Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Honeywell Automation India Ltd

Robust Q4, strong prospects

Capital Goods	Sharekhan code: HONAUT

Reco/View: Buy	↔	CMP: Rs. 39,077	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 37.89

Updated Mar 08, 2023

High Risk

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

Source: Morningstar

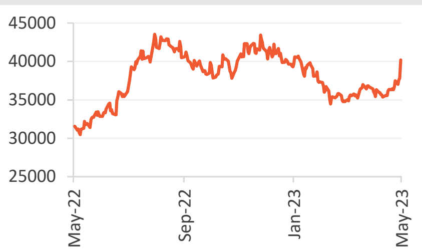
Company details

Market cap:	Rs. 34,544 cr
52-week high/low:	Rs. 44,347/30,185
NSE volume: (No of shares)	5,958
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	10.3	4.9	-5.6	23.9
Relative to Sensex	6.8	3.2	-5.4	10.3

Sharekhan Research, Bloomberg

Summary

- Q4FY2023 performance was healthy, led by strong improvement in margins and net profit. Revenue increased by 27% y-o-y to Rs. 850 crore.
- Operating profit increased by 59% y-o-y to Rs. 139 crore. OPM came in higher at 16.3% (up 327 bps y-o-y). Net profit increased by 54% y-o-y to ~Rs. 112 crore.
- As per the company's last media interaction, it expects uptick in execution and growth in top line as there are bright spots and opportunities in global markets. Margins are expected to improve from FY2023 levels, as inflation, chip shortage, and supply-chain issues are easing gradually.
- We retain our Buy rating on the stock with an unchanged PT of Rs. 45,000, as improving growth prospects across end-user industries, asset-light business model, strong parentage, and cash and bank balance of Rs. 2,380 crore justify the stock's premium valuation.

Honeywell's Q4FY2023 performance was healthy as OPM was above expectations with a miss on revenue estimates. The company's revenue grew by 27% y-o-y to Rs. 850 crore. Gross profit margin improved to 50.3% (vs. 49.4% in Q4FY2022 and 40.6% in Q3FY2023), as raw-material cost declined. As a result, operating profit increased by 59% y-o-y to Rs. 139 crore. Operating profit margin (OPM) came in higher at 16.3% (up 327 bps y-o-y). Net profit increased by 54% y-o-y to ~Rs. 112 crore (in-line with our estimates). Honeywell's FY2023 performance was commendable, given several challenges in the form of cost inflation, shortage of critical components, and other supply-side challenges. FY2023 sales grew by 16.9% y-o-y to Rs. 3,448 crore. Operating profit grew by 19.8% y-o-y to Rs. 519 crore, while OPM came in slightly higher at 15% in FY2023 vs. 14.7% in FY2022. Net profit for FY2023 increased by 29% y-o-y to Rs. 438 crore.

Key positives

- Sales grew by 27% y-o-y to Rs. 850 crore.
- GPM increased by ~90 bps y-o-y to 50.3% in Q4FY2023 vs. 49.4% in Q4FY2022.
- Net profit grew by ~54% y-o-y to Rs. 112 crore.
- Raw-material cost and employee cost declined proportionately

Key negatives

- Other income increased by a mere 6% y-o-y to Rs. 27 crore despite strong cash and bank balance.

Revision in estimates – We have fine-tuned our estimates for FY2024E and introduced FY2025E.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 45,000: Q4FY23 and FY2023 performance has been healthy despite cost and supply-side challenges. In the long term, the company has multiple domestic growth levers such as the government's infrastructure investments, including smart cities, airports, metros, and railways over the next five years as well as growing automation demand from metals, healthcare, and cybersecurity segments. Further, the company's parent has given an optimistic demand outlook in geographies such as India, China, and Middle East, while the U.S. 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 further. This shall boost revenue and earnings growth. We expect Revenue/PAT CAGR of ~17.5%/~26% over FY2023-FY2025E. Hence, given margin improvement and a strong earnings trajectory, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 45,000.

Key Risks

- A significant proportion of revenue and profit comes from Honeywell International and its affiliates.
- Softening of investments globally and geopolitical uncertainty would affect business operations.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net Sales	2,948	3,448	4,086	4,760
OPM (%)	14.7	15.0	16.2	17.7
Net Profit	339	438	662	704
EPS (Rs.)	383.6	495.5	616.3	796.9
EPS Growth (%)	(26.3)	29.2	51.1	6.4
PER (x)	101.9	78.9	63.4	49.0
P/BV (x)	10.1	9.0	7.8	6.6
EV/EBITDA (x)	65.4	54.2	41.9	32.3
ROCE (%)	14.1	15.4	17.2	19.1
ROE (%)	12.5	14.5	15.8	17.6

Source: Company; Sharekhan estimates

Stellar performance

Honeywell's Q4FY2023 performance was healthy as OPM was above expectations with a miss on revenue estimates. The company's revenue grew by 27% y-o-y to Rs. 850 crore. Gross profit margin improved to 50.3% (vs. 49.4% in Q4FY2022 and 40.6% in Q3FY2023), as raw-material cost declined. As a result, operating profit increased by 59% y-o-y to Rs. 139 crore. OPM came in higher at 16.3% (up 327 bps y-o-y). Net profit increased by 54% y-o-y to ~Rs. 112 crore (in-line with our estimates). Honeywell's FY2023 performance was commendable, given several challenges in the form of cost inflation, shortage of critical components, and other supply-side challenges. FY2023 sales grew by 16.9% y-o-y to Rs. 3,448 crore. Operating profit grew by 19.8% y-o-y to Rs. 519 crore, while OPM came in slightly higher at 15% in Q4FY2023 vs. 14.7% in Q4FY2022. Net profit increased by 29% y-o-y to Rs. 438 crore.

Optimistic outlook and change in lead management in the parent company

Honeywell's U.S.-based parent, Honeywell International has an optimistic outlook for CY2023 with a guidance of organic growth of 2% to 5% in sales; segment margin expansion of 50-90bps and earnings growth flat to 5% growth. Geography wise, while U.S. and Europe may face recessionary headwinds, it expects China, Middle East, and India to do well. Further, in its parent company, the incoming president and COO – Vimal Kapur – would lead the energy transition, automation, and digitalisation process of the company. This bodes well for Honeywell Automation as well.

Results (Standalone) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Total Revenue	**850**	**668**	**27.2**	**1,017**	**-16.5**
Operating Profit	**139**	**87**	**58.9**	**130**	**6.5**
Other Income	27	25	5.9	27	-2.6
Interest	0.49	1	-58.8	1	-52.4
Depreciation	14	13	6.0	13	2.7
PBT	**151**	**99**	**53.6**	**144**	**5.5**
Tax	40	26	52.3	38	5.0
Reported PAT	112	73	54.0	106	5.7
Adj. PAT	**112**	**73**	**54.0**	**106**	**5.7**
Adj. EPS (Rs.)	126.6	82.2	54.0	119.8	5.7
Margin (%)			**BPS**		**BPS**
OPM	16.3	13.1	326	12.8	352
NPM	13.2	10.9	229	10.4	277
Tax rate	26.1	26.3	(22)	26.2	(14)

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

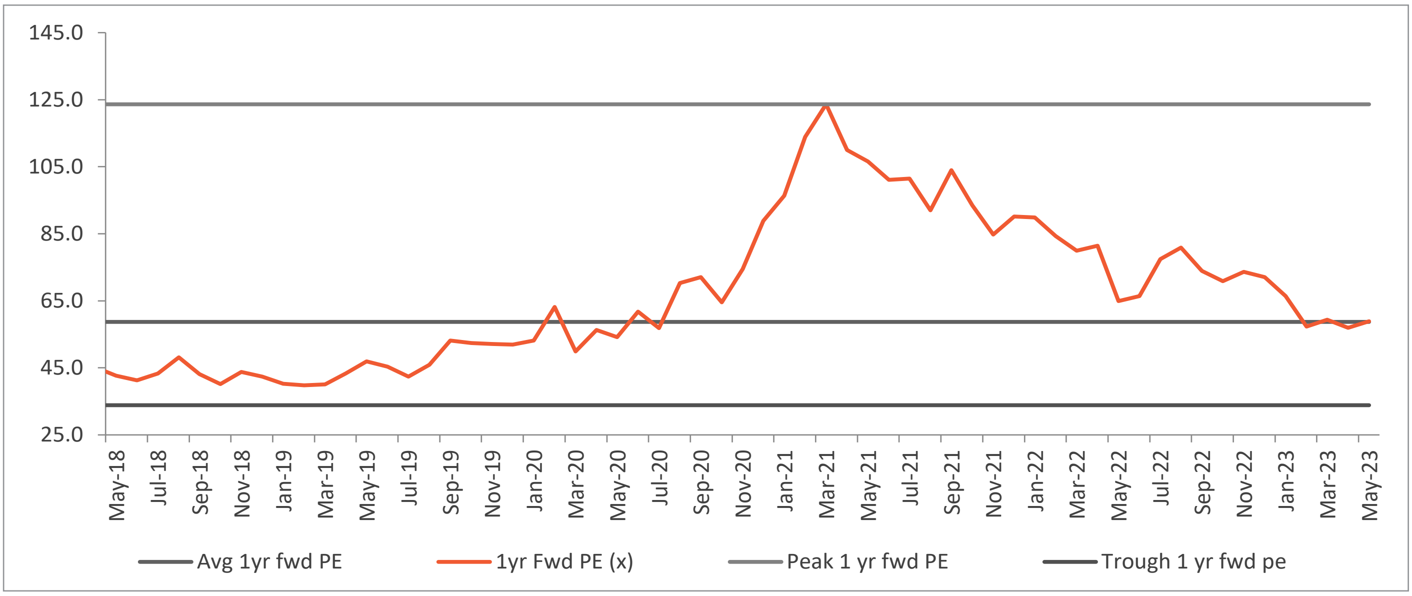
■ Company outlook - Strong long-term growth levers

Honeywell's focus on the 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. 45,000

Q4FY23 and FY2023 performance has been healthy despite cost and supply-side challenges. In the long term, the company has multiple domestic growth levers such as the government's infrastructure investments, including smart cities, airports, metros, and railways over the next five years as well as growing automation demand from metals, healthcare, and cybersecurity segments. Further, the company's parent has given an optimistic demand outlook in geographies such as India, China, and Middle East, while the U.S. 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 further. This shall boost revenue and earnings growth. We expect Revenue/PAT CAGR of ~17.5%/~26% over FY2023-FY2025E. Hence, given margin improvement and a strong earnings trajectory, we retain our Buy rating on the stock with an unchanged 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

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	3.74
3	Nippon Life India Asset Management	1.63
4	Life Insurance Corp of India	1.24
5	Vanguard Group Inc.	0.91
6	Canara Robeco Asset Management	0.68
7	Kotak Mahindra Asset Management	0.66
8	Invesco Asset Management India	0.63
9	Mirae Asset Global Investments	0.59
10	Kotak Mahindra Life Insurance	0.45

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

Sharekhan

by BNP PARIBAS

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