Honeywell International (HON)

Updated July 20th, 2018 by Nate Parsh

Key Metrics

Current Price:	$153	**5 Year CAGR Estimate:**	5.7%	**Volatility Percentile:**	1.7%
Fair Value Price:	$130	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	55.6%
% Fair Value:	118%	**5 Year Valuation Multiple Estimate:**	-3.3%	**Valuation Percentile:**	34.9%
Dividend Yield:	2.0%	**5 Year Price Target**	$182	**Total Return Percentile:**	35.2%

Overview & Current Events

Honeywell International is a diversified industrial company. The company has four divisions: Aerospace, Home and Building, Performance Materials and Safety and Productivity. Honeywell has more than 130,000 employees around the world and 44% of 2017 sales came from international markets. The company had more than $40 billion in sales in 2017 and has a current market capitalization of more than $114 billion.

Honeywell is expected to complete the spin-off of its Transportation Systems unit by the end of the third quarter. The new standalone company will be called Garrett Motion.

Honeywell released 2nd quarter earnings on July 20th. The company earned $2.12 per share, topping estimates by $0.11 and increasing 17.8% year over year. Revenue grew 8.3% to $10.92 billion, coming ahead of estimates by $120 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.76	$2.85	$3.00	$3.79	$4.48	$4.97	$5.56	$6.04	$6.59	$7.11	***$8.10***	***$11.36***
DPS	$1.10	$1.21	$1.21	$1.37	$1.53	$1.68	$1.87	$2.15	$2.45	$2.74	***$2.98***	***$4.18***

While Honeywell did see an earnings decline of 24% during the last recession, the company has managed to grow earnings every year since 2010. Over the past decade, earnings per share have grown by 6.6% per year.

Across the company, Honeywell had 6% organic sales growth during the quarter. As with the 1st quarter, Aerospace, the company's largest division, had 8% organic growth as demand for business aviation, commercial aftermarket services and defense continued to be strong. Home and Building Technologies had 3% organic revenue growth, largely due to increased sales for residential thermal products and thermostats. Performance Materials and Technologies grew 3% organically as the company was able to convert its backlog into higher volumes of sales. Safety and Productivity Solutions posted 11% organic growth because of demand for products in the areas of Sensing and the Internet of Things. Due to the strength of the first half, Honeywell raised its earnings per share guidance to a midpoint of $8.10 up from $7.95 previously. Honeywell expects organic growth of 5%-6% for 2018, up from 3%-5% previously. Due to organic growth, we forecast 7% EPS growth going forward.

Honeywell has paused its dividend growth several times over the past two decades, most recently in 2010. This was the prudent move as earnings suffered a step decline in 2009. It should be noted that the company paused, but did not cut its dividend during this time. Honeywell has increased its dividend for the last seven years, with a 12% raise on September 29th of this year. The average increase over the past decade is 10.6% per year. In order to be conservative, we forecast that dividend will grow in line with earnings going forward. Free cash flow grew 42% in the most recent quarter so it is possible that dividends could grow at a higher pace if this trend continues.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	12.8	12	14.7	14.3	13.2	16.0	16.9	16.9	17.0	18.9	***18.9***	***16.0***
Avg. Yld.	2.3%	3.5%	2.7%	2.5%	2.6%	2.1%	2.0%	2.1%	2.2%	2.0%	***2.0%***	***2.3%***

Disclosure: This analyst has a long position in the security discussed in this research report.

Honeywell shares are up just $2 from our May 29th update. Factoring in the update in EPS guidance, shares have a forward multiple of 18.9, down slightly from our prior update. Due to organic growth projections, we have a target P/E of 16 for the stock. If shares reverted to this valuation, the multiple could contract 3.3% per year through 2023.

Even with double digit annual dividend growth, shares of Honeywell have had an average dividend yield of ~2% over the last five years. This is near the yield of the S&P 500, but well below that of the 10-Year Treasury Bond.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	24.1%	19.2%	20.2%	20%	22.4%	23.5%	25%	24%	22.4%	21.8%	***21.9%***	***22.3%***
Debt/A	79.5%	75.1%	71.5%	72.6%	68.8%	61.3%	60.9%	62.7%	63.9%	70.6%	***70.2%***	***68.7%***
Int. Cov.	12.1	5.5	9.0	8.4	14.4	22.2	28.4	33.5	29.2	43.7	***39.1***	***20.6***
Payout	29.3%	42.5%	40.3%	36.1%	34.2%	33.8%	33.6%	35.6%	37.2%	38.5%	***36.8%***	***36.8%***
Std. Dev.	41.7%	34.3%	24.1%	31%	14.1%	11.7%	12.3%	12.5%	13.2%	8.3%	***10.7%***	***20.3%***

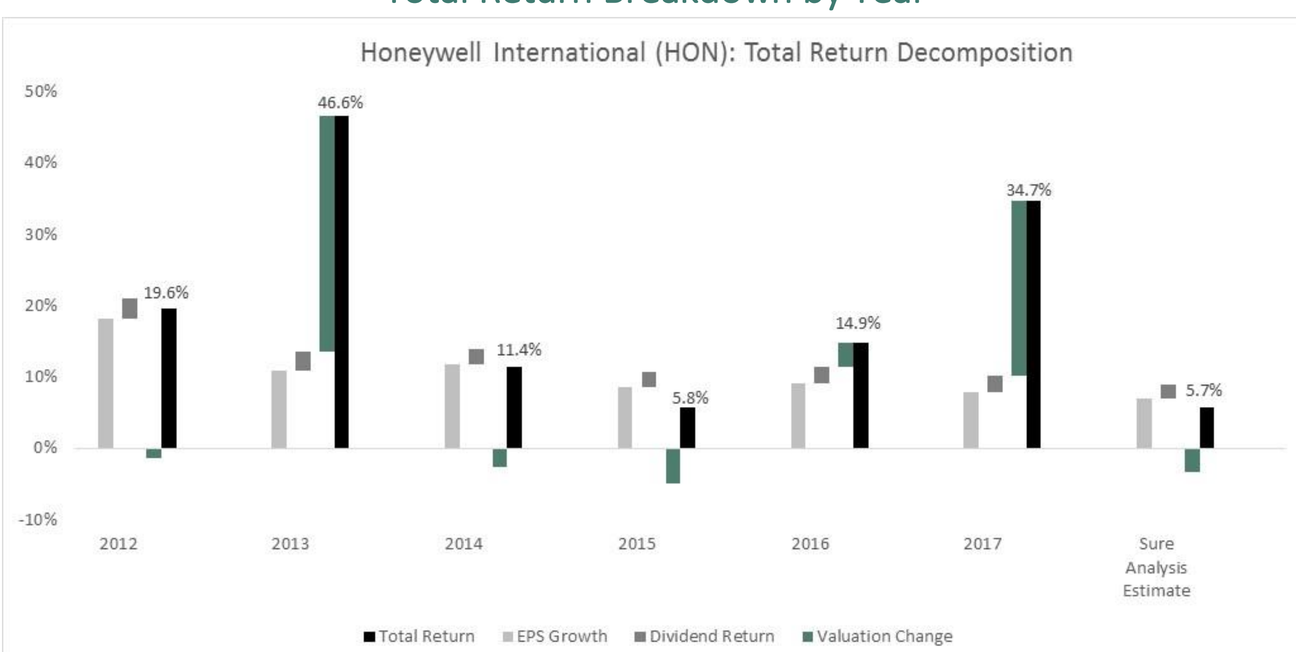
Honeywell experienced a sharp drop in earnings during the last recession. Industrial companies tend to perform very well when the economy is strong, but struggle in weak economic climates. Honeywell would likely see earnings declines in the next recession. On the plus side, Honeywell's gross profit as a percentage of assets has been very steady over the last ten years. Many industrials in our coverage universe cannot say the same. Consistent profitability could prove important during the next recession as investors seek out quality companies to park their investment dollars. One issue investors should be aware is the percentage of debt to assets is high, though down from peak levels in 2008.

Honeywell's payout ratio is typically below 40% and is projected to remain at this level over the next five years. This leaves plenty of room for the company to continue to increase its dividend, even in the event of a prolonged recession.

Final Thoughts & Recommendation

After the 2nd quarter earnings release, we expect shares of Honeywell to offer a total annual return of 5.7% through 2023, up from our previous estimate of 5.6%. This total return is a combination of earnings growth (7%), dividends (2%) and multiple contraction (3.3%). Honeywell saw growth in every division during the quarter and the company revised earnings and organic growth above its previous guidance. We feel that value orientated investors should wait for a pullback, but suggest that investors looking for growth consider purchasing Honeywell due to its high organic growth. We have raised our 2023 price target $4 to $182 to account for the increase in earnings per share guidance.

Total Return Breakdown by Year



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