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Q4FY21 result review
and reco change

Capital Goods

Target price Rs36,942

Earnings revision

(%)	FY22E	FY23E
Sales	↓ 9.0	↓ 9.0
EBITDA	↓ 16.5	↓ 16.3
EPS	↓ 16.7	↓ 15.1

Target price revision

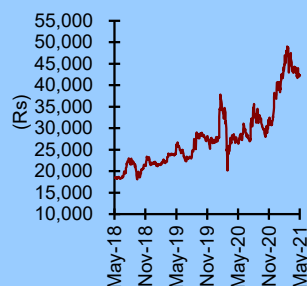
Rs36,942 from Rs40,679

Shareholding pattern

	Sep '20	Dec '20	Mar '21
Promoters	75.0	75.0	75.0
Institutional investors	15.0	14.8	14.9
MFs and other	12.9	12.4	11.0
FIs/Banks	0.0	0.0	0.0
Insurance Cos.	1.3	1.4	1.8
FII	0.8	1.0	2.1
Others	10.0	10.2	10.1

Source: BSE

Price chart



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INDIA

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Honeywell Automation India

REDUCE

Downgrade from Hold

Rs42,846

Weak execution impacts earnings

Honeywell Automation India (HAIL) witnessed 4.5% YoY and 23% QoQ drop in revenues to Rs6.7bn, which we believe should be due to advent of covid second wave. Company reported an EBITDA margin of 19.2% (up 100bps YoY / down 220bps QoQ) despite 340bps YoY increase in raw material costs to Rs3.3bn. Other expenses declined 26% YoY and staff expenses dipped 7% YoY due to cost-reduction measures, supporting the margins. We believe, the margin expansion was aided by reduction in travel due to covid restrictions. Net working capital increased to 51 days from 33 in FY20 due to higher receivables. Factoring-in the revenue slippage, we cut our FY21E and FY22E earnings estimates by 16.7% and 15.1% respectively. Given the rich valuation and near-term uncertainty of growth, we downgrade the stock to **REDUCE** (from *Hold*) with a revised target price of Rs36,942 (earlier: Rs40,679).

- **Downgrade to REDUCE on rich valuation and working capital stretch:** The long-term secular growth drivers in process automation, diversification towards building and cyber security, and constant improvement in the company's technical portfolio, will drive HAIL's long-term growth. However, given the near to medium term uncertainty and the increase in receivables impacting working capital, we downgrade the stock to **REDUCE**. In view of the outsourcing nature of the export segment, the multiple we assign to it is different from the one to the domestic segment. We assign a multiple of 65x FY23E earnings to the domestic business and 30x FY23E to the export business, thus arriving at an SoTP-based target price of Rs36,942. We assume the percentage contribution of exports in the earnings to be similar as in the revenues. We have rolled forward our target multiple to FY23E earnings from Sep'22E earnings.
- **Leadership in domestic process automation:** HAIL is engaged inter alia in 'smart city' solutions in the areas of traffic management, etc. Company also has healthy market share in automation solutions for other process industries such as chemicals, paper, sugar, metals, thermal power, etc. HPCL Barmer related tenders are expected to be finalised in the next six months and, we believe, HAIL will be a key beneficiary of the same. Company is also a key player in building and various infrastructure automation, hence can benefit from government spending towards the same.
- **Secular growth in exports:** Exports witnessed strong growth at 17% CAGR during FY16-FY20 and contributed 44% to FY20 revenues. Majority of these exports are towards overseas entities related to the parent and comprise global engineering services. We believe, due to the low-cost advantage of outsourcing to the Indian entity by the parent, HAIL's export growth trend is likely to continue.
- **Tapping into building automation:** HAIL is one of the major players in the domestic building automation market. The segment is expected to witness healthy growth given the general focus on security and safety.

Market Cap	Rs379bn/US\$5.2bn	Year to Mar	FY20	FY21	FY22E	FY23E
Reuters/Bloomberg	HONE.BO/HWA IN	Revenue (Rs mn)	32,900	30,427	34,991	39,762
Shares Outstanding (mn)	8.8	EBITDA(Rs mn)	6,364	5,889	6,998	8,102
52-week Range (Rs)	49050/26995	Net Income (Rs mn)	4,915	4,602	5,633	6,624
Free Float (%)	25.0	EPS (Rs)	556.0	520.6	637.3	749.3
FII (%)	0.8	P/E (x)	76.4	81.6	66.7	66.7
Daily Volume (US\$'000)	4,918	CEPS (Rs)	601.9	575.6	695.1	800.2
Absolute Return 3m (%)	(4.8)	EV/E (x)	56.7	60.7	50.3	50.3
Absolute Return 12m (%)	59.0	Dividend Yield	0.2	0.2	0.2	0.2
Sensex Return 3m (%)	6.0	RoCE (%)	25.3	19.5	20.1	20.1
Sensex Return 12m (%)	62.1	RoE (%)	25.0	19.3	20.0	20.0

Outlook and valuation

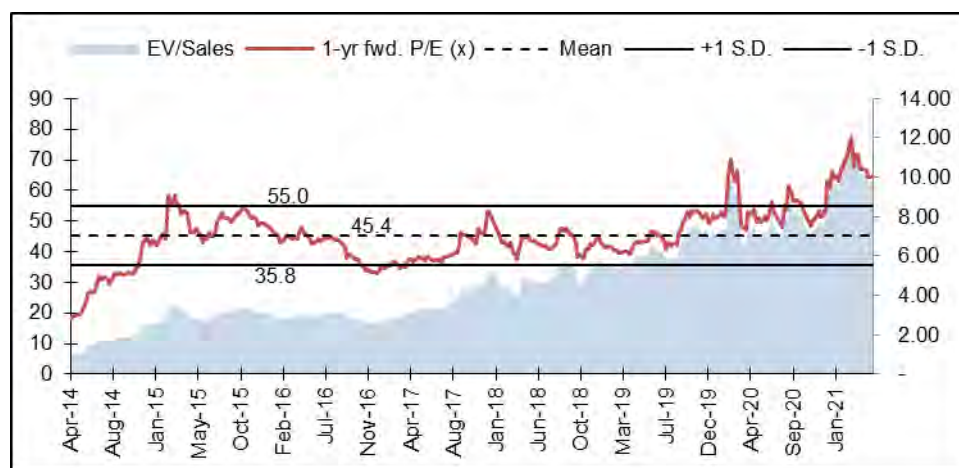
Honeywell Automation India (HAIL) is in a unique position as a secular play in the domestic process automation opportunity. It is also trying to hedge itself from the oil & gas segment by focusing on other areas such as building automation, 'smart city' solutions, cyber security, etc. Exports have been a major growth driver in the past 4-5 years.

Given the weak execution and the increase in working capital, we believe the growth momentum has been impacted in the near term. Current valuations are high, hence we have downgraded the stock to **REDUCE** (from **Hold**).

The three major focus areas in the near term are: (i) healthcare and pharma, (ii) air quality and hygiene products and solutions, and (iii) products and systems to ease remote working & connected buildings.

Given the diverse nature of its businesses, capabilities and returns of the outsourcing-based export segment and technology-based domestic process automation segment, we value the company by SoTP methodology. We assume the percentage contribution of exports in the earnings to be similar as in the revenues (the company does not share these data points separately). We assign a multiple of 65x FY23E earnings for the domestic automation segment and 30x FY23E earnings for the outsourcing-based export business.

Chart 1: 1-year forward P/E



Source: Bloomberg, I-Sec research

Table 1: SoTP valuation

SoTP	Contribution (%)	FY23E EPS (Rs)	Multiple (x)	Target price
Domestic	55	413	65	26,857
Export	45	336	30	10,084
Total		637		36,942

Source: Company data, I-Sec research

Table 2: Earnings revision

(Rs mn)

Rs mn	FY22E			FY23E		
	Earlier	Revised	YoY (%)	Earlier	Revised	YoY (%)
Revenue	38,451	34,991	(9.0)	43,696	39,762	(9.0)
EBIDTA	8,384	6,998	(16.5)	9,679	8,102	(16.3)
PAT	6,760	5,633	(16.7)	7,807	6,624	(15.1)

Source: Company data, I-Sec research

Table 3: Quarterly financial highlights

(Rs mn)	Q4FY20	Q4FY21	YoY(%)	Q3FY21	QoQ(%)	I-Sec est	Var (%)	FY20	FY21	YoY(%)
Net Sales	7,043	6,727	(4.5)	8,742	(23.0)	9,735	(30.9)	32,900	30,427	(7.5)
EBITDA	1,286	1,292	0.5	1,876	(31.1)	2,108	(38.7)	6,364	5,889	(7.5)
Margin	18.3	19.2	95bps	21.5	-225bps	21.7	-246bps	19.3	19.4	0bps
Depreciation	118	130	9.9	127	2.4	110	18.1	406	487	19.9
Finance Cost	15	17	8.6	13	25.0	14	14.6	69	60	(12.7)
Other Income	337	237	(29.6)	285	(16.6)	310	(23.3)	977	840	(14.0)
PBT	1,489	1,383	(7.2)	2,020	(31.6)	2,293	(39.7)	6,866	6,182	(10.0)
Tax	378	342	(9.4)	521	(34.3)	535	(36.0)	1,951	1,580	(19.0)
tax rate	25.4	24.8	-61bps	25.8	-104bps	23.3	142bps	28.4	25.6	-290bps
Reported PAT	1,111	1,040	(6.4)	1,499	(30.6)	1,758	(40.8)	4,915	4,602	(6.4)
Adjusted PAT	1,111	1,040	(6.4)	1,499	(30.6)	1,758	(40.8)	4,915	4,602	(6.4)
Margin(%)	15.8	15.5	-32bps	17.1	-168bps	18.1	-260bps	14.9	15.1	20bps
EPS	125.7	117.7		169.6		198.9		556.0	520.6	

Source: Company data, I-Sec research

Financial summary

Table 4: Profit & Loss statement
(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Total Income	32,900	30,427	34,991	39,762
Operating Expenses	26,537	24,539	27,994	31,660
EBITDA	6,364	5,889	6,998	8,102
% margins	19.3	19.4	20.0	20.4
Depreciation & Amortisation	406	487	511	450
EBIT	5,958	5,402	6,487	7,652
Gross Interest	69	60	60	60
Other Income	977	840	1,084	1,240
PBT before exceptional	6,866	6,182	7,511	8,832
Add: Extraordinary	-	-	-	-
/Exceptionals	0	-	-	-
Add: Share in associates	-	-	-	-
PBT	6,866	6,182	7,511	8,832
Less: Taxes	1,951	1,580	1,878	2,208
Less: Minority Interests	-	-	-	-
Net Income (Reported)	4,915	4,602	5,633	6,624
Adjusted Net Income	4,915	4,602	5,633	6,624

Source: Company data, I-Sec research

Table 5: Balance sheet
(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Assets				
Total Current Assets	29,559	35,090	41,765	49,461
of which cash & cash eqv.	15,139	17,969	23,530	28,740
Total Current Liabilities & Provisions	12,758	13,737	15,567	17,529
Net Current Assets	16,801	21,354	26,198	31,933
Investments	-	-	-	-
Other Non-Current Assets	2,912	2,248	2,248	2,248
Net Fixed Assets	2,103	2,187	2,180	2,230
Goodwill	-	-	-	-
Total Assets	21,816	25,789	30,626	36,411
Liabilities				
Borrowings	34	-	-	-
Deferred Tax Liability	-	-	-	-
Minority Interest	-	-	-	-
Equity Share Capital	88	88	88	88
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus	21,694	25,700	30,538	36,322
Net Worth	21,783	25,789	30,626	36,411
Total Liabilities	21,816	25,789	30,626	36,411

Source: Company data, I-Sec research

Table 6: Cashflow statement
(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Operating Cashflow	4,222	4,329	5,120	5,894
Working Capital Changes	-922	-1,646	717	-525
Capital Commitments	-509	-674	-504	-500
Free Cashflow	2,791	2,009	5,333	4,869
Cashflow from Investing Activities	654	1,484	1,084	1,240
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	34	-34	-	-
Interest paid	-69	-60	-60	-60
Dividend paid	-663	-751	-796	-840
Extraordinary Items/Others	147	183	-0	-0
Chg. in Cash & Bank balance	2,894	2,830	5,562	5,210

Source: Company data, I-Sec research

Table 7: Key ratios
(Year ending March 31)

	FY20	FY21	FY22E	FY23E
Per Share Data (in Rs.)				
Diluted adjusted EPS	556	521	637	749.3
Recurring Cash EPS	602	576	695	800.2
Dividend per share (DPS)	75	85	90	95.0
Book Value per share (BV)	2,464	2,917	3,465	4,118.9
Growth Ratios (%)				
Operating Income	3.6	-7.5	15.0	13.6
EBITDA	26.4	-7.5	18.8	15.8
Recurring Net Income	37.0	-6.4	22.4	17.6
Diluted adjusted EPS	37.0	-6.4	22.4	17.6
Diluted Recurring CEPS	42.0	-4.4	20.7	15.1
Valuation Ratios				
P/E	76.4	81.6	66.7	66.7
P/CEPS	70.6	73.8	61.1	61.1
P/BV	17.2	14.6	12.3	12.3
EV / EBITDA	56.7	60.7	50.3	50.3
EV / Operating Income	11.0	11.8	10.1	10.1
EV / Op. FCF (pre -Capex)	109.3	133.3	60.3	60.3
Operating Ratios				
Raw Material/Sales (%)	49.9	50.3	51.0	51.0
SG&A/Sales (%)	13.9	13.1	12.5	12.5
Other Income / PBT (%)	14.2	13.6	14.4	14.4
Effective Tax Rate (%)	28.4	25.6	25.0	25.0
NWC / Total Assets (%)	0.1	0.1	0.1	0.1
Inventory Turnover (days)	13.4	11.4	14.2	14.2
Receivables (days)	82.4	114.7	95.0	95.0
Payables (days)	205.8	261.5	221.4	221.4
Net D/E Ratio (x)	-0.7	-0.7	-0.8	-0.8
Return/Profitability Ratios (%)				
Recurring Net Income Margins	14.9	15.1	16.1	16.1
RoCE	25.3	19.5	20.1	20.1
RoNW	25.0	19.3	20.0	20.0
Dividend Payout Ratio	0.1	0.2	0.1	0.1
Dividend Yield (%)	0.2	0.2	0.2	0.2
EBITDA Margins	19.3	19.4	20.0	20.0

Source: Company data, I-Sec research

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