

Company Name: Honeywell
Company Ticker: HON US
Date: 2017-07-21
Event Description: Q2 2017 Earnings Call

Market Cap: 103,703.61
Current PX: 136.35
YTD Change(\$): +20.50
YTD Change(%): +17.695

Bloomberg Estimates - EPS
Current Quarter: 1.740
Current Year: 7.082
Bloomberg Estimates - Sales
Current Quarter: 9831.000
Current Year: 39451.625

Q2 2017 Earnings Call

Company Participants

- Mark Macaluso
- Darius Adamczyk
- Thomas A. Szlosek

Other Participants

- Charles Stephen Tusa
- Nigel Coe
- Jeffrey Todd Sprague
- Joe Ritchie
- Peter J. Arment
- Andrew Kaplowitz
- Andrew Burris Obin
- Julian Mitchell
- John G. Inch
- Gautam Khanna

MANAGEMENT DISCUSSION SECTION

Mark Macaluso

Non-GAAP Financial Measures

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

Darius Adamczyk

Business Highlights

Organic Sales Growth

- Today we reported another quarter of strong performance with each of our businesses either meeting or exceeding the sales guidance we provided in April
- Organic sales growth exceeded the high end of our guidance range at over 3% with good results in all four business segments
- Our performance in the Aerospace Aftermarket continued and our U.S. defense business improved as we anticipated
- In Advanced Materials within Performance Materials and Technologies, we recorded another quarter of double-digit revenue growth driven by the continued adoption of our Solstice line of low-global-warming

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products

Home and Building Technologies

- And in the Home and Building Technologies, we exhibited strong revenue growth at approximately 4% organic
- We also expanded margins by 50BPS this quarter, driven by commercial excellence and productivity, leading to EPS that came in at the high end of our guidance range at \$1.80, and up 10% from 2016 on a basis consistent with our guidance

Tax Rate

- Our second quarter tax rate was lower than initially anticipated and this enabled us to invest more than \$115mm in restructuring and other projects
- That's \$90mm higher than we contemplated in the guidance
 - These projects start delivering cost savings for us later this year and ultimately will result more than \$150mm in run rate savings
- Excluding this additional \$90mm of restructuring funding and 2016 earnings from last year's divestitures, on a normalized for tax basis, EPS grew 10% y-over-y

Growth and Investments

- I am pleased with our continued performance, especially our organic sales growth momentum, which is a testament to the growth and investments we made in new technologies, platforms, production capacity and M&A
- We are raising our full year sales guidance to a new range of \$39.3B to \$40B, up 2% to 4% organic, and again, raising the low end of our earnings guidance today. 2017 EPS is now expected to be between \$7 and \$7.10
- Tom will take you through the details shortly
- Each of our businesses made significant progress from our key initiatives this quarter, and I'd like to provide some brief highlights

Aerospace

- Let's turn to Slide 3
- In Aerospace, our suite of connected aircraft offering continue to gain traction
- We announced that GoDirect Connected Maintenance, which combines our connectivity, in-depth product knowledge and data analytics to predict when mechanical parts need to be fixed or replaced, will be used on the auxiliary power units of 60 of Cathay's Airbus A330 aircraft
- The agreement was a result of a successful trial, which saved Cathay Pacific several hundred thousand dollars in operational and reactive maintenance costs per aircraft, and reduced APU related delays by 51%

Home and Building Technologies

- In Home and Building Technologies, we launched the Lyric C1 Wi-Fi Security Camera, the latest in our growing line of do-it-yourself offerings that can help make homes smarter and serve a faster growing segment of the market

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- The C1 can be set up easily using the Lyric app on your mobile device and it offers intelligent sound and motion detection
 - Since its launch last month, the C1 camera has already generated more than \$1mm in sales and more than 80% of reviewers are recommending it
- We have an exciting pipeline of other new products in Home and Building Technologies that will roll out over the latter half of the year

Performance Materials and Technologies

- In Performance Materials and Technologies, we announced the agreement to acquire Nextnine, a leading provider of cyber security solutions for industrial sites
- Nextnine has an impressive installed base of more than 6,000 sites around the world
 - It is especially strong in the oil and gas, utility, chemical and mining manufacturing sectors
- We are excited about the combination of Nextnine to our growing cyber security business within Honeywell Process Solutions
- Nextnine broadens our offerings for our installed base while complementing our broader offerings in Connected Plant

Safety and Productivity Solution

- Lastly, in Safety and Productivity Solutions, we introduced Connected Freight, which was developed with Intel and third-party logistic companies
- Connected Freight can help shippers and logistic companies monitor high-value and perishable goods to prevent damage and loss
- Sensor tags are affixed to pallets or packages, and they send real-time information about the location and condition of critical freight while in transit
- Our connected offerings continue to gain traction and feedback from our customers has been extremely positive
- Our evolution as a software industrial leader is well underway and I'm encouraged by our progress

Thomas A. Szlosek

Financial Highlights

Organic Sales Growth

- I'm on slide 4
- As Darius mentioned, we achieved more than 3% organic sales growth in Q2
- The guidance was 0% to 2%
- The momentum continued from Q1 with all of our businesses either meeting or exceeding their sales guidance
- Segment profit was \$1.9B, that was up 6%, excluding the impact from our 2016 divestitures

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Segment Margin, EPS and Tax Rate

- Segment margin expanded 50BPS from 2016
- That was driven by volume leverage and commercial excellence as well as our continued focus on productivity and returns from previously executed restructuring projects
- EPS were \$1.80
- Our second quarter tax rate was 21.3%, lower than we originally expected, due to higher than anticipated employee stock option exercises
- But this favorable impact was offset by provisions for additional restructuring projects beyond what we anticipated in the original guidance
 - These investments will drive further growth and productivity mostly starting in 2018
- Excluding those investments and earnings from our 2016 divestitures and normalized for tax at 25% in both periods, EPS was up 10% y-over-y

FCF

- Our FCF momentum continues with strong operational performance in each of our segments
- YTD, FCF was up 39% from 2016 despite approximately \$300mm more in timing-related income tax payments
- Overall, it was another quarter of strong operational performance

Segment Results

Aerospace

- Let's move to slide 5 to discuss our segments in more detail
- Let me start with Aerospace, which delivered a very strong quarter in both sales and profit
- Aerospace sales growth was 2 percentage points above the high end of our guidance
- Strength in the Commercial Aftermarket continued this quarter with strong repair and overhaul activity, growing sales of retrofits, modifications and upgrades, and robust spares demand in the air transport and regional segment
- The business in general aviation aftermarket was also up, primarily driven by timing of customer demand
- Overall, aftermarket sales grew 5% this quarter

OE Dynamics

- The OE dynamics we've talked about in the last quarter continued, with market-related weakness in business in general aviation and slowing shipments for the legacy air transport platforms, partially offset by growth in new platforms
- Overall, OE sales were down 5%
- Defense sales were up 2% driven by deliveries related to the F-35 program and sensors and guidance systems within the U.S. defense segment

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- This was partially offset by continued weakness in the space and commercial helicopter markets as we anticipated

Transportation System

- In Transportation Systems, growth was driven by continued recovery of the commercial vehicles market with demand especially strong for on-highway turbos in the U.S., Europe and China
- The China growth was driven by new regulations that restrict the weight of commercial vehicles, spurring demand for turbocharger technology that can provide more power to smaller sized engines
 - This is a trend we expect to continue for the remainder of 2017
- Aerospace segment margin expansion of 140BPS for the quarter exceeded the high end of our guidance, driven by that higher sales volume as well as productivity net of inflation, and the favorable impact of the 2016 divestiture of the government services business

Home and Building Technologies

- Home and Building Technologies performance was mixed with strong organic sales, but lower than the anticipated margin rate growth
- HBT organic sales grew 4%, at the high end of the guidance range, driven by both products and distribution
 - Within products, we executed several large smart meter program rollouts
- We saw continued strong demand for clean air and water products in China, and we delivered nice growth within our homes business in North America
- The sales growth acceleration in the products segment was also encouraging

Building Solutions and Backlog

- Distribution continued to perform well, with strength in both Honeywell Building Solutions and global distribution
- Orders were up 5% in building solutions and backlog was up double digits
 - So we expect growth in this business to continue
- Segment margin for HBT was below our expectations, coming in flat for the quarter
- We continue to see benefits from previously funded restructuring and our ongoing productivity initiatives, but those savings were offset by unfavorable sales mix in the quarter

Smart Energy

- We had higher sales of lower margin products in Smart Energy and Environmental and Energy Solutions and lower volumes in Security and Fire
- In Smart Energy, we're conducting aggressive value – or cost value engineering efforts aimed at reducing manufacturing costs, but our results from those projects have not materialized as quickly as we anticipated

China

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- We also saw margin pressure from a regional perspective, as we had plus-20% growth in China and over 40% in some of the HBT businesses in China
- But we saw weaker sales growth in other more profitable regions
- Clearly not the complete result we desire in HBT, but we're encouraged by the sales momentum and we're taking actions to address the profit performance, including better material productivity and stronger commercial execution

Performance Materials and Technologies

- Performance Materials and Technologies had another very strong quarter, with organic sales up 6%, the guide was 3% to 5%; and 200BPS of margin expansion, the guide was 170 to 200BPS.
- There is encouraging news throughout the PMT business
- Overall, UOP sales were up mid single-digits, orders were up 40% and the backlog is up double-digits
- There was continued strength in UOP Russell, specifically in the modular gas processing applications, with six new units booked this quarter
 - We've booked 12 Russell units so far this year, more than double the amount booked in H1 2016

HPS

- The orders in other segments of UOP support a continued ramp-up in organic sales volumes in Q3
- In HPS, sales were down slightly, but margins expanded significantly due to commercial excellence and productivity
- We saw lower backlog conversion in the projects business and lower demand for process, measurement and control products in Europe
 - This was partially offset by significant growth in the short cycle software and service businesses
- HPS orders were up about 15% and the backlog is growing nicely

CapEx Investments

- Advanced Materials had another quarter of double-digit growth and margin expansion enabled by CapEx investments we made for our Solstice line of low-global-warming products
- In May, we started up our largest Solstice facility and the world's largest automotive refrigerant plant in Louisiana, which is meeting continued demand for our Solstice yf product
- Sales in our Solstice business nearly doubled in the quarter

Margin Expansion

- Margin expansion came in at the high end of our guidance range driven by productivity, net of inflation
- Results from our commercial excellence efforts; and the divestiture of the former Resins and Chemicals business in Q3 2016
 - We'll lap this impact in Q4

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- And as I mentioned, margin performance was particularly strong in HPS and the Advanced Materials business

Safety and Productivity Solution

- In Safety and Productivity Solutions, organic sales were up 1%
- Safety grew 2% on an organic basis driven by our high risk personal protection equipment and gas detection offerings
- The general safety business has been improving sequentially for the past several quarters and also returned to positive organic growth in Q2, thanks to sales and marketing initiatives as well as investments in our sales force
- Workflow solutions also grew high single-digit in the quarter, driven by high demand for our leading voice-enabled solutions and double-digit growth in the Movilizer software business, driven by a large win in Europe

Sensing and IoT

- In Sensing and IoT, demand for sensing controls remain robust, particularly in high-growth solutions
- Intelligrated continues to deliver impressive results, growing more than 30% this quarter compared to Q2 2016 when it was not yet owned by Honeywell
- Now, this was driven by large project awards with key accounts

Orders and Backlog Growth

- We continue to see strong orders and backlog growth in Intelligrated which, as a reminder, will begin to be counted in Honeywell's organic sales growth rates at the beginning of September
- Productivity products was down in the quarter, driven by decreased North America sales, particularly for the mobility business
 - Although we anticipate that productivity products will improve in Q3 and Q4, our more aggressive product launches will occur in Q4 and we'll likely continue to see softness in the mobility business until early 2018
- SPS segment margins, while below our expectations, were still strong, expanding 90BPS, excluding the first year dilutive impact from M&A

Productivity and Restructuring Benefits

- This was primarily driven by continued productivity and restructuring benefits and was partially offset by investments in our commercial excellence as well as lower volumes in the mobility business
- The shortfall to our expectations was primarily driven by lower than expected volumes in productivity products, accelerated investments related to the go-to-market strategy shift for the retail business, as well as the new product launch investments I mentioned

EPS

- Slide 6 is a walk of our EPS from Q2 2016 to Q2 2017
- In Q2 last year, earnings from our 2016 divestitures were approximately \$0.05 per share, and we exclude those amounts from our 2016 baseline consistent with our guidance framework

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Tax Rate

- For comparison purposes, we have also normalized the tax rate for Q2 2016 to the 25% effective tax rate we initially assumed in our 2017 guidance, the impact of which was minor
- Segment profit improvement resulted in an \$0.11 increase in EPS, and all of our segments are contributing to the growth
- Other below-the-line items, principally, lower interest expense as a result of the debt refinancings we did in 2016 as well as higher pension income accounted for \$0.05 improvement to EPS, bringing it to the \$1.80, right at the high end of our guidance and up 10% y-over-y

Restructuring

- As I mentioned earlier, our second quarter tax rate was lower than anticipated at 21.3%, principally the result of higher than anticipated stock option exercises, which resulted in \$0.09 EPS benefit
- Conversely, the additional restructuring provisions that Darius and I mentioned reduced EPS by a similar \$0.09

Run Rate Cost Savings

- On average, the payback of these projects is under two years
- And overall, they will generate more than \$150mm in run rate cost savings
- The pipeline of funded but unexecuted restructuring projects is robust at more than \$300mm and will continue to drive returns as the projects are executed

Aerospace

- Let's turn to slide 7 to discuss our expectations for Q3
- In Aerospace, reported sales are expected to be down 2% to 4%, primarily due to the impact of the 2016 divestiture of the government service business, and organic sales are expected to be flat to up 2%
- Within Commercial OE, we expect strong air transport deliveries for new platforms, partially offset by the impact of declining shipments on legacy platforms
 - We anticipate a tailwind from customer incentives, which will improve our sales and segment margin in Q3

Business Jet OE Market

- And as we have mentioned, we do not expect a recovery in the business jet OE market until closer to the late 2018 or 2019 timeframe, but we do anticipate modest growth in the business aviation aftermarket on continued R&O activity
- We also expect continued strength in the air transport aftermarket driven by retrofits, modifications and upgrades as well as by the typical seasonal demand

Commercial Vehicle Market

- The commercial vehicle market should continue to recover, driving modest growth in Transportation Systems

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- Growth in light vehicle gas continues to be driven by demand in high-growth regions
- Aerospace margins should expand significantly this quarter, driven by the OEM incentive tailwind, improving volumes and the continued benefit from prior year restructuring projects

HBT

- In HBT, we anticipate organic sales of 1% to 3% and reported sales growth to be slightly lower, so flat to up 2%, due to the impacts of foreign currency translation
- In Q2, there was gradual month-over-month sales growth improvement, with good momentum exiting the quarter
 - We expect those strong trends to continue
- Within the products business, we'll have additional large smart meter program rollouts principally in Europe, and anticipate continued demand for air and water products in China

Distribution

- In distribution, the strong orders and backlog trends in building solutions combined with the commercial excellence initiatives and growing scale of our global distribution business will continue to contribute to growth
- HBT segment margins are expected to expand 10 to 40BPS driven by cost reductions from prior restructuring actions, ongoing commercial excellence and productivity initiatives
 - These will be partially offset by the continuation of the headwinds from the unfavorable product mix I mentioned earlier

Performance Materials and Technologies

- In Performance Materials and Technologies, sales are expected to be down 6% to 8% on a reported basis, primarily due to the impact of the 2016 spin-off of the Resins and Chemicals business
- But on an organic basis, we expect PMT to grow at 7% to 9%, driven by conversion to sales of our strong backlog
- UOP is expected to deliver more than 20% growth, driven by strong licensing sales, continued strength in the modular gas processing business, and demand for hydroprocessing catalysts
 - We expect strong growth across the entire HPS portfolio, but primarily in our lifecycle solutions and services, field products and combustion businesses

Advanced Materials

- In Advanced Materials, we expect mid single-digit growth fueled principally by Solstice
- PMT segment margins are expected to expand 130 to 170BPS driven by commercial excellence, productivity and the favorable impact of the Resins and Chemicals divestiture

Safety and Productivity Solution

- In Safety and Productivity Solutions, sales are expected to be up 2% to 4% on an organic basis, with reported sales increasing about 20% due to the impact of sales from the Intelligrated acquisition

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- Q4 is the first full quarter of Integrated organic sales
- In the safety business, we expect further recovery in general safety products and a gradual improvement in the retail channel, as our go-to-market transition from a distribution model to a direct sales model is executed
- Growth in productivity will be driven by a robust order pipeline in the workflow solutions and continued strong demand for sensing controls

SPS Margin

- SPS margins are expected to expand by more than 150BPS, excluding the first year dilutive impacts of M&A
- And this is driven primarily by benefit from last year's restructuring projects, the higher volumes as well as the results from our ongoing productivity efforts
- So for the company in total, organic sales growth is anticipated to be 2% to 4%, with 120 to 160BPS of margin expansion, leading to EPS of \$1.70 to \$1.75
 - That's up 13% to 16% y-over-y
- And again, that excludes divestitures and it's normalized to Q3 tax rate of 26%
- To the extent our tax rate is lower than 26%, like we did in Q2, we intend to undertake additional restructuring projects

Guidance

EPS

- Let's move to slide 8
- As we previously mentioned, we're raising the low end of our full year EPS guidance by \$0.10, so the new range is \$7 to \$7.10
 - That's up 8% to 10%, and again, that excludes the divestitures and last year's debt refinancing charges
- We're also raising our full year sales guidance to \$39.3B to \$40B
- Sales are now expected to be up 2% to 4% organic, driven by higher volumes

Organic Sales Growth

- In terms of our segments, PMT organic sales growth guidance is now 5% to 7% for the full year
- SPS reported sales growth guidance is now 18% to 20%
- And the low end of the Aerospace's sales outlook is up slightly since the last quarter

Segment Margin Expansion Perspective

- From a segment margin expansion perspective, we remain within the initial guidance range of 70 to 110BPS
- We have lowered the full year margin guidance for both HBT and SPS and increased the margin guide for Aero
- In SPS, we still expect strong operational margin performance consistent with our previous guidance

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- Overall, there'll be puts and takes across the businesses, but we're confident in our ability to deliver our full year margin expansion guidance
- And we remain focused on executing for the remainder of 2017

FCF

- There's no change to our full year FCF guidance
- H1 FCF performance was good, showing a 39% performance y-over-y, and we're focused on continuous improvements in our execution across the organization
- Let me turn to slide 9 for a quick wrap-up
- We had a strong second quarter with higher than anticipated organic growth, continued margin expansion and good performance in all segments
- The trends we've seen in H1 are expected to continue, leading to third quarter EPS that are expected to be up healthy double digits

Investments

- The entire organization is focused on executing Darius' key priorities, which as you'll recall, include improving organic sales growth, maintaining our productivity rigor, becoming a best-in-class software industrial company, and continuing to aggressively deploy capital, all the while continuing to make significant investments in Honeywell's future

QUESTION AND ANSWER SECTION

<Q - Charles Stephen Tusa>: So just a question on the ACS-related businesses. In HBT, obviously, the margins have been a little bit weak there and even in the SPS business. Darius, can you talk maybe about the volume of kind of investments you guys are putting to work there? I mean, any kind of color on, is this – I know investment's usually not discretionary, per se, given competitive pressures out there, but maybe some degree of magnitude around what kind of money you're putting to work there. I think that's the first question. I have a quick follow-up.

<A - Darius Adamczyk>: Yeah. I mean, I think, clearly, we're investing both in RD&E and really reallocating our sales force as well. Because frankly, we've had some places where fundamentally underinvested. And I think as a matter of fact, I would say in our developed markets, we underinvest in terms of sales force. And HGR, although we've had very aggressive investments, we also want to make sure that those investments are paying off. And they are.

Because by the way, as I look at what happened in HBT in Q2, part of the issue here is a mix change. Just to give you a couple of facts. Our China EE&S business was up 45% in Q2. And that's a little bit part of the margin mix challenge that we had here in the quarter. But overall, I continue to be very bullish.

The other thing is that we're working on is what I call kind of a second tier or value offerings for EE&S and HSF as well as investing in our DIY platforms. That's how I'd characterize most of the investments.

<Q - Charles Stephen Tusa>: Is there are a degree of kind of margin pressure that's happening today that kind of spin back into the numbers as growth comes through? Is it kind of like a step-up? Or just any way to somewhat quantify that, or not really?

<A - Darius Adamczyk>: Yeah. I mean I think, obviously, the – yeah, I should say that ruefully...

<Q - Charles Stephen Tusa>: Okay.

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<A - Darius Adamczyk>: I think that some of it as a mix and frankly, some of it is we've got to do a little bit better on a couple of elements. The two places I point to is I think we have an opportunity to drive better material productivity. I have higher expectations there. And the second one is around pricing and commercial excellence, because I think, frankly, some of those are areas that we haven't done as well as we could have.

Having said that, I think, overall, it's a pretty positive story because as you look at our markets, we grew faster than our markets, particularly on the residential side. So all in all, yeah, I'm slightly disappointed by the margin rate, but we have some actions that Terrence and his team are working and I don't want to also forget about our 4% top line growth with tremendous growth in China, just well north of 20% for HBT.

<Q - Charles Stephen Tusa>: And that could be an 2018 story, that improvement, 2018 story?

<A - Darius Adamczyk>: Yes. [indiscernible] (30:18)

<Q - Charles Stephen Tusa>: Okay. And then one last quick one – one last one on FCF. Normal seasonality kind of gets you north of where you're guiding to. Is there anything that kind of reverses in H2 that suggests that it shouldn't kind of track a more normal seasonal trend for H2, Tom?

<A - Thomas A. Szlosek>: No, I think we're fine on cash. I mean, we've kind of – when you draw the market at the end of H1, overall conversion is right in line with where we were last year. But in H2, some of the initiatives that we've got going are going to drive that stronger performance.

Frankly, I think we should do better than overall 5% to 7% to your point on H1 growth. But we've got a little bit of a track record of not necessarily being entirely accurate on our cash forecast. And so we want to be sufficiently conservative as we had in H2, but big effort for us.

<A - Darius Adamczyk>: Yeah, and Steve, I'd just point out that we've had had some headwinds, both in H1 on cash taxes well north of \$300mm, and then we have some more coming in H2. So that's why I think – by the way, that's already reflected in our outlook for the year, and that's why it may seem like we're being a little conservative but we've got some real headwinds.

<Q - Nigel Coe>: Just wanted to dig back into HBT. And I think the moving parts there were pretty well known. But obviously, Fire and Security's a bit weaker vs. segment average. So I'm wondering, do we have visibility on some improvement in that in H2, or is that more of an 2018 story?

And then the second part of that question is I think this is the first time you've called out China as a below fee average margin geography. Maybe I'm wrong there, but what is the part towards getting China margins back towards the average or better?

<A - Darius Adamczyk>: Yeah, I wouldn't – I think as any kind of high-growth/HGR, geography, it's slightly dilutive to the overall average. And obviously, when you blend it in at 45% growth, it has an impact. In terms of margins, we work those pretty aggressively. Terrence is all over this, both on the productivity side as well as the commercial excellence side.

We have some opportunity, there's some new products coming, so I expect some level of recovery and we are going to grow margins in that business this year. We probably were a little bit aggressive initially and that's why we made some – we had puts and takes in overall Honeywell portfolio. That happened to be one of the takes. But we expect growth there [ph] into (33:13) the margin growth for 2017 and further enhancements for 2018. And I can also tell you that a good portion of the restructuring funds that we allocated in Q2 went to HBT.

<Q - Nigel Coe>: Okay. Okay. That's helpful. And then a question for Tom on the hedging, and given the weakness in the dollar we've seen continuing through Q3. So the way I understand it, it's helpful to top line, it's harmful to EBIT. So there's a bit of a margin pressure. So just looking at your unchanged segment guidance for the year, I'm wondering if you know better volumes on margin is being offset by a little bit of pressure from FX or maybe, it's immaterial, but maybe you can just clear that up. And then where do you stand on hedging for 2018?

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<A - Thomas A. Szlosek>: Yeah. So just for 2017, Nigel, we're more or less about three quarters or more locked in on FX rates. And as you know, our hedging program is intended when you consider all the aspects of it. The net result is to hedge the operating income and not necessarily the top line – definitely not the top line. So our top line will definitely flow as the FX flows.

And so if you see the euro strengthening as you have over the last few weeks, our top line should improve. However, our margin rates – our margin dollars are more or less locked in for most of the major currencies for the year, given the hedging that we did at the beginning of the year. So if you start to see a strengthening or weakening, H2, that's not going to have a material impact on our margin rates themselves, given that we've kind of locked the rates in.

So 2018, we're taking a similar approach, we don't necessarily disclose all the positions but we're keeping a strong eye on the currencies where we have major exposures, euro being a big one, and taking risk off the table as we see the opportunities arise.

<Q - Jeffrey Todd Sprague>: A couple questions. First on Intelligrated and the growth that you're seeing there, would this all still be associated with what they had in the pipeline and the order book at the time of the deal, or is there some kind of Honeywell benefit that's starting to show up in the results? That's the first question.

<A - Darius Adamczyk>: No. The answer to your question is no, this was not there at the time of the deal. There's a lot – the pipeline is growing substantially, and certainly, there's a inherent Honeywell benefit. I mean, frankly, the Honeywell brand is really well known throughout the industrial and – or at least in the logistics world, and we've benefited from the current relationships that we've had.

And as you recall, the premise behind this business going into SPS is our Scanning and Mobility business, its strongest vertical is transportation and logistics, so there's a lot of benefit in terms of cross-selling and leveraging that sales force to generate leads for Intelligrated. So we're certainly seeing the benefits from that. And that pipeline, Intelligrated, is extraordinarily robust.

<Q - Jeffrey Todd Sprague>: Right. And then just on thinking about PMT margins, and a lot going on there with UOP and HPS, but just thinking about how Solstice ramps, can you give us some sense of how fully utilized the new factory or factories are? And kind of what kind of operating leverage we could expect flowing as you ramp up Solstice here?

<A - Darius Adamczyk>: Yeah, so I mean, the new factory, the Apollo factory that Tom referred to, it's not fully utilized yet. That just came online, it started up in May. So, think about a 50%-like utilization, which is kind of normal at this stage because it's still ramping up to its full. So there's more leverage there to come. And we're going to be kind of shifting our supply a bit from sort of externally sourced and so on to more internally produced. Obviously, that's going to be accretive, which is good news. So, the short story here is that there is more leverage to come.

And as you saw, Jeff, really, really nice story in PMT. I mean, both in terms of orders, leverage on the revenue, and Solstice continues to deliver.

<A - Thomas A. Szlosek>: And strong backlogs, too. I mean, we have a nice backlog we had in H2 in all the businesses.

<Q - Jeffrey Todd Sprague>: Great. And just one other quick one. Tom, can you just put a finer point on what the variance is Q3 vs. Q3 and the Aero incentives, either in dollars or margin...

<A - Thomas A. Szlosek>: Yes, it's about a, I'd say, 50BPS margin impact y-over-y. And it's – as you know, the 2000 overall incentives for the year are going to be probably 40 to 60BPS down, most of that coming in H2 and most of that being in Q3. So this is where you see the biggest impact, and that's why those Aerospace margin rates for Q3 will be so robust. I mean, they're already robust without the incentives, but up to 300-plus basis points of improvement is pretty strong.

<Q - Jeffrey Todd Sprague>: Indeed it is.

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<A - Thomas A. Szlosek>: And I think the other thing to point to is...

<Q - Joe Ritchie>: Hey, Tom, maybe just following up on that point right there on the OEM incentives. It's interesting when you take a look at your organic growth guidance for Q3 in Aero, surprised that it wasn't a little bit higher, because you do have the benefit from OEM and you have a pretty easy comp. So is there any – what's kind of offsetting that in Q3? Or is this just kind of like a conservative Q3 guide?

<A - Thomas A. Szlosek>: Yes, I think we want to build up some momentum. We had a strong Commercial Aftermarket, 5% in Q2. And we kind of want to see that momentum continue. I mean, that we sort of factored in at low single-digits for Q3. I think Defense & Space, we've got a comparable q-over-q. The incentives do come through. And if they do – I mean, they will come through. If the aftermarket comes through like it did in Q2, we should be definitely at the high end of that 2% organic, it's not pushing higher.

<A - Darius Adamczyk>: Joe, if I – just add. I think the mix is such that we know the visibility is on OE. We know roughly what that looks like. And so we're actually getting much more into the shorter cycle business or aftermarket especially, on the BGA side. So frankly, we don't have as much visibility as we normally would in Aerospace because that's what we're counting on. And thus, as Tom pointed out, we want to kind of see that rate of aftermarket activity, both on the ATR and BGA side maintain, and that's why we let the guidance be where it is.

<Q - Joe Ritchie>: Got it, okay. And then maybe just following up on Steve's question from just a little earlier, but asking it slightly differently. I guess, if you think about all the restructuring actions that you guys have taken, the pull-forward in Q3 last year, additional restructuring this year in Q2, it's nice to see the growth uptick. But I guess, maybe if you could just kind of comment on just what you're seeing competitively in your ability to hold the cost benefits into your margin, and how much you're actually having to utilize to actually offset potentially a competitive pricing environment. I think any color around that would be helpful.

<A - Darius Adamczyk>: Sure. Yeah. I mean, there's a couple of points. The first one is, we definitely are seeing the benefits of restructuring come through and that's certainly there. I think your question is probably more around HBT. And, yeah, it is a competitive environment. However, we also have a very strong competitive composition and we're seeing that in our growth rates, particularly in the high-growth regions but also in DM.

So part of it is mix, but part of it is we've got an opportunity to be a little bit better, like I said, on the material productivity side, commercial excellence and so on, as well as some of the new product launches that we're doing and kind of offering – having the Honeywell premium tier as well as the value tier, as well as expansion of DIY.

So there are some self-help things that we're embarking upon and really started in Q2, and I expect to see some benefit of that towards the end of this year and even more so next year. So, yeah, it's a competitive environment. But given our brand, product positioning, overall value to customers, I'm bullish on how we're going to perform there.

<Q - Peter J. Arment>: Tom, you mentioned briefly on PMT, on the backlog, ex, kind of, Solstice, how is backlog holding up, or what kind of visibility do you have? Can you give us a little more color there?

<A - Thomas A. Szlosek>: Yes. It's – I mean, it's really strong. When you look at both HPS as well as UOP, I mean, they're both north of 10% – or I'm sorry, in total, they're north of 10%, but UOP is pushing 20%. HPS, as I said, strong momentum and we think that's going to continue.

When you look at the character of what's in UOP, it's particularly encouraging because you see it across all of their product lines, which means that it's not just in aftermarkets we're getting catalyst sales, but we're getting the full gamut of things, the engineering, new projects, the equipment. And that means that there is even more investing going on than we had seen over the course of last year. So good prospects and good character – comprehensive character of backlog across the UOP businesses.

In HPS, same thing, I mean, even more skewed towards the higher profit service side for HPS. I mean, that's pushing 10% up. And then the only reason the HPS backlog isn't where the UOP one is in terms of double digits is that we've been carrying and been very successful in some of these mega projects in HPS. And as you execute those and they come out of the backlog, obviously, you see the impact. Those projects carry a lot of third-party content, however,

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they're not necessarily the most profitable. But they build the installed base and we find them, overall, to be very attractive long term.

So when I look at HPS backlog, even though it's mid single-digits growth, the character of it, from a profitability perspective, is quite different than you would have thought a year ago or you would have seen a year ago, so...

<A - Darius Adamczyk>: If I could just add even more color, because we're very pleased with what we're seeing there. I mean if you think about backlog for all of PMT, up double digit. Think about order rates for PMT for Q2, up north of 20%. And the best part, Q3 outlook, high single-digit outlook for order rates. So we're really, really pleased how that business is performing and this is going to get maintained and that kind of momentum is out there for us.

<Q - Peter J. Arment>: Thanks. And just a quick unrelated follow-up. On the bizjet weakness, Tom, it just sounds like it's been a lingering issue for a long time, but I mean does it sound like things have gotten worse on the OE side? Any color there would be appreciated.

<A - Thomas A. Szlosek>: No, I mean – when you go back 18 months or a couple years and you were seeing heavy double-digit declines on the BGA OE. Remember in Q4 we're – or H2, we were down over 30% on the OE side. Those declines have moderated. It was mid single-digit decline in Q2 for the BGA OE business. And we kind of expected to moderate around that. I mean, the orders can be a little bit lumpy and the timing doesn't necessarily exactly correlate to what our customers would report for their unit shipments. But I'm not going to say we've seen the bottom, but the rates of decline are significantly, significantly less than what they were a year ago.

<Q - Andrew Kaplowitz>: You didn't make an acquisition in Q2, but acquisition activity has still been relatively quiet. And you've talked about valuations in the past being pretty high and maybe waiting for tax reform. Can you expect to have a big ramp-up in M&A activity in H2 this year? And if not, do you end up buying back more stock? I mean, how should we look at capital allocation in H2?

<A - Darius Adamczyk>: Yeah. All right. I would say that the pipeline is very active and we probably have three to five things we're looking at very, very seriously. But we're going to continue to be cautious buyers. And I think part of it is just the discipline around purchase price. There are certainly things out there that we're very interested in, but they also have to come at the right price.

So hopefully – and I never guarantee what will happen, but hopefully, we'll have some additions to the portfolio here in H2. We certainly have some interesting properties that we're closely examining. But it also has to happen at the right price, so we'll see what happens. And we're not – I mean, I think the tax environment regime, I think there's more uncertainty in that now than maybe even before, so I can't let that sort of rule the business, and we're not going to hold that up. I indicated before, we have a slight preference for overseas M&A vs. domestic, but certainly, we'll look at anything. So we'll see what happens.

Now in terms of share buyback, as I indicated, depending on what happens on the M&A front and we're going to be looking that at a lever as well. But I want to make sure we really exhaust those possibilities first, and I'm still hoping we'll have a little bit more clarity on the tax front, maybe even before the end of this quarter.

<A - Thomas A. Szlosek>: And Andy, just to add to that for a little bit of balance on that. You remember Darius said at the Investor Day that from a capital allocation perspective, U.S. we would look to deploy \$5B this year between dividends, share buybacks and M&A. The dividend is more or less understood to be about \$2B of that \$5B, leaving \$3B between share buyback and M&A.

So far, we've done about \$1B of share buyback, and so we've got a couple billion left, Darius says we're going to watch that. So that's the \$5B in the U.S. Outside the U.S., as he said at the time, there's close to \$10B of capacity that's ready to be put to use immediately, let alone – or excluding even the leveraging capabilities.

So I think we're on track on both fronts, but same thing with Darius, I don't think there's an impending rush of deals that you're going to see after we get off this call. So we'll keep you guys in the loop.

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<Q - Andrew Kaplowitz>: All right. Thanks for that, guys. And then Darius, your commentary around your productivity products business suggests that maybe your new product rollouts there have been maybe slower than you thought or at least not quite as effective. Can you talk about your confidence level on turning around that business as you turn the portfolio here?

<A - Darius Adamczyk>: Yeah. And I think the one thing that's important to – as you think about SPS, I think it's important to put in context where the issue is. The issue is in one business and in one segment of the business called mobility, and it's even more regional than that, which is called North America.

And as I pointed out, the issue in the last call, which hit sort of our array of products in the Android operating system. Frankly, we're not where we need to be in terms of our range and offering. We did launch a good product in Q2, which will help. I don't think it's the full solution. The team has very robust launch plans, but frankly, those won't happen until about Q4 of this year.

So we're expecting some improvement in H2, but really, kind of a full improvement will really happen in 2018, as all those products come to market. Although, I will say we are encouraged by the product launch that they did do in May, but we don't really have a lot of revenue yet generated from those offerings.

<Q - Andrew Burris Obin>: Good to see a little bit of green on my screen today. Just a follow-up question on China. Is the mix in China changing? Because historically, my understanding is that China was more profitable, but you have been talking about a big push in consumer area in China, is that something that is impacting margin?

<A - Darius Adamczyk>: No, China is still very attractive and very profitable. The product segments that happen to do, especially in HBT this quarter, were sort of a mix which is, as I mentioned, slightly dilutive to the overall HBT rate. But overall, we are very, very pleased of the China profitability and overall, on a Honeywell basis, it compares to our overall margins. And when we're seeing the kind of growth we're seeing, that's a great thing for us. And we're very bullish there. And I think if I had to point to a market that I was extraordinarily pleased with in Q2, that would be it. Our China growth was spectacular.

<A - Thomas A. Szlosek>: Yes. Just to accentuate that a little bit, the GDP – whatever the right GDP is for China, say it's 7%, I mean, every one of our businesses was well north of that. Aerospace is doing fantastic on the R&O side. TS has got new launches, taking advantage of the air quality opportunities there.

HBT, a lot of new products particularly around air and water, up double-digit. Safety and Productivity, up double-digit, and PMT up double-digit. And UOP and HPS, Advanced Materials, all of them were just outstanding in China. As we get more momentum there and we leverage the capacity that we have from a production perspective, the profitability continues to grow and it's already very, very healthy.

<Q - Andrew Burris Obin>: And Shane and his team have always had a very – and I think Honeywell have always had a very sophisticated view of China. We're getting a lot of questions from investors about Chinese growth after this big Party Congress they're going to have in October/November. What are your guys sort of framework for growth in H1 the 2018? Some people tell us growth will slow down, some people tell us they'll try to save face and so the new team will see good growth as well. What are your insights?

<A - Darius Adamczyk>: Obviously, it's very important for the Chinese economy to do pretty well until that November timeframe. But overall, we continue to be bullish on China. I think whether this pace is maintained or something slightly lower than that, I don't think that changes our calculus as it relates to China, because we expect growth there to be 4, 5 times what it is in some of our DM markets, and we're showing those kinds of numbers.

By the way, when Tom talked double digits, that's not 10%, think of a number that's well 2x times that number. So we don't – we have the right momentum, we have the right presence. We're very comfortable with our strategies in terms of what we're doing east for east and east to west. And I still think it's still very early innings for us in terms of building out our China business and actually using it more as a hub for a lot of the other HGR economies. So I continue to be optimistic, whether it's going to get better or slightly worse, in my view, it doesn't change our investment profile and our bullishness overall on the market.

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<Q - Julian Mitchell>: ...around the transport piece within Aerospace. The growth there was around 1% or 2% in H1. I think you're seeing commercial vehicles recovering a bit, but the automotive side may be softening. So maybe talk a little bit about what you're seeing in automotive, specifically, how you think that plays out in H2, and how you're thinking more broadly about the growth outlook for transport.

<A - Darius Adamczyk>: Yeah we have to talk about automotives. Again, automotive grew – that business grew for us this past quarter. It's kind of – it was a bit of an interesting mix. Diesel was down and it was down high single-digit, but more than offset by growth in gasoline, growth in commercial vehicles and high-growth regions really, really took off. I talked about China again, but again, a great story. You talk about double-digit growth in China, we grew over 40% there in Q2. So a really nice growth rate and we're really well positioned globally.

So even though some of our markets in U.S. and Europe were down slightly, they were more than offset by our presence and our growth in HGR. So really nice positioning of that business and we continue to be very, very bullish on its outlook. Even a country like Brazil grew well double digits, so nice, nice story for us.

<A - Thomas A. Szlosek>: The other thing I would add to that, Julian, is some of this is just timing-related. As we complete platforms – or our customers – our OE customers, discontinued platforms that we're on, that can have a short-term impact on rates, and we've seen a couple platforms come to completion in Q2. But as you know, our win rates on new platforms for the business has been in an all-time high. I mean, we think we're pushing 50% of the win rate on new platforms. So that will start to come through as well. So I wouldn't read into the 1% as indication of any challenge, I think overall, we're in pretty good shape, as Darius says, on the transportation business.

<Q - Julian Mitchell>: Understood. Thank you. And then my second question would really be on SPS and sort of the platform outlook there within warehouse, automation and logistics specifically. You had Intelligrated now within the portfolio for nine months or so, do you think you're in a position now, having integrated it well to date, to do further M&A in that warehouse arena, or are you pretty satisfied with the market share and the offering you have right now?

<A - Darius Adamczyk>: We certainly like the space, if there's the right acquisition to be had, we'd certainly look at it. An interesting market for us, we do have a strong presence between our Scanning and Mobility business, between Intelligrated, even our industrial safety and a lot of the safety gears that we sell into that market, all go together and create a very coherent and valuable proposition for our customers, but certainly look at some other segments if there's something of interest there. So we'll see what happens.

<A - Thomas A. Szlosek>: I think the warehouse automation space is going to be a really nice one for us to continue to invest in. You've got the building blocks but there are a lot of both adjacencies geographically as well as software-wise, that really we can enhance the model with. So we're excited by what we see.

<Q - John G. Inch>: Is there a way to qualify and maybe quantify possibly the impact of sort of relatively stable crude prices here? You guys have a decent amount of direct and indirect exposures, and I'm just curious how, Tom and Darius, you would think about that or articulate that?

<A - Darius Adamczyk>: Yes. There's a lot of directional movement. One minute, U.S. inventory is down. Today, not such good news. There's talk about Saudi holding back production. So every day, there seems to be sort of a different data point which has an impact on the oil prices. But the punchline for us is that something north of \$40, and if we get some stability like we've had, then things are fine. If price of oil drops below \$40 and stays there for a bit, that would concern me. We'll see what happens.

There's a lot of moving pieces between continued expansion of U.S. shale production between what OPEC is going to do, what's Libya and Nigeria, what are they producing, what's Iran going to do. So there's a lots of moving pieces here, it's hard to decipher exactly what decisions are going to be made.

I think this next OPEC meeting is going to be a very, very important one, in which case we can set some directionality. But overall, as of right now and as you can see from our order rates for both HPS and UOP, the market is good. And the activity is very good, very good second quarter and we're bullish on Q3 as well.

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<A - Thomas A. Szlosek>: Yeah. I think those portfolios have proven to be fairly resistant to massive movement in the oil prices. And what I mean by that, if you look at the nature of where we participate, I mean we're in the midstream and downstream, almost exclusively in the downstream for UOP, so refining and petrochemicals, those are areas that stood up very well in the – when oil was down at all-time lows. HPS, a little bit more in midstream. But still, I think the positioning of our portfolios makes them fairly resistant. I mean not immune, not trying to put that out there, but...

<Q - John G. Inch>: Yeah, and I mean...

<A - Thomas A. Szlosek>: ...this is the case that's [ph] broke (01:03:22).

<Q - John G. Inch>: Yeah. Now, Tom, I mean you went through that when oil was crashing, right? You went through a fairly elaborate exercise to sort of basically pitch for the resilience of the portfolio. I'm just trying to understand, we've had semi reasonably stable oil prices. Are we seeing some sort of a – kind of a net tailwind that maybe if oil stays here, anniversaries next year, so the benefit you're getting this year maybe dissipates a little next year? I don't know, I'm just trying to put this into context, that's all.

<A - Darius Adamczyk>: Yes, I mean, I would say that the market's come back this year, that's unquestionable, but I don't think it's come back in a V kind of a fashion. I would say the HPS and UOP teams are just doing very, very well in terms of their performance. I mean the kind of booking rates that they're getting and we're seeing, I haven't seen from anybody else. So I'm very pleased with how they're performing. But I still think that provided the oil price stays stable or maybe upticks, there could be a bit more tailwinds here to come. So I'm optimistic. And the pipeline that we have in terms of our quote log makes me optimistic. Obviously, that could change, but right now, I'm fairly bullish on the market.

<Q - John G. Inch>: Yeah. That makes sense. Then just as a follow-up, Darius, the portfolio review, are we still – no one's asked about it, you didn't really talk about it in your prepared remarks – are we on track for some sort of the presentation announcement? I think you've said by the summer, and I just want to clarify it's not going to be in the last week of August, is it? I mean, by summer, do you mean when we get back from Labor Day?

<A - Darius Adamczyk>: Well, I just want to make sure everybody's on holiday, no. No, I said late summer, early fall.

<Q - John G. Inch>: No, Friday in the last week of...

<A - Darius Adamczyk>: We're still targeting, what I exact – what I said was late summer, early fall. We're very much tracking to that and that's when I'd anticipate some further clarity around the portfolio.

<Q - John G. Inch>: Right. So don't change the vacay plans just yet. Okay. Thank you. Appreciate it.

<A - Darius Adamczyk>: No, I think you're safe the last week of August. Relax, all right. Beach is nice.

<Q - Gautam Khanna>: Many of my questions have been answered. But I did want ask, at the Paris Air Show and over the last couple quarters, Boeing has talked a lot about penetrating the service business and they cited avionics as one of the areas that they're trying to get more share of in the aftermarket. And I just wanted to get your opinion on what form do you think this takes? Is this more of an opportunity, or is it a risk for Honeywell longer term? And how do you guys approach this potential change in the marketplace?

<A - Darius Adamczyk>: Yeah. All right. Yeah. I think the clearest answer I could give is I'm not really sure yet because we haven't seen some of those plans yet rolled out by Boeing. Boeing is very well respected within Honeywell as a customer, and we talk to Boeing on a number of things. They're a great customer and we're going to do whatever we need to do to support them as a customer.

In terms of exactly what's going to happen and how they're going to be going after their services business, I think that's yet to be found out. So to me, there isn't – that clear whether it's a opportunity or a threat. I will tell you that our Connected Aircraft, which I think is something of value to Boeing and a lot of the other OEMs, is something that's picking up pace very, very quickly.

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I talked about the connected APU in my opening and that's getting tremendous traction of customers. And by the way, that's only the beginning in terms of our offerings for Connected Aircraft. We have many, many more coming. So I think that that's complementary to what Boeing is doing and some of the other OEMs. So overall, I'm very positive on our continued strong relationship with Boeing going forward.

Darius Adamczyk

Q2 Highlights

FCF and Restructuring Project

- Q2 was another strong one for us with strong organic growth, margin expansion and continued FCF momentum, which is up nearly 40% on a y-over-y basis
- And we're able to undertake some sizable restructuring projects that will benefit our future performance
- It was not a perfect quarter and we have several opportunities that are well within our control to improve
 - There's a lot more upside for Honeywell and we'll continue our focus on improving organic growth, maintaining our productivity rigor, becoming a best-in-class software industrial company and aggressively deploying capital
- We also remain committed to investing in our future and looking forward to sharing more great results with you in October
- On behalf of the entire Honeywell team, we wish you a pleasant and relaxing summer.

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