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Honeywell

NYSE: HON

Buy

February 27, 2002

S&P Sector – Industrials

Industry – Aerospace/Defense

MARKET DATA

Price	52-Wk Range	Price Target	Shares Out.	Market Cap.	Beta	Dividend	Price to Earnings	Book Value	LT Debt/Equity	Credit Rating
2-22-01 Close	Low Mid-Sept.	Valuation Result	(Million)	(Billion)	MSN.com	Yield	Forward	Per Share	Per Share	Moody's/S&P
\$35.09	22.15 to 53.90	\$55	812	\$28.53	1.2	2.1%	14.83	\$11.38	38%	A2/A



COMPANY OVERVIEW – FROM YAHOO! FINANCE

Honeywell International Inc. is a diversified technology and manufacturing company, serving customers worldwide with aerospace products and services, control technologies for buildings, homes and industry, automotive products, power generation systems, specialty chemicals, fibers, plastics and electronic and advanced materials. The Company's operations are conducted by strategic business units, which have been aggregated under four segments: Aerospace Solutions (41% of sales, 60% of operating profit), Automation & Control (30% of sales, 28% of operating profit), Performance Materials (14% of sales, 2% of operating profit) and Power & Transportation Products (15% of sales and 10% of operating profits).

INVESTMENT RECOMMENDATION:

Buy 300 shares of HON

REASONS FOR RECOMMENDATION

- ❑ On February 22, 2002, David Cote was named President and CEO to replace Lawrence Bossidy. The market viewed the selection of the former TRW CEO and General Electric (GE) executive positively as it bid the stock price up over 10% on the news.
- ❑ Former CEO Lawrence Bossidy was overseeing a series of cost-cutting, six sigma and digitization-driven productivity, and cash flow improvement initiatives. David Cote is expected to continue these initiatives, but will likely forward a growth strategy centered on Honeywell's strong aerospace and defense business.
- ❑ David Cote is a GE trained manager with turnaround experience in the aerospace industry with TRW. It is believed he will either rev up Honeywell's "growth engine" or pursue strategic alternatives that will unlock the value of its businesses.

- ❑ In late 2000, GE offered to purchase Honeywell for \$45 billion, plus assumed debt. Honeywell currently has a market cap of \$28 billion (the debt level is unchanged), 60% below the GE (European Union regulators failed to approve the merger between GE and Honeywell.)
- ❑ Honeywell is experiencing strength in its defense and security businesses due to the Pentagon's Joint Strike fighter, which will benefit 2002 revenues. Going forward, Honeywell should be well positioned to take advantage of economic strength in it currently beleaguered Aerospace and Materials Businesses.

INVESTMENT RATIONAL

Background

On December 2, 1999, AlliedSignal completed its acquisition of Honeywell and immediately adopted Honeywell's name and ticker symbol. (Honeywell's stock closed above \$60 the day prior to the merger completion.) Prior to the merger, both companies were performing well but earnings quickly became under pressure and the company began cutting its workforce. As Honeywell's market value slipped, interested suitors stepped in.

Less than one year after the merger, GE offered the winning bid of \$45 billion, stating that Honeywell's businesses would fit nicely with GEs without direct overlap. Honeywell's shareholders agreed to the offer, but the European Union regulators failed to approve the merger after a lengthy series of negotiations. As it became evident that the merger would not take place, Honeywell named its Chairman Lawrence Bossidy (former AlliedSignal Chairman, President, and CEO) as the president and CEO; Michael R. Bonsignore, after serving more than 30 years at Honeywell, retired after serving as president and CEO through the AlliedSignal failed GE mergers.

Mr. Bossidy immediately implemented tight cost controls measures and began selling off non-core businesses. In addition, he implemented a six-sigma and digitization-driven productivity program and oversaw the final of 19,000 layoffs. While Mr. Bossidy was able to implement these measures, the fact that he was set to retire in June of 2002 made it difficult for him to forward a long-term growth strategy.

Surprisingly, on February 20, 2002, Honeywell announced the appointment of David Cote as president and CEO effective immediately. Mr. Cote will become chairman when current Lawrence Bossidy steps down at the end of June. These initiatives are expected to save \$1.3 billion this year. Mr. Cote was hired away from TRW, where he became CEO in the beginning of 2001. Both Bossidy and Cote served in senior management roles at GE under Jack Welch.

Recent News

The Joint Strike Fighter contract and events of September 11 have impacted the company in many ways. Honeywell stands to make over \$5 billion from the Joint Strike Fighter and will see improved revenues from its array of security offerings. On the other hand, the company's commercial aerospace business has been hurt from the drastic fall off of the commercial airline industry.

Two companies that Honeywell previously owned used asbestos in their products and are party to class-action lawsuits. In fact, a jury recently awarded \$53 million dollars

to be paid by 36 defendants, which included Honeywell. Honeywell's most recent 10Q states, "with respect to environmental matters involving the production of products containing asbestos and other toxic substances, we believe that the costs of defending and resolving such matters will be largely covered by insurance, subject to deductibles, exclusions, retentions and policy limits."

Outlook

Honeywell has a diverse set of businesses that in GE's view were worth \$45 billion in late 2000. Since that time, the defense and security businesses have experienced improved outlooks, which will begin to impact financial results over the next few quarters. Ongoing cost-cutting and productivity measures should continue to improve the company's efficiency and expand free cash flow. Given these positives, Honeywell will be well positioned to take advantage of an economic rebound.

INVESTMENT IMPACT

Investment Risks

- ☐ Honeywell has been adversely impacted by decreased business spending, the drastic reduction in commercial aviation spending, and the slowdown in the electronics market. Management's 2002 earnings estimate of \$2.36 per share is based on the belief that these difficulties will moderate as the economy improve slightly in the second half of 2002. If the economy does not improve, it could have a material adverse impact on management's earnings projections.
- ☐ Since its merger with AlliedSignal, Honeywell has had three CEOs and was almost purchased by GE. The combination of the two companies, the resulting poor performance, and recent charges related to cost-reduction initiatives make the financials statements difficult to use for valuation purposes. As the new CEO's initiatives take hold and the financials statements stabilize, they will provide a clearer picture of the company's intrinsic value.
- ☐ The outstanding asbestos liability could materially impact Honeywell's financial condition, significantly altering the company's economic outlook.

**Overall Effect on
Wright Fund**

The Industrials Sector is currently 5.3% underweight, and the Industrials research team has decided that the sector should be market weight. My recommendation will bring us 33% closer to market weight, leaving each of the other two analysts an opportunity to make a stock recommendation.

VALUATION

**GE
Offer**

GE offered to buy Honeywell for \$45 billion in late 2000. To trade at this valuation, Honeywell shares would have to increase 60% from their current level. Since GE's offer was an arms length transaction, it constitutes a good starting point for valuing the equity.

**Bloomberg
DDM**

Using the default settings, the Bloomberg dividend discount model values

Honeywell's stock at \$38, an 8% premium to the current price.

Conclusion I believe GE's offer of \$55 per share is a reasonable target price. Given GE's merger record, it is likely that Honeywell is worth a bit more than \$55 per share if its operations are rationalized, which is Mr. Cote's specialty. A stop price of \$25 will protect against excessive loss due to asbestos related pressures.

FINANCIAL INFORMATION

Earnings & Growth Estimates:

Earnings Estimates	Qtr(3/02)	Qtr(6/02)	FY(12/02)	FY(12/03)
Average Estimate	0.45	0.57	2.32	2.64
Number of Analysts	9	8	11	8
High Estimate	0.49	0.60	2.40	2.75
Low Estimate	0.44	0.52	2.13	2.32
Year Ago EPS	0.51	0.55	2.05	2.32
Growth Rate	-10.89%	3.18%	13.17%	13.69%

Earnings Growth Rates	Last 5 yrs.	FY 2002	FY 2003	Next 5 yrs.	02 P/E
Company	2.60%	11.40%	15.80%	12.80%	17.20
Industry	7.10%	8.30%	16.00%	11.80%	19.90
S&P 500	8.40%	-21.70%	12.30%	7.50%	24.80

Zacks Industry: DIVERSIFIED OP

Recent Annual Financials (from MSN Money)

Annual Income Statement (Values in Millions)	12/2001	12/2000	12/1999	12/1998	12/1997
Sales	23,652.0	25,023.0	23,735.0	15,128.0	14,472.0
Cost of Sales	NA	18,095.0	17,614.0	10,867.0	10,872.0
Gross Operating Profit	NA	6,928.0	6,121.0	4,261.0	3,600.0
Selling, General & Admin. Expense	NA	3,134.0	3,216.0	1,690.0	1,581.0
Other Taxes	NA	0.0	0.0	0.0	0.0
EBITDA	NA	3,794.0	2,905.0	2,571.0	2,019.0
Depreciation & Amortization	NA	995.0	881.0	609.0	609.0
EBIT	NA	2,799.0	2,024.0	1,962.0	1,410.0
Other Income, Net	NA	2.0	161.0	180.0	300.0
Total Income Avail for Interest Exp.	NA	2,913.0	2,559.0	2,142.0	1,936.0
Interest Expense	NA	481.0	265.0	162.0	175.0
Minority Interest	NA	34.0	46.0	37.0	45.0
Pre-tax Income	NA	2,432.0	2,294.0	1,980.0	1,761.0
Income Taxes	NA	739.0	707.0	612.0	546.0
Special Income/Charges	NA	112.0	374.0	0.0	226.0
Net Income from Cont. Operations	-99.0	1,659.0	1,541.0	1,331.0	1,170.0
Net Income from Discont. Ops.	0.0	0.0	0.0	0.0	0.0
Net Income from Total Operations	-99.0	1,659.0	1,541.0	1,331.0	1,170.0
Normalized Income	NA	1,547.0	1,167.0	1,331.0	944.0
Extraordinary Income	0.0	0.0	0.0	0.0	0.0
Income from Cum. Eff. of Acct. Chg.	0.0	0.0	0.0	0.0	0.0
Income from Tax Loss Carryforward	0.0	0.0	0.0	0.0	0.0
Other Gains (Losses)	0.0	0.0	0.0	0.0	0.0
Total Net Income	-99.0	1,659.0	1,541.0	1,331.0	1,170.0
Dividends Paid per Share	0.75	0.75	0.68	0.60	0.52
Preferred Dividends	NA	0.00	0.00	0.00	0.00
Basic EPS from Cont. Operations	-0.12	2.07	1.95	2.37	2.07
Basic EPS from Discont. Operations	0.00	0.00	0.00	0.00	0.00
Basic EPS from Total Operations	-0.12	2.07	1.95	2.37	2.07
Diluted EPS from Cont. Operations	-0.12	2.05	1.90	2.32	2.02
Diluted EPS from Discont. Operations	0.00	0.00	0.00	0.00	0.00

Diluted EPS from Total Operations	-0.12	2.05	1.90	2.32	2.02
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Annual Balance Sheet (Values in Millions)	12/2001	12/2000	12/1999	12/1998	12/1997
Assets					
Current Assets					
Cash and Equivalents	NA	1,196.0	1,991.0	712.0	611.0
Receivables	NA	4,623.0	3,896.0	1,993.0	1,886.0
Inventories	NA	3,734.0	3,436.0	2,332.0	2,093.0
Other Current Assets	NA	1,108.0	1,099.0	556.0	983.0
Total Current Assets	NA	10,661.0	10,422.0	5,593.0	5,573.0
Non-Current Assets					
Property, Plant & Equipment, Gross	NA	12,460.0	12,703.0	9,358.0	9,189.0
Accum. Depreciation & Depletion	NA	7,230.0	7,073.0	4,961.0	4,938.0
Property, Plant & Equipment, Net	NA	5,230.0	5,630.0	4,397.0	4,251.0
Intangibles	NA	5,898.0	4,660.0	2,999.0	2,426.0
Other Non-Current Assets	NA	3,386.0	2,815.0	2,571.0	1,457.0
Total Non-Current Assets	NA	14,514.0	13,105.0	9,967.0	8,134.0
Total Assets	NA	25,175.0	23,527.0	15,560.0	13,707.0
Liabilities & Shareholder's Equity					
Current Liabilities					
Accounts Payable	NA	2,364.0	2,129.0	1,423.0	1,345.0
Short Term Debt	NA	1,682.0	2,609.0	2,011.0	1,092.0
Other Current Liabilities	NA	3,168.0	3,534.0	1,751.0	1,999.0
Total Current Liabilities	NA	7,214.0	8,272.0	5,185.0	4,436.0
Non-Current liabilities					
Long Term Debt	NA	3,941.0	2,457.0	1,476.0	1,215.0
Deferred Income Taxes	NA	1,173.0	864.0	795.0	694.0
Other Non-Current Liabilities	NA	3,140.0	3,335.0	2,807.0	2,976.0
Minority Interest	NA	0.0	0.0	0.0	0.0
Total Non-Current Liabilities	NA	8,254.0	6,656.0	5,078.0	4,885.0
Total Liabilities	NA	15,468.0	14,928.0	10,263.0	9,321.0

Shareholder's Equity

Preferred Stock Equity	NA	0.0	0.0	0.0	0.0
Common Stock Equity	NA	9,707.0	8,599.0	5,297.0	4,386.0

Total Equity	NA	9,707.0	8,599.0	5,297.0	4,386.0
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Total Liabilities & Stock Equity	NA	25,175.0	23,527.0	15,560.0	13,707.0
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Total Common Shares Outstanding	813.2 Mil	807.3 Mil	795.1 Mil	558.5 Mil	558.3 Mil
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Preferred Shares	NA	0.0	0.0	0.0	0.0
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Treasury Shares

Annual Cash Flow (in Millions)	12/2001	12/2000	12/1999	12/1998	12/1997
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Cash Flow from Operating Activities

Net Income (Loss)	NA	1,659.0	1,541.0	1,331.0	1,170.0
Depreciation and Amortization	NA	995.0	881.0	609.0	609.0
Deferred Income Taxes	NA	414.0	-11.0	233.0	138.0
Operating (Gains) Losses	NA	45.0	463.0	-14.0	-31.0
Extraordinary (Gains) Losses	NA	0.0	0.0	0.0	0.0

Change in Working Capital

(Increase) Decr. in Receivables	NA	-560.0	-54.0	-143.0	-104.0
(Increase) Decr. in Inventories	NA	-45.0	90.0	-57.0	-92.0
(Increase) Decr. in Other Curr. Assets	NA	-73.0	-39.0	3.0	-88.0
(Decrease) Incr. in Payables	NA	186.0	121.0	37.0	226.0
(Decrease) Incr. in Other Curr. Liabs.	NA	-632.0	-618.0	-666.0	-209.0
Other Non-Cash Items	NA	0.0	0.0	-138.0	-313.0
Net Cash from Cont. Operations	NA	1,989.0	2,374.0	1,195.0	1,306.0
Net Cash from Discont. Operations	NA	0.0	0.0	0.0	0.0

Net Cash from Operating Activities	NA	1,989.0	2,374.0	1,195.0	1,306.0
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Cash Flow from Investing Activities**Cash Flow Provided by:**

Sale of Property, Plant, Equipment	NA	594.0	851.0	388.0	762.0
Sale of Short Term Investments	NA	0.0	11.0	430.0	0.0

Cash Used by:

Purchase of Property, Plant, Equipmt.	NA	-3,376.0	-2,297.0	-1,896.0	-1,935.0
Purchase of Short Term Investments	NA	-17.0	0.0	0.0	-129.0
Other Investing Changes Net	NA	85.0	1,144.0	-1.0	19.0

Net Cash from Investing Activities	NA	-2,714.0	-291.0	-1,079.0	-1,283.0
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Cash Flow from Financing Activities

Cash Flow Provided by:

Issuance of Debt	NA	1,810.0	431.0	1,392.0	402.0
Issuance of Capital Stock	NA	296.0	419.0	156.0	263.0

Cash Used for:

Repayment of Debt	NA	-1,411.0	-375.0	-295.0	-307.0
Repurchase of Capital Stock	NA	-166.0	-1,058.0	-930.0	-898.0
Payment of Cash Dividends	NA	-599.0	-527.0	-338.0	-295.0
Other Financing Charges, Net	NA	0.0	0.0	0.0	-42.0

Net Cash from Financing Activities	NA	-70.0	-1,110.0	-15.0	-877.0
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Effect of Exchange Rate Changes	NA	0.0	0.0	0.0	0.0
Net Change in Cash & Cash Equivalents	NA	-795.0	973.0	101.0	-854.0
Cash at Beginning of Period	NA	1,991.0	1,018.0	611.0	1,465.0
Free Cash Flow	NC	-1,986.0	-450.0	-1,039.0	-924.0

CHARTS / TECHNICAL

Honeywell One Year Chart (Dividend yield below)



INDUSTRIALS CORRELATION MATRIX

	<i>ASD</i>	<i>FWRD</i>	<i>GE</i>	<i>HON</i>
ASD	1.00	0.16	0.28	0.46
FWRD	0.16	1.00	0.25	0.16
GE	0.28	0.25	1.00	0.33
HON	0.46	0.16	0.33	1.00