Company Name: Honeywell
Company Ticker: HON US
Date: 2017-04-21
Event Description: Q1 2017 Earnings Call

Market Cap: 96,877.93
Current PX: 127.08
YTD Change($): +11.23
YTD Change(%): +9.694

Bloomberg Estimates - EPS
Current Quarter: 1.753
Current Year: 7.034
Bloomberg Estimates - Sales
Current Quarter: 9860.154
Current Year: 39218.667

Q1 2017 Earnings Call

Company Participants

- Mark Macaluso
- Darius Adamczyk
- Thomas A. Szlosek

Other Participants

- Scott R. Davis
- Charles Stephen Tusa
- Nigel Coe
- Andrew Burris Obin
- Jeffrey T. Sprague
- Deane Dray
- Gautam Khanna
- Joe Ritchie
- Howard Alan Rubel
- Christopher Glynn

MANAGEMENT DISCUSSION SECTION

Mark Macaluso

Non-GAAP Financial Measures

This call and webcast, including any non-GAAP reconciliations are available on our website at www.honeywell.com/investor

Darius Adamczyk

Business Highlights

EPS and Revenue Growth

- Today we reported a very strong start to 2017
- We met or in most cases exceeded our guidance ranges, and I'm pleased with our results in Q1
- We recorded EPS of $1.66 normalized at our expected full-year tax rate
  - This is $0.02 above the high end of the guidance we provided in January
- Excluding divestitures and normalizing for tax, EPS was up 11% vs. 2016 or 10% on a reported basis
- Organic sales were up more than 2%

- We recorded double-digit revenue growth in Advanced Materials, a win in Performance Material Technologies, on demand for our Solstice product line, and we saw continued strength in UOP, as the oil and gas end markets improve

Home and Building Technologies

- In Home and Building Technologies, our global distribution business continued to outpace the market, while the products business generated strong results at 3% organic growth
- In Aerospace, we had strong performance in the aftermarket, particularly in air transport on robust repair and overhaul activity
- And in Safety and Productivity Solutions, we saw growth in most of the businesses, particularly noteworthy performance exhibited in workflow solutions, sensing and IoT, as well as industrial safety

HOS Gold Operating System

- We expanded segment margins by 70BPS
- We are delivering high value offerings to our customers and our execution is improving as the ongoing benefits of our HOS Gold operating systems materialize
- We also continue to optimize our cost structure by highlighting our March Investor Day, driven by productivity initiatives and the restructuring actions we've took through 2016

FCF

- Driving segment margin improvement continues to be an ongoing focus for Honeywell
- We delivered significant improvement in FCF y-over-y, largely driven by improved working capital performance
- FCF performance will continue to be a key priority for Honeywell
- We have renewed level of focus on working capital at all levels across the company, and we expect we will drive improved FCF conversion in every business

Performance

- Given the strong performance, we are raising the low end of our full year EPS guidance by $0.05 to $6.90 to $7.10, and reaffirming our 2017 organic sales, segment margin, and FCF guidance
- We are encouraged by Q1 growth and execution, but are taking on tempered approach to our forward outlook given the potential volatility in our end market and limited view of the year at this time

Aerospace

- Each of our business had significant commercial achievements in Q1
- On slide 3, I'd like to highlight some of them
- In Aerospace, together with Airbus, we announced that our auxiliary power unit is now standard equipment on the A320 family of aircraft replacing a competitor's APU as the base option

Airbus

- Airbus selected Honeywell because of our APU superior reliability and fuel savings capability
- In addition, both Japan Airlines and India's Jet Airways announced that they are using our GoDirect fuel efficiency software
- Fuel consumption typically accounts for more or as much as 20% to 40% of our airlines' operating cost, and GoDirect can help customers save more than 2% annually

MAXPRO

- In Home and Building Technologies, we launched MAXPRO Cloud for connected buildings
- MAXPRO provides streamlined video and access management to our customers that manage multiple buildings
- In addition, Honeywell Building Solutions announced contracts to improve energy efficiency at 21 U.S. Federal Aviation Administration facilities and at the U.S. Air Force base in Los Angeles, as well as airport wins in emerging regions, including Turkey and Singapore

Performance Materials and Technologies

- In Performance Materials and Technologies, UOP technologies and Honeywell Process Solutions controls were selected in China for one of the largest crude-to-chemicals complexes in the world
- In addition, UOP will provide the process technology for the largest Oleflex units in Europe
- And UOP's hydrotreating catalyst will be used by Wantong Petrochemical to produce cleaner burning ultra-low sulfur diesel fuel without a costly modification of its existing hydrotreating unit
- As you will hear shortly, the orders thus far for PMT have been very strong
- Our customers recognize the value of Honeywell's technologies, and this is allowing us to win the marketplace, especially in China

Safety and Productivity Solutions

- In Safety and Productivity Solutions, we introduced AutoCube, a 3D dimensioning system that helps customers instantly capture the volume of parcels to enable space optimization in volume-based pricing
- Safety and Productivity Solutions also won four prestigious International Forum iF Design awards, recognizing our product design focus and the Honeywell User Experience
- As you know, driving organic sales growth is one of my key priorities
- I'm pleased with the results we saw in Q1
- Investing in development of new products, breakthrough initiatives, and commercial excellence will help us to accelerate our momentum

Thomas A. Szlosek

Financial Highlights

Organic Sales Growth

- I'm on slide 4
- As Darius mentioned, we delivered more than 2% organic sales growth this quarter
- Now truth be told, we were actually within inches of 3%, but it did come out at 2%
- All of our segments were at or above the high end of the sales guidance we provided back in January, so a strong start from a growth perspective

EPS Expansion

- Segment profit was up 8% excluding divestitures, and segment margins expanded 70BPS from 2016
- This accounted for the bulk of the EPS expansion, as you'll see in a minute
- The segment profit growth was driven by sales improvement, our ongoing productivity initiatives, the benefits from the significant restructuring programs that were funded in 2016, and overall front-end commercial excellence

Tax Rate

- Reported EPS of $1.71 were up 10%
- This $1.71 includes $0.05 benefit from a lower than anticipated tax rate
- So for proper comparability and to remove all tax favorability from our results, we've normalized 2016 to reflect the expected 2017 full-year tax rate and to eliminate the $0.05 from 2016 relating to the divested businesses
- On that basis, EPS was up 11% to $1.66, and that's, as Darius said, $0.02 above the high end of the guidance range

Free Cash Performance

- Free cash performance was also encouraging in the quarter
- As Darius mentioned, the entire organization at all levels is focused on our working capital performance
- We're breaking down our order-to-cash processes into a myriad of sub-segments, and we're systematically measuring and improving the cycle time of each of those sub-segments
- We're adjusting incentives to foster more improvement in working capital, and we have a standard operating cadence that culminates in a monthly review with Darius and me by each business
  - There's still much to do in this area, and while it is still early in the year, we're encouraged by our progress so far
- So overall, a very strong start to 2017, but still a lot of opportunity for further improvement over the next three quarters

Aerospace

- Let's move to slide 5 and discuss each of the segments

- In Aerospace, we finished the quarter above the high end of our first quarter sales guidance range, driven primarily by a strong performance in the air transport aftermarket
- We saw an uplift in spares demand and strength in repair and overhaul activities with our airline customers, particularly in the sale of repairs, modifications, and upgrades, that resulted in high single-digit growth rate in the ATR aftermarket

OE Performance

- The aftermarket in business and general aviation was roughly flat, with stronger than anticipated R&O and connectivity revenue, largely offset by a decline in spares
- Our OE performance was as expected, with volumes to our air transport customers up slightly on the strength of A350 shipments, offset by declines in business and general aviation

Defense Sales

- Defense sales were roughly flat, with strong organic sales growth in our core U.S. and international defense businesses, offset by space and commercial helicopter weakness
- And there was continued strength in light vehicle gas turbo penetration, particularly driven by new launches in Europe and China
- As well, there were some encouraging signs in the on-highway commercial vehicle market globally, and most notably in China and in Europe

Segment Margin Expansion

- Aerospace segment margin expansion for the quarter of 90BPS also exceeded the high end of our guidance, driven by productivity, commercial excellence, and the favorable impact of the divestiture of the Government Services business in 2016
- Overall, a very strong start to 2017 for Aerospace

Home and Building Technologies

- Home and Building Technologies generated organic sales growth of 3%, driven by a strong performance in environmental and energy solutions, security and fire, and our global distribution businesses
- Growth in the China business in HBT was nearly 15% this quarter
  - That was led by the clean air and water product portfolios in E&S.
- We continue to see momentum in the residential real estate market in China and anticipate continued infrastructure investment that will help drive future growth

Segment Margin

- Across HBT, there was gradual sales improvement over the quarter with decent exit momentum
- Segment margin, while below our expectation, was still quite strong at 70BPS improvement, stemming from our ongoing productivity initiatives and the restructuring actions taken in H2 2016
- The mix dynamics of sales in the quarter were a bit less favorable than we anticipated

Performance Materials and Technologies

- Performance Materials and Technologies had a very strong quarter
- Sales up 5% on an organic basis, margins expanded 260BPS, and orders were up double digits
- The performance was led by Advanced Materials, where Solstice sales growth exceeded 150% on an organic basis, enabled by the capital investments we've made over the past several years

Sales

- Sales in UOP were up 3% organic, led by gas processing
- There continues to be increasing interest in domestic modular units in particular
- In Q1 alone, we signed six new deals in the U.S. for pre-engineered cryogenic plants that separate natural gas liquid
  - This compares favorably to the 12 units we had for all of 2016, including two in Q1
- Growth in the catalyst business was at low single digits, driven by new Oleflex units
- The orders in UOP were up over 15% in Q1, setting the stage for continued performance in this business

Process Solutions

- Sales in Process Solutions were roughly flat on an organic basis
- We had healthy customer adoption of our Assurance 360 service offering and good growth in our lifecycle solutions and services business
  - This was offset by slower sales in our large projects business
- Orders in HPS were up nearly 10% on an organic basis

Margin Expansion

- The margin expansion in PMT was driven by productivity, commercial excellence initiatives, and the impact of the spinoff of the former resins and chemicals business in 2016, so all in all a great result for PMT and encouraging forward indicators across all of its business units

SP&S

- Finally in SP&S, organic sales were up 3%, exceeding the high end of our guidance range
- Industrial safety, the largest business within SPS grew 4% on organic basis, driven by our high risk and gas detection offerings
- There was also a significant growth in our workflow solutions business due to strong demand and improved supply chain execution

IoT Business

- Growth in our IoT business was also strong with good performance in a number of regions, and Intelligrated grew in excess of 20% this quarter compared to Q1 2016 when it was not owned by Honeywell, and this was driven by large projects in a number of key accounts
- Excluding the first year dilutive impacts from M&A, SPS segment margins expanded more than 300BPS, driven by continued productivity and restructuring benefits and the conversion on the strong sales volume
    - We're encouraged by the trends that we saw in Q1 in SPS and in the rest of the portfolio
- Slide 6 contains a walk of our EPS from Q1 2016 to Q1 2017
- In Q1 last year, earnings from our 2016 divestitures were $0.05 and we exclude those amounts from the 2016 baseline consistent with the 2017 earnings guidance framework we provided

Tax Rate

- For comparison purposes, as I said earlier, we've also normalized the tax rate for Q1 2016 for the expected 2017 full year tax rate, and this effect was minor, as you can see
- In Q1 2017, the segment improvement I highlighted for each business accounted for $0.12 of the y-over-y improvement in EPS
- Below the line items and a slightly lower share count contributed $0.04 this quarter bringing our 2017 EPS, excluding benefits from the lower tax rate to $1.66, which is at $0.02 beat to the $1.64 high end of our first quarter guidance
- EPS increased 11% y-over-y on this basis
- And for the full year, we expect our share count to be consistent with the 772mm shares we projected in January

EPS Growth

- Regarding tax, our planned tax rate for the quarter was about 25%, but the actual rate was 22.7% with the difference contributing an additional $0.05 of EPS growth, resulting in reported EPS of $1.71
- Our expectation is that the effective tax rate in quarters two, three, and four will be at or above 25% and to the extent that change we'll provide an update

End Markets

- Let's turn to slide 7 to discuss what we're seeing in our end markets, heading into Q2
- Last quarter, we told you about some encouraging trends in our oil and gas businesses and those have continued this quarter
- The combined UOP and HPS book-to-bill ratio was strong at 1.15 and UOP orders, as I said earlier, were up over 15%, driven by our gas processing business

Domestic Russell Business

- The domestic Russell business has outpaced our expectations, as the demand for non-gas liquid separation technology strengthens in the U.S
- There are also more orders for licensing, which is typically one of the first indicators that the oil and gas cycle is restarting

- The activity in UOP China has been particularly strong and we've won a number of key projects, which will allow us to leverage the capacity investments we've made over the past few years

Elster Acquisition

- Within Home and Building Technologies in Q2, we anticipate several large smart meter project roll-outs in Europe and better backlog conversion in the Americas
- Smart meter business came to Honeywell as part of the Elster acquisition and it continues to perform well
- Overall, the short-cycle demand in the commercial and residential segments continues to be robust

Aviation Market

- The aviation market continues to be resilient with the high-end single-digit growth, driven by spares demand, and repairs, modifications, and upgrades in the air transport and regional business
- This is supported by the outlook for continued flight hour growth of 4% to 5% in air transport and regional

BGA

- In the business and general aviation market, we had strong demand in the repair and overhaul business, but weaker performance in spares, driven by a continued decline in maintenance events
- We expect continued aftermarket strength heading into Q2 with the airlines business growing faster than BGA
- Flight hours in BGA are likely to remain flat to down in 2017
- Our connectivity business grew double digits in Q1 and will continue to be a source of strength for aftermarket revenues

Industrial Safety Business

- We were encouraged by the increased activity in our businesses that serve the industrial sector
- Our industrial safety business was up mid-single digits, driven by demand for gas detection in high-risk safety equipment
- The backlog and pipeline of future orders at Intelligrated continue to be strong, and we were encouraged about the prospects for 2017
- As planned, we expect lower shipments and fewer engine maintenance events than 2016 for business jets
  - We continue to plan conservatively and do not anticipate a recovery until the 2018/2019 timeframe

Transportation Systems

- And now on slide 9 with a preview of Q2
- Aerospace; sales are expected to be in the flat to down 2% range on an organic basis with continued strength from the ATR aftermarket and solid demand in the U.S. core defense
- In Transportation Systems, we anticipate continued recovery from the commercial vehicles business combined with growth in light vehicle gas applications, especially in China

- These benefits will be offset by the ongoing secular softness in the BGA and space markets

Sales

- We expect reported sales will be down 5% to 7% due to the 2016 divestiture of the government service business
- Aero margin expansion will be driven primarily by the benefit from our 2016 restructuring projects and a stronger mix of aftermarket growth
- Importantly, Q2 is expected to be the last quarter of the headwind associated with OEM incentives
- In H2, they become an approximate $70mm tailwind to sales and segment margin, as compared to an approximate $25mm headwind in H1

T Series

- In Home and Building Technologies, reported sales are expected to be down 1% to up 1%, due to the impacts of foreign currency translation, with organic sales growth up 2% to 4% driven by the large Elster smart meter rollouts I mentioned earlier
- In the other products businesses, we expect continued contribution from new product introductions like our T Series thermostat and do-it-yourself security products, which were on display earlier this month at ISC West

China

- In China, we again expect double-digit growth driven by continued air and water demand and growth in security and fire systems associated with large real estate projects
- We also expect continued strength in our global distribution business and stronger growth in Building Solutions
- HBT's segment margins are expected to expand 70 to 100BPS, driven by cost reductions from prior restructuring actions, commercial excellence, and ongoing productivity initiatives, partially offset by product mix headwinds associated with the strength of our distribution sales

PMT

- In PMT, we anticipate continued strong performance across the group with 3% to 5% organic sales growth
- Advanced Materials is expected to be up significantly on continued demand for Solstice low-global-warming products
- In UOP, improving oil and gas markets and the strong backlog will drive continued growth, primarily in licensing and equipment sales
  - We also expect modest growth in the Process Solutions business, driven primarily by our short-cycle software and service offerings

Margin Expansion

- On a reported basis, PMT sales are expected to be down y-over-y due to the spin-off of Resins and Chemicals business in Q4

- The projected segment margin expansion of 170 to 200BPS is driven by higher volumes, productivity and the impact of the spin-off of the former Resins and Chemicals business

Safety and Productivity Solutions

- In Safety and Productivity Solutions, sales are expected to be up flat or to be flat-to-up 2% on an organic basis, with reported sales increasing north of 25%, due to the impact of the Intelligrated acquisition
- The organic growth will be slightly lower quarter-to-quarter, as the significant workflow solutions growth we saw from improved supply chain execution in Q1 normalizes in Q2

M&A

- In the safety business, growth in the industrial business will be driven by new product introductions and better end-market outlooks
- In Intelligrated, orders were strong exiting Q1, and we anticipate double-digit growth to continue
- SPS margins are expected to expand by more than 250BPS, excluding the first year of dilutive impacts of M&A, driven primarily by benefits from last year's restructuring projects and by the sales growth and ongoing productivity initiatives

Organic Sales Growth

- For the company in total, we're expecting EPS of $1.75 to $1.80, which will be up 7% to 10% y-over-y, excluding 2016 divestitures and normalizing for our expected full year tax rate
- Organic sales growth is anticipated to be flat to 2%, with 50 to 80BPS of margin expansion
- We expect that reported sales will be down 1% to 3% due to the 2016 portfolio actions I mentioned

EPS

- Let me move to slide 9
- As Darius mentioned, we're raising the low end of our full year EPS guide by $0.05 to $6.90 to $7.10, up 7% to 10%, excluding divestitures
- At a total Honeywell level, we continue to anticipate delivering between 70 and 110BPS of margin expansion for the full year, driven by slightly better performance in Aerospace and PMT overcoming a slower start in HBT

Summary

Let me turn to slide 10 for a brief wrap up

In summary, we delivered a high quality first quarter result with all of our segments contributing to the performance

Our end markets continue to improve across our businesses and our execution is getting better as well

We expect second quarter earnings to grow 7% to 10% y-over-y excluding divestitures and normalized for tax, and we raised the low end of our full year EPS guide by $0.05

End Markets

- Our businesses to continue to win in growing end markets, the investments we've made in 2016, including significant restructuring projects are also delivering for us
- And our Honeywell Operating System is continuing to drive commercial gains and productivity improvements
  - We're well positioned to continue to outperform for the remainder of 2017

QUESTION AND ANSWER SECTION

<Q - Scott R. Davis>: You're welcome. It's tough to replace somebody like Dave Cote, but at least you can pronounce maybe China a little bit more appropriately than "Chiner", but anyways, jokes are falling flat on a Friday morning.

If we can talk, can you guys just remind us where we are with the big UOP and Solstice capacity adds? I know you've been taking orders, but when do you really see the lion's share of that revenue ramp from - maybe each one of those is a separate question, but I'll just leave it at that.

<A - Darius Adamczyk>: So I would say that the big facility that we've been building for the last couple of year comes online at the end of Q2, early Q3, which is really the last portion of the capacity expansion. And as we saw starting early this year, with the MAC [Mobile Air Conditioning] initiative kicking in, in Europe we saw a nice volume ramp up, and our Solstice product line is up double digits so far this year, and we expect that to continue and even accelerate further as we head into 2017 and further into 2018. But I think the short answer here is that as we get into H2 2017, we're going to be exactly where we need to be from a capacity perspective.

<A - Thomas A. Szlosek>: I'd add, Scott, to that that the orders are supporting that. We had, as we mentioned, double-digit orders growth in PMT overall and was across all of the businesses, but especially in the ones where we're making those capacity investments, and the backlog is picking up nicely.

<Q - Scott R. Davis>: So help us just to understand. What kind of capacity utilization will you be at or how does that – are you profitable with those new orders in the first year, or does it take until you get to a certain percent of capacity utilization? Just help us understand that, and that will be it for me. Thanks.

<A - Darius Adamczyk>: I think with any new process startup, we're obviously not going to be operating at full capacity, and we had planned for that, and things are going to be ramped up. But I would say we're targeting well north of 80% once we get into 2018 and beyond. And frankly, we can bring even more capacity online as we secure new orders. We think that Solstice, we've done a really nice job securing orders, and a lot of that I would say are developed markets. But we see a lot of potential in our HCR markets as well given the acceptance of some of the Paris outcome, and we have some extra capacity that we can bring to bear to generate revenue. And we also have plans for further expansions should some of those regulations be enacted, which we think that there is a very good chance that that will happen.

<Q - Charles Stephen Tusa>: So you guys did about $0.12 of continuing ops improvement y-over-y in Q1. I think you had these OEM incentives. What were the OEM incentives in Q1? I know you said $25mm in H1. What were they in Q1?

<A - Thomas A. Szlosek>: They were minor, y-over-y impact was minor on OEM incentives in Q1.

<Q - Charles Stephen Tusa>: Okay, so that will be in Q2.

<A - Thomas A. Szlosek>: For second quarter, you'll see that.

<Q - Charles Stephen Tusa>: Okay. When we look at H2 vs. H1, you're doing $0.12 y-over-y in these core businesses in Q1. Maybe it's a little bit less than that because of the OEM incentives in Q2, although your guidance wouldn't suggest that. Just remind us. Is there anything in H2 other than the OEM incentives that makes the y-over-y comp tougher? It seems to me like H2 dropped off a bit, so you have easier y-over-y comps there. Is there anything we should consider, whether it's mix or orders timing or anything like that, or should that $0.12 or whatever you do here in H1 actually be better in H2?

<A - Thomas A. Szlosek>: I think the incentives, clearly as I said, a drag in H1, a nice tailwind in H2, and that will continue into 2018 and 2019. We do get ramp up of repositioning in H2. And then we're continuing to integrate the acquisition. We're still actively integrating nine deals, including Intelligrated. And those tend to get better as the year progresses in terms of operating margin improvement when those synergies kick in. But I'd say those are the major impacts H1/H2.

<Q - Charles Stephen Tusa>: So those are all good guys from a run rate perspective?

<A - Thomas A. Szlosek>: They should be helpful.

<Q - Charles Stephen Tusa>: Okay. So I think the – go ahead.

<A - Darius Adamczyk>: I was just going to say, Steve, that we can't point to any specific headwinds other than frankly market uncertainty and although we're excited, frankly, about the long-term orders performance we had in Q1, most of our business is short-cycle, and I think the environment is probably fairly volatile, so we're being a little bit tempered of our expectations for H2. And given that it's week three into the new role, we're being a little bit, I would say, tempered around our expectations, but certainly excited about the kind of start we had here.

<Q - Charles Stephen Tusa>: I think I would agree. It looks like your guidance suggests really very minimal run rate improvement, so a smart move only being in the seat for a few weeks.

<Q - Nigel Coe>: So I just wanted to pick up on Steve's last question about how things develop here. And, Darius, you mentioned the environment is uneven, volatile. Is that a reference to what happened H2 last year, Q3 very weak, Q4 came back, and then Q1 back to the races? Is that what you're referring to, or are you seeing intra-quarter volatility during Q1?

And then on top of that, maybe you can just color in what you're seeing today vs. what you saw back in December when you put the plan together.

<A - Darius Adamczyk>: The answer to first part of your question, no, actually it has nothing to do with Q3 or Q4 last year. And I would say overall, and I think consistent with what I said at Investor Day, the environment in 2017 is better than 2016. I think we certainly see that in PMT. We see it in HBT, SPS, and so on. I would also temper that and say it's not dramatically better, but it's better, but not – it's certainly not at the kind of a recovery.

In terms of comps vs. December and how we deal today vs. back then? I think maybe the only deal that, I think that's a little bit different is that – I think Dave sort of called it kind of the expectations around what's going to happen around tax reform. They've been tempered a little bit as well. We continue to remain optimistic that things will happen. But I would say that there was almost a clear expectations and now I think there's a little bit more hesitancy. We got the elections in France coming up this weekend. There's still quite a bit of uncertainty in terms of geopolitical environment at the moment.

<Q - Nigel Coe>: Yes, for sure. And then just digging into TS a little bit more detail. You referenced, Tom, the commercial vehicle tails on highway and I'm assuming off-highway too. And then, obviously, we have a continued growth and penetration in gas. But then offsetting that, we've got a little bit of LV production headwinds in H2, maybe even Q2. And then diesel penetration in Europe seems to be ticking down. So I'm just wondering how should we stitch that together in thinking about the TS growth for the back half of the year?

<A - Thomas A. Szlosek>: Yes. I think you've got all the factors laid out there, Nigel. The overall global market probably will be flattish to up a little bit in terms of total production. So when you look at the way we've modeled it out, I would say that Q2 is not inconsistent with what you can expect for the rest of the year for TS.

<Q - Andrew Burris Obin>: So just a question on FCF, very impressive first quarter. Can you just provide us with more insight as to what are the areas that you're looking for improvement, what businesses you're targeting, what accounts and what should we see throughout the year?

<A - Thomas A. Szlosek>: Sure. Well, first quarter for us, the biggest driver, as we said was improved working capital performance. We saw that particularly in PMT and in Aerospace, but I think we're just – we're at the outset there. That's going to be the major area of focus for us in terms of driving improved FCF conversion.

You've also got the CapEx, and as you know, we were at the peaks in 2016 into 2017, that starts to moderate as the investments that Darius was talking about earlier ramp down and we get into the full run mode, particularly in PMT. And with the combination of those two things, we expect to continue to drive that conversion higher.

<A - Darius Adamczyk>: Just to add and I would just emphasize the point that working capital is, I'd say a renewed level of emphasis in all – Honeywell, in your question around, which businesses. I think all of them have an opportunity. We're driving receivables, inventory in all these businesses. I think PMT particularly is noteworthy. They did a really nice job in their receivables.

So part of that is due to the recovery in the oil and gas markets where some of our customers are recovering and they've made really, really nice progress in Q1, and by the way, there's more to do. So I expect progress in all four of the SBGs going forward.

<Q - Andrew Burris Obin>: And just a follow-up question then on PMT. Great commentary on UOP, but generally, what are you guys seeing on large project discussions and maybe outside of UOP, and maybe you could just go around the world just to give us some color as to what you're seeing?

<A - Darius Adamczyk>: Yeah, I mean, overall actually nice orders performance; high single-digit up for HPS; teens, high-teens up for UOP, so we're seeing the order activity returning. I would characterize the orders, kind of being medium size, so we didn't have the mega orders like we did in the last 12 to 18 months, which HPS has won. These would be kind of the medium sized orders. We actually didn't see the base business be as strong as we like it to, so this would be kind of the mid-size order activity.

As we look at it region-by-region, South America continues to be relatively soft. The Middle East has had a nice comeback. China very, very strong performance in Q1, won a lot of work there and that continues to come back. Also the U.S. especially in our GP&H business in UOP, which is well correlated to the activity in the unconventional segment and as you see the rig count being up, I think 80% in the U.S. and much more than that in Canada, so very, very strong order activity in GP&H business with the cryo plant.

So overall, as the oil price stabilized here at $50, $50-plus, and we're encouraged by some of the news we're hearing about the production freezes that OPEC is encouraging its members to do, I think that this is going to continue to be a tailwind for us for the rest of the year.

<Q - Jeffrey T. Sprague>: Just a couple of things from me. I wonder if you could just elaborate a little bit more on what's going on with the Intelligrated. Obviously, I think we're all aware of the e-commerce effect on retail and its knock-on effects to distribution. But really, my question is how much of the strength that you're seeing relates to – Intelligrated now being part of Honeywell and you being able to open it up into other areas? Or should we think of this as a kind of truly organic Intelligrated as it stands now? And if the answer is it's really kind of just legacy Intelligrated, maybe a little bit more color on the integration of the business and how you see the growth going forward.

<A - Darius Adamczyk>: Yes. I think it's both, Jeff, because for example, one of the elements where we're investing in heavily right now is – Intelligrated was predominantly a U.S. business. And we're globalizing that business, investing, and let's say metricizing it. And we see the international growth as a big opportunity for us in the future. That hasn't come through in the form of big orders yet, but I can tell you that a lot of the big customers that we currently have in the U.S., they would want us to have a much broader global presence than we've invested in that, and we expect to materialize that.

In terms of overall business performance; I think I would describe it in one word, terrific. This business has substantially exceeded any financial metrics we've had for it and continues to impress us with its rate of growth. And we see strong double-digit growth rate, both in revenue and bookings for this year. And the more I learn about it and the more of the customers of this business I meet, the more excited I get. I think that we have a very exciting growth profile for this business both in terms of making it more global, expanding our software solutions, expanding or applying robotics to a lot of different directions to go, organically and potentially inorganically.

<A - Thomas A. Szlosek>: And the other thing I'd add in terms of the Honeywell value is the – those aftermarket kinds of positionings. The installed base, we mentioned 20% sales growth this quarter. Backlog is up strongly in the double-digits. We're building a big install base there and developing that aftermarket business model, in addition to what Darius mentioned about Europe, is going to be a nice driver for Intelligrated growth.

<A - Darius Adamczyk>: And, Jeff, maybe just one last thing to add is and this is – I highlighted this before, but just to reinforce. The sweet spot of the Intelligrated business is e-commerce. Its high throughput high-speed package processing, which as you know, is the segment that's grown the fastest right now. So this business is exactly in the sweet spot of where the big growth sector is at the moment.

<Q - Jeffrey T. Sprague>: And then just a separate unrelated question. On UOP, can you just elaborate a little bit more on the licensing up-tick you're seeing? What verticals is that, and any color on what's going on in the refinery turnaround and chemical plant turnaround landscape? Thank you. That's it from me.

<A - Darius Adamczyk>: Yeah. I would say the big uptick is in petrochemical; particularly in China, is a place I would point to we've had a lot of recent successes, much larger integrated complexes and the combination of HPS and UOP is working very well.

We've got a number of wins there and a very, very strong Q1. So, as the economy grows, so does the demand for the petrochemicals. And I would point to that as one of the highlights of the booking activity here in Q1, and certainly China. India has been good, but really strength across the globe, and even some activity returning to Middle East, which is really nice to see.

<Q - Deane Dray>: Darius – you know what, its Deane this morning. For the – your four priorities that you laid out at the outlook, we're not expecting you to touch and check off every box, every quarter, but we did see the accelerated organic revenues. You got that expanding margins, you got that certainly, more excitement and traction around being a software industrial. Maybe not hearing much here this morning about more aggressive capital deployment, but maybe you could just touch on that, and what kind of expectations do you want to set over the near term?

<A - Darius Adamczyk>: Yeah, I mean, I think on capital deployment as I promised, that is one of the core initiatives. Frankly, we continue to be very active. The pipeline for M&A deals is very, very active. But things are a little bit expensive out there, so we're being cautious because as I pointed out on our Investor Day, we do want to be active and secure the right deals. But we also want to continue to be prudent buyers, not overspend, and that's frankly why maybe we haven't announced some of the – any deals yet this year. But rest assured we're very, very active.

In terms of buybacks, timing, and we're committed to having the flat share count as we said and potentially do even more later in the year. So timing is everything from that perspective. So, yeah, it's been a little bit quiet, but you've got to also remember that I'm only about three weeks into the role, so probably – I'm pleased with some of the levers actually coming through in our results in Q1.

<Q - Deane Dray>: Got it. And then just as a follow-up one of the goals that you've set is on the new product vitality index expect to track to 20% in 2017, an uptick from last year. How did Q1 play out?

<A - Darius Adamczyk>: I think it played out well, but in full transparency, I would say most of our new product launches are really back end loaded this year. We have some things coming out in Q3. Q3 will be a very, very new product launch quarter.

So I think in fairness, I'll be in a better position to answer that question as we get deeper into the year because right now, it's really too early to tell, and I don't want to declare a success until we see how some of the bigger, even more exciting new product launches happen in Q2, and especially in Q3, which is going to be a big launch quarter for us.

<Q - Gautam Khanna>: Wanted to ask if you can characterize any of the channels that may have any destocking still going on. Previously you've talked about S&PS. I wonder if that's abated. And recently we've heard some other aerospace companies talking about destocking on some of the aircraft programs, 787, 777, A380, et cetera. If you're seeing any of that or if you expect to? Thanks.

<A - Darius Adamczyk>: I think let me comment on SPS. I think we see this continuation of destocking, and frankly, as some of our distribution partners are operating at lower inventory levels than what we historically have seen. That's certainly true in SPS.

In Aero, I'm not sure that we've noticed that as much. I think that that's been fairly steady, at least for us, and that's exhibited at the fact that frankly, we performed a little bit better than we projected for Q1, and especially in the aftermarket segment of the business, which has been very, very strong and we're very pleased with it. So I'm not sure that we've seen it in Q1.

<Q - Gautam Khanna>: Okay, and just a quick follow-up on the M&A question from earlier. Are you seeing any areas that are more promising than others, if you could comment on where valuations are perhaps more stretched vs. more attractive when looking at your segments?

<A - Darius Adamczyk>: I guess unfortunately, they're pretty stretched everywhere. The market is pretty warm right now. There's a lot of cash sitting around both on the private equity as well as the strategics. I wouldn't say that anything is particularly cheap at the moment.

Now having said that, we have a very, very big pot to fly in, and we have a lot of different options in terms of the segments that we're looking at, and I can tell you that we have attractive deals that we're looking for in every one of our SBGs. Now what actually lands or what happens we'll see, but I would say overall things are a bit expensive. There's no question about that, and I don't think that that's a comment that's end market specific. That's true really across our entire portfolio.

<Q - Joe Ritchie>: So, Tom, you mentioned inches, inches this quarter on the organic growth side. It sounds like the order growth across a lot of your segments right now is going in a positive way. You've looked at the comps for next quarter, looks pretty easy. I'm just trying to understand, I guess, the guidance, the flat to 2% organic growth guidance for Q2. It just seems like a layup based on the commentary and based on the comps. So maybe a little bit more color there would be helpful.

<A - Thomas A. Szlosek>: That's fine, Joe. We had a sense that that would be a question. When you look at our businesses overall, long-cycle is about 40%, short-cycle is about 60%. So we're still in an environment on the short-cycle side where the demand patterns are not quite consistent. The word volatility was used before. It's not exactly something that we have good extended sight into on that short-cycle side. But with that, if you look at it by each business, Aerospace is more long-cycle oriented with the exception of the aftermarket, so fairly well grounded.

We did flat in Q1. We're calling minus 3% to minus 1% for Q2. That's mostly OE related. You have those incentives coming through, as we mentioned. The bulk of H1 incentives hit us in that second quarter. You've got regional that's on the OE side that's been fairly weak, and BGA continues to be in that flattish range.

From an HBT perspective, short-cycle we're a little bit more cautious. So yeah, we did 3% in Q1. We're calling 1% to 3% in Q2. Let's see how the demand patterns emerge over the quarter. I'd say the same thing for SPS, although there are a couple other things going on there. So SPS was 3% first quarter, we're calling zero to 2% in Q2. We've got a change in our go-to-market model on the retail side, and we're going more direct to our customers. And as a result, there are some timing patterns in the channels.

We also had, as I mentioned, significant improvement in Q1 on workflow solutions supply chain. So there was strong demand, but there was some unintended backlog at the end of Q4 that we worked our way through, and that helped Q1 specifically on SPS, so that tempers a little bit.

And lastly on PMT, I think it's fairly well grounded given the backlogs, 5% in Q1, 3% to 5% in Q2. Certainly, Darius and I talk to Rajeev every day about this. So we have the same expectation that we'll do a little bit better there. But we just want to be cautious on demand on some of the advanced materials. It's been going like gangbusters, as I said, 150% improvement on those Solstice sales, and I don't want to just bank on that every single quarter going forward.

<A - Darius Adamczyk>: And, Joe, maybe just to add a couple of comments, I think as you look at our long-cycle business and our backlog, we're very encouraged by what we saw in Q1, backlog being up pretty much for every one of those businesses. So certainly there's a level of confidence in what we're seeing on the long cycle.

The short cycle is a slightly different story and we're positive on the short cycle too. But if you think about the animal spirits that we saw overall in the markets, particularly in the U.S. in let's say January vs. what we see now, I would say that's a slight down arrow vs. what it was, and I think some of that could be reflected in the short cycle. And frankly, we're being a little bit cautious and measured in terms of our outlook, and certainly hope to deliver to the upside of what we stated.

<Q - Joe Ritchie>: Got it. No, that's an interesting observation on the bifurcation there. I guess the follow-up question I guess is maybe even slightly similar is really on the cash flow side. Seasonally, incredibly strong. It didn't sound like you guys called out any one-time items this quarter. What's stopping you from potentially raising the cash flow guidance for the year?

<A - Thomas A. Szlosek>: So we're calling 5% to 7% growth for the full year guide, Joe, as you know, Q1 was 6x. First quarter is generally our most volatile quarter when it comes to cash. Now couple that with these new initiatives that we've put in place around working capital, you did see some significant uptick. I guess we want to see a sustained level of performance. Let's see where we are at the end of Q2, and let's see whether we're really sticking with the working capital improvements that we've seen, but I have a bias like you do that that could get better as the year progresses.

<A - Darius Adamczyk>: I think I'd agree with what Tom said. I mean, we need to see sustained performance. One quarter doesn't make a year, and although we're very encouraged by what we saw in Q1, I need to see it continue in Q2, and frankly, if we see continued sustained performance like that at the end of Q2, we're going to revisit our guidance at the conclusion of Q2.

<Q - Howard Alan Rubel>: Two things. First, maybe you can talk a little bit about the progress with connectivity. How many installs you have and sort of what kind of customer feedback you are now getting with that business. It's becoming a little more prevalent in the marketplace?

<A - Darius Adamczyk>: I think, Howard, we're building out our organization. We saw a couple of key hires and Que Dallara and Steven Gold join us in very senior leadership spots. We're building out our offerings in, whether it's connected aircraft where we've had a number of wins that we highlighted in the report today, whether it's connected homes, buildings, connected plant. We've signed up multiple partners. So I'm not sure that we really measure it yet in terms of the number of connections we have. We measure it by the number of customer engagements we have, kind of, interactions we have. And frankly some of the connected enterprises are ahead of the others. I would classify connected aircraft, connected plant are little bit further ahead and some of the others still a little bit more behind.

But I can tell you that for all of them, we are at a stage where we are engaging customers. We're optimizing our solutions and iterating, iterating quickly. The way to grow this business is to have hypothesis, talk to customers, iterate, and bring the value, because in many instances, the customers – they can't define exactly what they're looking for. So we have a hypothesis that we optimize and optimize.

But very, very big build-out in this organization, so whether it's our Atlanta software CoE [Center of Excellence] or some of the senior people that I've pointed out, we're quickly building out our capabilities. But at the same time engaging customers for revenue generation, and I can tell you that software business was – in total was up double-digits in Q1.

<Q - Howard Alan Rubel>: No, I understand the challenge of doing that. I appreciate that. And then as a follow-up in the other area. On HBT, you called out the profitability was a little bit below what you might have expected and me as well. And kind of a two-part question. Is part of it mix and can you elaborate on that?

And then from a strategic point of view, we've seen a lot of what I'd call retail struggle a bit and that has, in fact, been a benefit of the e-commerce world. So can you talk about that structural dynamic? And then also the near-term issue?

<A - Darius Adamczyk>: I think, Howard, you have it exactly right. I think mix has been our biggest issue for Q1 in HBT, both from a – mix from a products vs. distribution perspective, but also a geographic perspective, where we saw great – tremendous rate of growth in some of the HGR regions, which tend to be slightly less accretive vs. some of the developed markets. So that was issue number one.

Now in terms of the retail vs. transitioning to e-commerce, I'm not sure that was really one of the causes, frankly, our North America business was a little bit softer than we had expected. But HBT, when I pointed out earlier when I answered a question around new product launches, there isn't a business out there that has more exciting product launches coming up in Q2 and Q3, and I expect that we're going to have a really, really nice strong H2 the year, as well as a nice recovery during Q2.

<A - Thomas A. Szlosek>: The other point I would add, Howard, is that in some of those – some of the businesses that are growing faster than others, for example, as Darius mentioned, the Americas region, when you have an OEM business where we're providing parts or components to OEMs that is growing quite strongly low to mid single-digits. The margins on the initial sale are not great, but we're building the install base. That's the business that we're in here, so creating aftermarket opportunities. I think you're seeing a little bit of that in the Americas as well.

<Q - Christopher Glynn>: Hey, noticed your comments on the several large smart meter project rollouts. Just wondering how much of that has developed since December, and some complexion on how those came to fruition and should roll?

<A - Darius Adamczyk>: Some of them certainly are, we secured those since December. Overall, we're very bullish on the smart energy business for really the rest of the year. Those revenues tend to be maybe more lumpy than one expect. We were kind of flattish in Q1, but expect double-digit growth in Q2 and high single-digit growth for the year. So we've been very successful in securing some of those larger wins. Really pleased with what we saw in terms of win activity in Q1. So overall, very bullish on the Elster acquisition and what we're seeing in our smart energy business.

<Q - Christopher Glynn>: Thanks. And then to follow up, just long-term pension income, I'm curious if you could update the thoughts there. It's certainly a little bit arcane if you could – it's a nice income right now. What's kind of the long-term characteristic and sense of variability on how that P&L impact can swing over time?

<A - Darius Adamczyk>: As you know, I like to simplify the model into two pieces. One is the assets and the other is the liabilities. The assets, you used the word archaic accounting model. I mean, we just apply and assume return to the assets and that goes into our income. So as long as that assets pool that we have is performing and it has performed fairly well, you keep applying that same rate of income and you tend to grow your pension income.

On the liability side, it's interest rate related. So we're in a low interest rate environment and we apply that interest rate to the liabilities and that goes into our expense as well, that's a component of our expense. As that interest rate rises, you would see a decline in the pension income. But it overall is flat.

The important part for us is that the plans are in very good shape. They are well funded. We're in the mid-90s or higher in most of our plans including the big one in the U.S. We don't foresee any contributions in the foreseeable future. So it just becomes kind of a bookkeeping thing for us as we go forward here.

Darius Adamczyk

Q1 Highlights

Sales Performance

- I am pleased with our performance in Q1, especially our sales performance and overall execution

- It was a clean quarter all around with every business either meeting or exceeding the top line guidance we provided
  - However, there's more work to do
- Everyone in the organization is focused on our key priorities, improving organic growth, maintaining our productivity rigor, and becoming a best-in-class software industrial company.
- We're going to continue to stay focused on outperforming for our customers, our shareholders and our employees
- And I look forward to sharing our continued success with you on future calls.