Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Honeywell Automation India Ltd

OPM pressure continues in Q2; Retain Buy

Capital Goods	Sharekhan code: HONAUT

Reco/View: Buy	↔	CMP: Rs. 36,825	Price Target: Rs. 45,000	↓

↑ 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 Updated Aug 08, 2023	24.45

Medium Risk

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

Source: Morningstar

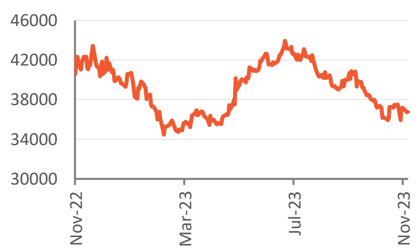
Company details

Market cap:	Rs. 32,553 cr
52-week high/low:	Rs. 44,100 / 34,383
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	3.1
DII	12.4
Others	9.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.7	4.9	-5.6	23.9
Relative to Sensex	6.8	3.2	-5.4	10.3

Sharekhan Research, Bloomberg

Summary

- Q2FY24 saw a healthy beat on revenues although OPMs continued to disappoint on weak gross margins.
- Revenue beat is likely on account of strong domestic execution. Its long cycle contracts may have remained under pressure owing to higher input costs in a highly competitive environment.
- It aims to grow at double the GDP in India, while growth in exports may revive gradually. Focus would remain on industrial digitalization, automation and sustainability.
- We retain a Buy on Honeywell Automation with a revised PT of Rs. 45,000 led by cut in net earnings partially getting offset by rolling forward our valuation multiple to September 2025E earnings.

Revenues were better than expected although they continued to disappoint on OPM during Q2FY2024. Net revenues were up 39% y-o-y to Rs. 1104 crore which is likely to have been driven by higher execution domestically. However, OPM at 12.5% (down 356 bps y-o-y and 41 bps q-o-q) came in lower than our estimate of 13.5%. Miss on OPM was mainly led by lower gross margins (down ~10 percentage points y-o-y and q-o-q to 38.7%. The company's long cycle contracts are likely to have felt sustained pressure on gross margins led by higher input costs since Q1FY2024. Consequently, operating profit was up just 8.3% y-o-y at Rs. 138 crore. Lower OPMs along with lower other income (down 11% y-o-y) led to meagre 3.3% y-o-y growth in net profit which stood at Rs. 122 crore.

Key positives

- Sales grew by 39% y-o-y to Rs. 1104 crore which is likely to have been driven by domestic markets.
- Lower other expenses (down 213 bps y-o-y and 524 bps q-o-q as a % of sales) partly negated lower gross margins.
- Healthy beat on revenues led to in-line PAT.

Key negatives

- Gross margins remained under pressure contracting ~10 ppts both y-o-y and q-o-q to 38.7%.
- Other income declined by 11% y-o-y to Rs. 40 crore.
- OPM continued to remain under pressure over the trailing two quarters.

Revision in estimates – We have lowered our net earnings estimates for FY2024E/FY2025E factoring lower OPMs.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 45,000: HAIL continued to report strong revenue growth led by its robust expansion in domestic market while exports have been remaining stable. The company is expected to see strong growth and is domestically aiming to grow twice of GDP. However, OPMs have remained under pressure as increased input costs affect its long cycle business contracts in a highly competitive environment. It continues to focus on industrial digitalisation, automation and sustainability which is expected to drive revenue growth for a longer period. A wide and rich portfolio of products, solutions, digital-software and services enables it to participate in multiple opportunities, thereby helping it wade through the downturn in some sectors. 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. We have introduced our FY2026E earnings in this note. We expect a revenue/PAT CAGR of ~17%/~20% (FY2023-FY2026E). We retain a Buy rating on the stock with a revised price target (PT) of Rs. 45,000 led by cut in net earnings partially getting offset by rolling forward our valuation multiple to September 2025E earnings.

Key Risks

Softening of investments globally and geopolitical uncertainty would affect business operations.

Valuation (Standalone) Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Net Sales	3,448	4,177	4,845	5,524
OPM (%)	15.0	14.0	15.0	16.0
Net Profit	438	585	620	754
YoY growth (%)	29.2	33.5	6.0	21.6
EPS (Rs.)	495.5	562.8	701.2	852.8
PER (x)	74.3	65.4	52.5	43.2
P/BV (x)	9.0	7.9	6.8	5.9
EV/EBITDA (x)	54.2	47.5	37.7	30.4
ROCE (%)	15.4	15.4	17.0	18.1
ROE (%)	14.5	14.5	15.9	16.6

Source: Company; Sharekhan estimates

Results (Standalone) Rs cr

Particulars	Q2FY24	Q2FY23	Y-o-Y %	Q1FY24	Q-o-Q %
Total Revenue	**1,104**	**794**	**39.0**	**932**	**18.4**
Operating Profit	**138**	**128**	**8.3**	**121**	**14.7**
Other Income	40	45	-10.7	33	21.7
Interest	1	1	-32.2	1	6.7
Depreciation	14	13	7.9	14	1.4
PBT	**164**	**159**	**3.2**	**139**	**17.7**
Tax	42	41	3.2	36	17.5
Adj. PAT	**122**	**118**	**3.3**	**103**	**17.7**
Adj. EPS (Rs.)	**137.8**	**133.4**	**3.3**	**117.0**	**17.7**
Margin (%)			**BPS**		**BPS**
OPM	12.5	16.1	(356)	12.9	(41)
NPM	11.0	14.8	(382)	11.1	(6)
Tax rate	25.6	25.7	(2)	25.7	(4)

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 to 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 – Strong long-term growth levers

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

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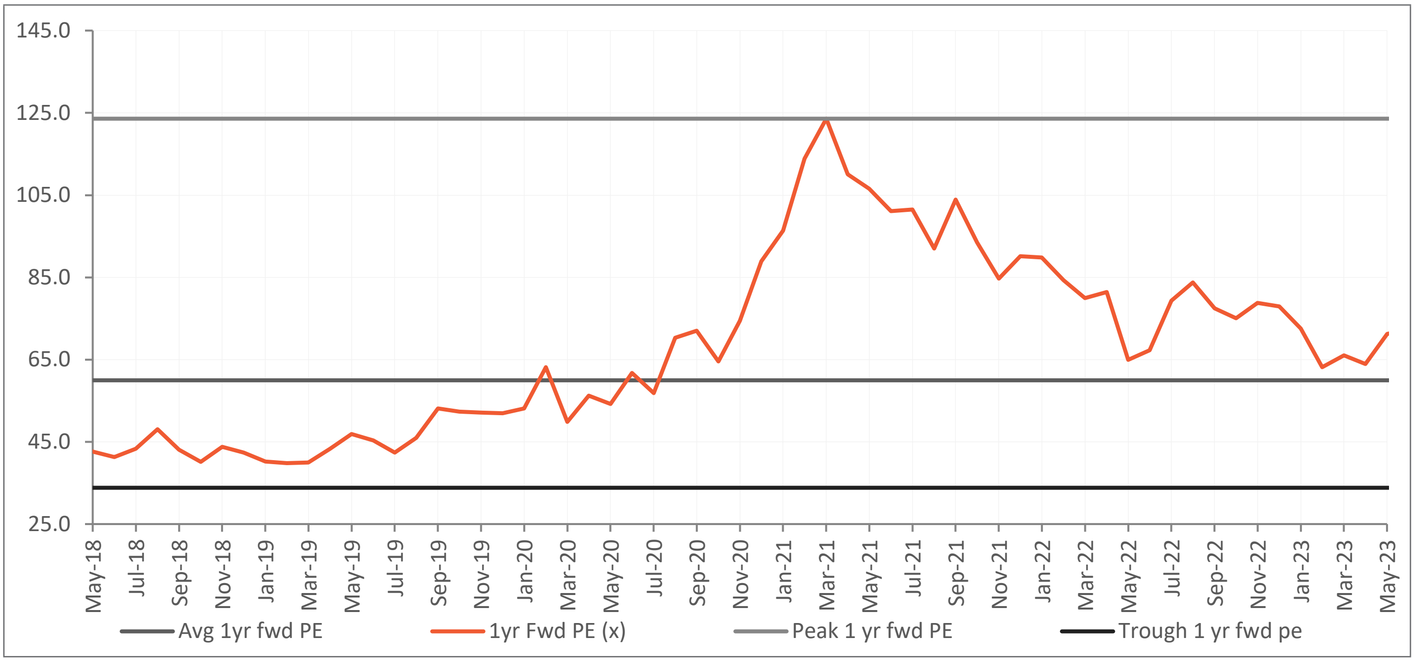
One-year forward P/E (x) band



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, Vadodara, Bengaluru, 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 Asset Management Company	3.55
2	Nippon Life India Asset Management Limited	1.48
3	Life Insurance Corporation of India	1.24
4	Vanguard Group Incorporation	0.78
5	Kotak Mahindra Asset Management Company	0.76
6	Invesco Asset Management India Private	0.72
7	Canara Robeco Asset Management Company	0.62
8	Mirae Asset Global Investments Company	0.57
9	Kotak Mahindra Asset Management Company	0.44
10	Axis Asset Management Company Limited	0.40

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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