew by 91% y-o-y.

Key positives

- Sales grew by 18.3% y-o-y to Rs. 1,017 crore.
- Net profit grew by ~18% y-o-y to Rs. 106 crore.
- Employee expenses have declined proportionately on a y-o-y and q-o-q basis.
- Other income increased by ~91.4% y-o-y to Rs. 27 crore on account of strong cash balance.

Key negatives

- Gross margins declined 147 bps y-o-y and 760 bps q-o-q to 41.5%,
- Operating profit and OPM were lower than our expectations.

Revision in estimates – We have fine-tuned our estimates for FY2023-FY2024E.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 45,000: Q3FY23 performance has not been as per expectations despite positive commentary from the management. Hence, the stock may remain range bound in the near term. However, in the long term, the company 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. Further, the company's parent has given robust demand outlook in geographies like India, China and Middle East while the US and Europe may face recessionary fears. 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. Following weak profitability in Q3FY23, we have downgraded our estimates for FY23E. We expect Revenue/PAT CAGR of ~16%/~33% over FY2022-FY2024E. Hence, given a strong earnings CAGR and correction in the stock price, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 45,000.

Key Risks

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

Valuation Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Sales	3,043	2,948	3,457	3,944
OPM (%)	19.4	14.7	14.7	17.1
Net Profit	460	339	435	603
EPS (Rs.)	520.4	383.6	492.0	682.6
EPS Growth (%)	(6.4)	(26.3)	28.2	38.8
PER (x)	73.2	99.3	77.4	55.8
P/BV (x)	11.1	10.1	8.5	7.0
EV/EBITDA (x)	45.5	61.4	51.1	37.4
ROCE (%)	22.7	14.1	15.0	16.9
ROE (%)	19.3	12.5	14.4	16.5

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 Dec 08, 2022

High Risk

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

Source: Morningstar

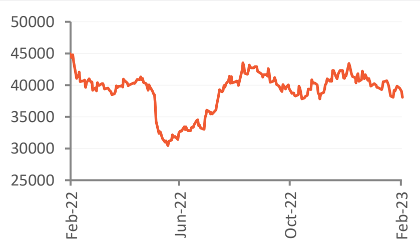
Company details

Market cap:	Rs. 33,662 cr
52-week high/low:	Rs. 45,469/30,185
NSE volume: (No of shares)	5,840
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	-1.9	-2.2	-3.4	-11.9
Relative to Sensex	-3.2	-1.4	-6.4	-16.9

Sharekhan Research, Bloomberg

Poor operating performance

Q3FY23 performance was a mixed bag, wherein revenue were above estimates, however profitability was below expectations. Its revenue grew by 18.3% y-o-y to Rs. 1,017 crore. Gross margins declined to 41.5% (vs 43% in Q3FY22 and 49.1% in Q2FY3) due to higher raw material cost. As a result, operating profit increased at a slower pace of 6.8% y-o-y to Rs. 130 crore. OPM came in at 12.8%, lower by 138 bps/328 bps y-o-y/q-o-q (much below our estimate of 17.5%). Net profit increased by 18% y-o-y to ~Rs. 106 crore (Vs our estimate of Rs. 113 crore) mainly because of higher other income, which grew by 91% y-o-y. During the management's last interaction, it stated that demand environment is favourable and supply-side challenges are easing which should lead to better performance in the long term.

Strong Q4 performance and optimistic outlook by parent bodes well for future growth

Honeywell's US-based parent, Honeywell International, reported a stellar Q4CY23, meeting its guidance and street's expectations. Organic sales were up 10% y-o-y led by double-digit growth in commercial aviation, building products, advanced materials, driven by strong demand from end markets, particularly in long-cycle businesses. Order backlog grew to a new record of US$29.6 billion, up 7% y-o-y and 2% q-o-q. Its outlook for CY23 is on a conservative side with an organic growth of 2% to 5% in sales; segment margin expansion of 50 to 90 basis points and earnings growth flat to up 5%. Hence, strong earnings performance bode well for Honeywell as it indicates that supply-side constraints are being managed well. Geography-wise, while US and Europe may face recessionary headwinds, it expects China, Middle East and India to do well.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Total Revenue	**1,017**	**860**	**18.3**	**794**	**28.1**
Operating Profit	**130**	**122**	**6.8**	**128**	**2.0**
Other Income	27	14	91.4	45	-38.9
Interest	1	1	-4.6	1	-12.7
Depreciation	13	14	-3.3	13	2.7
PBT	**144**	**122**	**18.0**	**159**	**-9.5**
Tax	38	32	18.1	41	-7.5
Reported PAT	106	90	18.0	118	-10.2
Adj. PAT	**106**	**90**	**18.0**	**118**	**-10.2**
Adj. EPS (Rs.)	119.8	101.5	18.0	133.4	-10.2
Margin (%)			**BPS**		**BPS**
OPM	12.8	14.2	(138)	16.1	(328)
NPM	10.4	10.4	(3)	14.8	(444)
Tax rate	26.2	26.2	2	25.7	57

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 & 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.

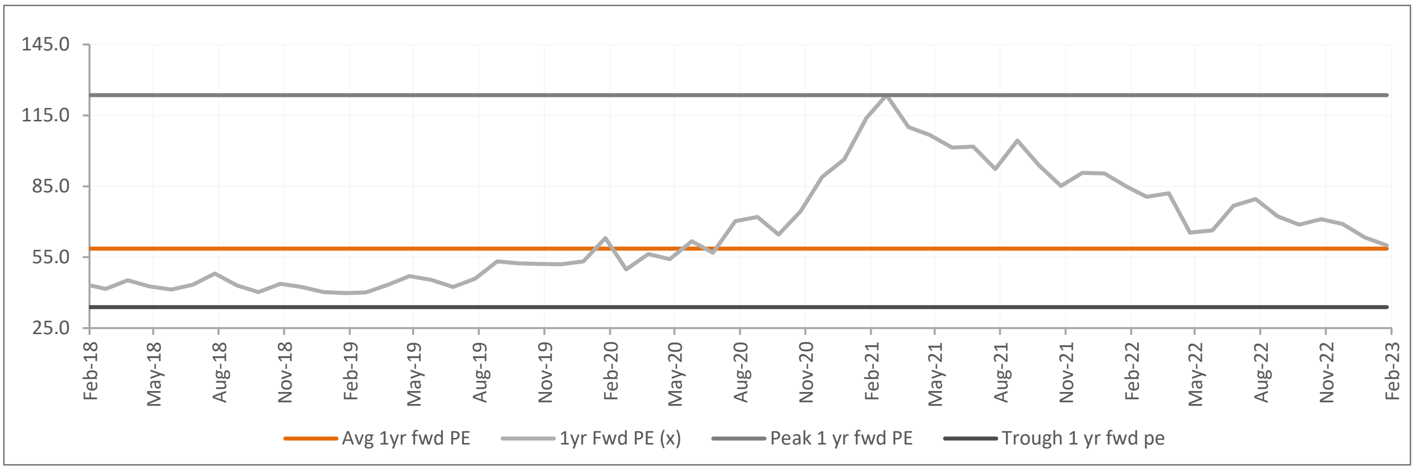
■ Company Outlook – Long-term growth levers intact despite near-term weakness

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 a revised PT of Rs. 45,000

Q3FY23 performance has not been as per expectations despite positive commentary from the management. Hence, the stock may remain range bound in the near term. However, in the long term, the company 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. Further, the company's parent has given robust demand outlook in geographies like India, China and Middle East while the US and Europe may face recessionary fears. 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. Following weak profitability in Q3FY23, we have downgraded our estimates for FY23E. We expect Revenue/PAT CAGR of ~16%/~33% over FY2022-FY2024E. Hence, given a strong earnings CAGR and correction in the stock price, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 45,000.

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 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. Pulkit 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 Trustee Co Pvt Ltd	3.83
2	Aditya Birla Sun Life Asset Management Co Ltd	3.80
3	Vanguard Group Inc	2.19
4	Canara Robeco Asset Management Co Ltd	0.79
5	Mirae Asset Global Investments Co Ltd	0.60
6	UTI Asset Management Co Ltd	0.60
7	Kotak Mahindra Asset Management Co Ltd	0.56
8	Axis Asset Management Co Ltd	0.41
9	Invesco Asset Management India Pvt Ltd	0.36
10	Tata Asset Management Pvt Ltd	0.35

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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Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

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