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Q2FY21 result review

## Capital Goods

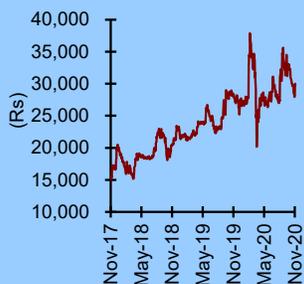
Target price: Rs31,400

### Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	75.0	75.0	75.0
Institutional investors			
MFs and other	14.6	14.6	15.0
FIs/Banks	13.6	13.0	12.9
Insurance Cos.	0.0	0.0	0.0
FII	0.3	0.8	1.2
FII	0.7	0.8	0.9
Others	10.4	10.4	10.0

Source: BSE

### Price chart



INDIA

**ICICI Securities**

# Honeywell Automation India

**HOLD**

Maintained

**Rs30,551**

## Healthy margin and cashflow

Honeywell Automation India (HAIL) has witnessed 8% YoY drop in revenue to Rs7.6bn, implying slow pickup in execution. The company has reported EBITDA margin of 19% (up 80bps YoY) as material costs decreased 150bps YoY to 49.6% and 11% YoY drop in other expenses due to cost reduction measures supporting margin. We believe margin expansion is aided partly by rupee depreciation and partly by reduction in travel given the Covid-19 pandemic related restrictions. Given the market leadership in domestic oil & gas space (both in the refinery segment and retail stations), strong parent's expertise and sustainable growth in export segment, we maintain our HOLD rating on the stock with an unchanged target price of Rs31,400.

- ▶ **Working capital increased, however, in control:** There has been an increase in receivables, which we believe, might be due to higher mix of government contracts. Despite this, the cash from operations has been healthy at Rs1.3bn vs Rs1.6bn in H1FY20. We believe this should normalise going forward.
- ▶ **Leadership in domestic process automation:** HAIL is also engaged in 'smart city' solutions in areas of traffic management, etc. The company also has healthy market share in automation solutions for other process industries such as chemicals, paper, sugar, metals, thermal power, etc.
- ▶ **Secular growth in exports:** Exports witnessed strong growth at 17% CAGR during FY16-FY20 and contributed 44% to FY20 revenue. Majority of these exports are towards overseas entities related to the parent comprising global engineering services. Given the low-cost advantage of outsourcing to the Indian entity by the parent, HAIL's export growth trend may continue, in our view.
- ▶ **Tapping into building automation:** HAIL is one of the major players in the domestic building automation market. This segment is likely to witness healthy growth given the focus on security and safety. Additionally, energy optimisation solutions are evolving as a potential growth area.
- ▶ **Maintain HOLD given rich valuation:** Given the long-term secular growth drivers in process automation, diversification towards building and cyber security, and constant improvement in the company's technical portfolio, we maintain our **HOLD** rating on the stock despite rich valuation. Given the outsourcing nature of the export segment, we assign a different multiple for this segment than domestic segment. Hence, we value the stock by SoTP methodology. We assign multiple of 60x FY22E earnings to the domestic business, 30x FY22E to export business and hence, arrive at SoTP-based target price of Rs31,400. We assume the percentage contribution of exports in earnings will be similar to revenues.

Market Cap	Rs270bn/US\$3.6bn	Year to Mar	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	HONE.BO/HWA IN	Revenue (Rs mn)	31,747	32,900	33,435	37,536
Shares Outstanding (mn)	8.8	EBITDA (Rs mn)	5,034	6,364	6,517	7,361
52-week Range (Rs)	37857/20149	Net Income (Rs mn)	3,588	4,915	5,207	6,024
Free Float (%)	25.0	EPS (Rs)	405.9	556.0	589.0	681.5
FII (%)	0.9	P/E (x)	75.4	55.0	52.0	44.9
Daily Volume (US\$'000)	2,014	CEPS (Rs)	423.9	601.9	637.2	732.1
Absolute Return 3m (%)	(1.5)	EV/E (x)	51.3	40.1	38.4	33.1
Absolute Return 12m (%)	9.6	Dividend Yield	0.1	0.2	0.1	0.2
Sensex Return 3m (%)	12.3	RoCE (%)	22.8	25.3	21.7	20.6
Sensex Return 12m (%)	6.9	RoE (%)	22.7	25.0	21.5	20.5

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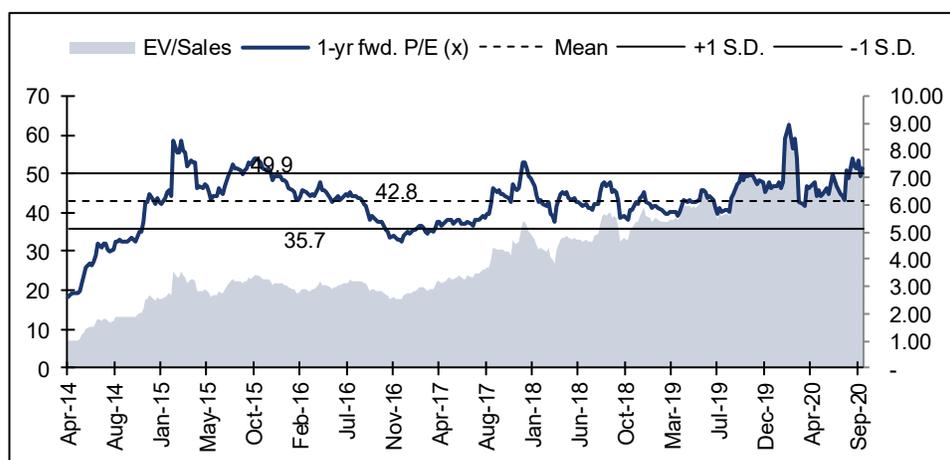
## Outlook and valuation

Honeywell Automation India (HAIL) is in a unique position as a secular play in domestic process automation opportunity. The company is also trying to hedge itself from 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 and this trend is likely to continue.

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. Long-term risk to business includes entry of Chinese and other Asian players into this market, which may increase the competition and reduce the scope of improvement in revenue and profitability. We believe the risk from aggressive pricing strategy by Chinese may get mitigated because of the recent anti-China stance by the government of India.

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 earnings will be similar to revenues (the company does not share these data points separately). We assign a multiple of 60x FY22E earnings for domestic automation segment and 30x FY22E earnings for outsourcing-based export business.

**Chart 1: 1-year forward P/E**



Source: Bloomberg, I-Sec research

**Table 1: SoTP valuation**

SoTP	Contribution (%)	FY22E EPS (Rs)	Multiple (x)	Target price
Domestic	54	365	60	21,913
Export	46	316	30	9,487
<b>Total</b>		<b>681</b>		<b>31,400</b>

Source: Company data, I-Sec research

**Table 2: Quarterly financial highlights**

(Rs mn)	Q2FY20	Q2FY21	YoY(%)	Q1FY21	QoQ(%)	H1FY20	H1FY21	YoY(%)
Net Sales	8,275	7,597	(8.2)	7,362	3.2	16,846	14,959	(11.2)
EBITDA	1,505	1,443	(4.1)	1,279	12.8	3,192	2,722	(14.7)
Margin	18.2	19.0	80bps	17.4	162bps	18.9	18.2	-80bps
Depreciation	87	114	30.4	116	(1.8)	173	230	33.2
Finance Cost	14	18	29.4	15	18.9	35	32	(8.0)
Other Income	261	144	(45.0)	174	(17.6)	448	318	(29.0)
PBT	1,666	1,455	(12.6)	1,323	10.0	3,432	2,778	(19.1)
Tax	463	374	(19.2)	342	9.5	1,089	716	(34.2)
tax rate	27.8	25.7	-209bps	25.8	-11bps	31.7	25.8	-590bps
Reported PAT	1,202	1,081	(10.1)	981	10.2	2,343	2,061	(12.0)
Adjusted PAT	1,202	1,081	(10.1)	981	10.2	2,343	2,061	(12.0)
Margin(%)	14.5	14.2	-30bps	13.3	90bps	13.9	13.8	-10bps
EPS	136.0	122.2		111.0		265.1	233.2	

Source: Company data, I-Sec research

**Table 3: Net-working capital**

(Rs mn)	Q4FY20	Q2FY21	Change
Inventory	1,209	1,030	(179)
Debtors	7,236	7,534	298
Other financial assets	4,937	5,439	503
Other assets	1,046	1,100	54
Payables	8,480	9,046	566
Other liabilities	2,112	1,615	(496)
<b>Net working capital</b>	<b>2,734</b>	<b>3,482</b>	<b>747</b>
Net working capital as % of sales	8.3	11.2	-292bps
<b>Net working capital days</b>	<b>30</b>	<b>41</b>	<b>11</b>
Inventory days	13	12	(1)
Debtors days	80	89	8
Payables days	94	106	12

Source: Company data, I-Sec research

**Table 4: Key assumptions**

	CY 10	CY 11	CY 12	CY 13	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20	FY 21E	FY 22E
Exports (Rs bn)	4.8	5.4	6.0	5.5	7.6	7.7	10.5	12.0	14.6	14.4	15.1	17.4
Growth YoY (%)	(0.9)	11.7	11.6	(8.8)	39.2	1.0	36.0	14.6	21.7	(1.3)	5.0	15.0
as % of total sales	35.6	33.3	36.1	32.1	31.7	35.2	43.5	44.5	46.0	43.8	45.3	46.4
Domestic (Rs bn)	8.7	10.8	10.6	11.6	16.4	14.2	14.0	15.0	17.1	18.3	18.3	20.1
Growth YoY (%)	26.8	23.2	(1.4)	9.3	41.6	(13.7)	(1.4)	7.2	14.3	6.8	-	10.0
as % of total sales	64.4	66.7	63.9	67.9	68.3	64.8	57.9	55.5	53.9	55.6	54.7	53.6
Manufactured products & jobs (Rs mn)	8,501	10,286	9,903	10,539	15,250	13,395	13,680	15,053	18,134	18,315		
as % of total sales	61.9	62.9	58.5	60.7	62.5	60.3	56.0	55.8	57.1	56.0		
Traded products (Rs mn)	1,605	1,809	1,898	2,080	2,668	2,587	3,041	3,634	4,269	4,183		
as % of total sales	11.7	11.1	11.2	12.0	10.9	11.6	12.4	13.5	13.5	12.8		
Sale of services (Rs mn)	3,635	4,264	5,132	4,753	6,493	6,223	7,716	8,282	9,331	10,216		
as % of total sales	26.4	26.1	30.3	27.4	26.6	28.0	31.6	30.7	29.4	31.2		

Source: Company data, I-Sec research

Revenue CAGR for the period CY10-FY20 was 10%, wherein exports CAGR was 12.6% and domestic revenue CAGR 8.3%. Within products and services, for CY10-FY20, CAGR has been 11.8% for services, 11% for traded products and 8.7% for manufactured products and jobs.

Given that export contribution has been increasing steadily (from 35% in FY16 to 44% in FY20), we expect exports to be a major growth driver in near to medium term. For FY20-FY22E, we expect an overall revenue CAGR of 6.8% with export CAGR of 10% and domestic revenue CAGR of 5%.

## Financial summary

**Table 5: Profit & loss statement**
*(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E
<b>Total Income</b>	<b>31,747</b>	<b>32,900</b>	<b>33,435</b>	<b>37,536</b>
<b>Operating Expenses</b>	<b>26,714</b>	<b>26,537</b>	<b>26,919</b>	<b>30,176</b>
<b>EBITDA</b>	<b>5,034</b>	<b>6,364</b>	<b>6,517</b>	<b>7,361</b>
<i>% margins</i>	<i>15.9</i>	<i>19.3</i>	<i>19.5</i>	<i>19.6</i>
Depreciation & Amortisation	159	406	426	447
<b>EBIT</b>	<b>4,875</b>	<b>5,958</b>	<b>6,091</b>	<b>6,913</b>
Gross Interest	35	69	60	60
Other Income	709	977	912	1,179
<b>PBT before exceptional</b>	<b>5,549</b>	<b>6,866</b>	<b>6,943</b>	<b>8,032</b>
Add: Extraordinaries	-	-	-	-
/Exceptionals	-	0	-	-
Add: Share in associates	-	-	-	-
<b>PBT</b>	<b>5,549</b>	<b>6,866</b>	<b>6,943</b>	<b>8,032</b>
Less: Taxes	1,961	1,951	1,736	2,008
Less: Minority Interests	-	-	-	-
<b>Net Income (Reported)</b>	<b>3,588</b>	<b>4,915</b>	<b>5,207</b>	<b>6,024</b>
<b>Adjusted Net Income</b>	<b>3,588</b>	<b>4,915</b>	<b>5,207</b>	<b>6,024</b>

Source: Company data, I-Sec research

**Table 6: Balance sheet**
*(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E
<b>Assets</b>				
Total Current Assets	25,144	29,567	36,837	44,353
of which cash & cash eqv.	12,245	15,139	20,518	27,065
Total Current Liabilities & Provisions	11,431	12,792	14,983	16,670
<b>Net Current Assets</b>	<b>13,713</b>	<b>16,774</b>	<b>21,854</b>	<b>27,683</b>
Investments	-	-	-	-
Other Non-Current Assets	2,830	2,936	2,936	2,936
<b>Net Fixed Assets</b>	<b>932</b>	<b>2,072</b>	<b>1,846</b>	<b>1,599</b>
Goodwill	-	-	-	-
<b>Total Assets</b>	<b>17,475</b>	<b>21,783</b>	<b>26,636</b>	<b>32,218</b>
<b>Liabilities</b>				
Borrowings	-	-	-	-
Deferred Tax Liability	-	-	-	-
Minority Interest	-	-	-	-
Equity Share Capital	88	88	88	88
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus	17,386	21,694	26,547	32,129
<b>Net Worth</b>	<b>17,475</b>	<b>21,783</b>	<b>26,636</b>	<b>32,218</b>
<b>Total Liabilities</b>	<b>17,475</b>	<b>21,783</b>	<b>26,636</b>	<b>32,218</b>

Source: Company data, I-Sec research

**Table 7: Cashflow statement**
*(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E
<b>Operating Cashflow</b>	<b>3,410</b>	<b>4,195</b>	<b>4,781</b>	<b>5,353</b>
Working Capital Changes	-292	-895	299	718
Capital Commitments	-198	-509	-200	-200
<b>Free Cashflow</b>	<b>2,920</b>	<b>2,791</b>	<b>4,880</b>	<b>5,871</b>
<b>Cashflow from Investing Activities</b>	<b>424</b>	<b>654</b>	<b>912</b>	<b>1,179</b>
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	-	-	-	-
Interest paid	-35	-69	-60	-60
Dividend paid	-398	-663	-354	-442
<b>Extraordinary Items/Others</b>	<b>141</b>	<b>181</b>	<b>0</b>	<b>0</b>
<b>Chg. in Cash &amp; Bank balance</b>	<b>3,053</b>	<b>2,894</b>	<b>5,379</b>	<b>6,548</b>

Source: Company data, I-Sec research

**Table 8: Key ratios**
*(Year ending March 31)*

	FY19	FY20	FY21E	FY22E
<b>Per Share Data (in Rs.)</b>				
Diluted adjusted EPS	406	556	589	681
Recurring Cash EPS	424	602	637	732
Dividend per share (DPS)	45	75	40	50
Book Value per share (BV)	1,977	2,464	3,013	3,645
<b>Growth Ratios (%)</b>				
Operating Income	17.7	3.6	1.6	12.3
EBITDA	38.4	26.4	2.4	13.0
Recurring Net Income	43.7	37.0	5.9	15.7
Diluted adjusted EPS	43.7	37.0	5.9	15.7
Diluted Recurring CEPS	41.4	42.0	5.9	14.9
<b>Valuation Ratios</b>				
P/E	75.4	55.0	52.0	44.9
P/CEPS	72.2	50.8	48.0	41.8
P/BV	15.5	12.4	10.2	8.4
EV / EBITDA	51.3	40.1	38.4	33.1
EV / Operating Income	8.1	7.8	7.5	6.5
EV / Op. FCF (pre -Capex)	82.8	77.4	49.2	40.1
<b>Operating Ratios</b>				
Raw Material/Sales (%)	51.9	49.9	50.5	51.0
SG&A/Sales (%)	15.2	13.9	13.1	12.8
Other Income / PBT (%)	12.8	14.2	13.1	14.7
Effective Tax Rate (%)	35.3	28.4	25.0	25.0
NWC / Total Assets (%)	0.1	0.1	0.1	0.0
Inventory Turnover (days)	12.1	13.4	14.2	14.2
Receivables (days)	59.4	80.3	80.0	69.9
Payables (days)	184.8	189.2	223.6	221.4
Net D/E Ratio (x)	-0.7	-0.7	-0.8	-0.8
<b>Return/Profitability Ratios (%)</b>				
Recurring Net Income Margins	11.3	14.9	15.6	16.0
RoCE	22.8	25.3	21.7	20.6
RoNW	22.7	25.0	21.5	20.5
Dividend Payout Ratio	0.1	0.1	0.1	0.1
Dividend Yield (%)	0.1	0.2	0.1	0.2
EBITDA Margins	15.9	19.3	19.5	19.6

Source: Company data, I-Sec research

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