

HONEYWELL INTERNATIONAL INC

Form 11-K

June 29, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 11-K

☒ ANNUAL REPORT PURSUANT TO SECTION 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-8974

Honeywell Savings and Ownership Plan

(Full Title of Plan)

Honeywell International Inc.

115 Tabor Road

Morris Plains, NJ 07950

(Name of Issuer of Securities Held Pursuant to the Plan and
the Address of its Principal Executive Office)

Honeywell Savings and Ownership Plan

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* Other schedules required by Section 2520.103-10 of the Department of Labor Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 have been omitted as the conditions under which they are required are not present.

Report of Independent Registered Public Accounting Firm

Plan Participants and Plan Administrator of the Honeywell Savings and Ownership Plan

Morris Plains, New Jersey

Opinion on the Financial Statements

We have audited the accompanying statements of net assets available for benefits of the Honeywell Savings and Ownership Plan (the "Plan") as of December 31 2017 and 2016, the related statement of changes in net assets available for benefits for the year ended December 31, 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2017 and 2016, and the changes in net assets available for benefits for the year ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on the Plan's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Plan in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting in accordance with the standards of the PCAOB. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion in accordance with the standards of the PCAOB.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Supplemental Information

The supplemental Schedule H, Line 4(i) – Schedule of Assets (held at end of year) as of December 31, 2017 has been subjected to audit procedures performed in conjunction with the audit of the Honeywell Savings and Ownership Plan's financial statements. The supplemental schedule is the responsibility of the Plan's management. Our audit procedures included determining whether the information presented in the supplemental schedule reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental schedule. In forming our opinion on the supplemental schedule, we evaluated whether the supplemental schedule, including its form and content, is presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. In our opinion, the supplemental schedule is fairly stated in all material respects in relation to the financial statements as a whole.

/s/ Crowe Horwath LLP

We have served as the Plan's auditor since 2016.

New York, New York

June 29, 2018

Honeywell Savings and Ownership Plan

Statements of Net Assets Available for Benefits

at December 31, 2017 and 2016

	2017	2016
	(dollars in millions)	
Plan interest in Honeywell Savings and Ownership Plan Master Trust, at fair value	\$15,510	\$13,283
Notes receivable from participants	17	15
Contribution receivable from participating employees	1	-
Contribution receivable from the Company, net of forfeitures	1	1
Total receivables	19	16
Net assets available for benefits	\$15,529	\$13,299

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The accompanying notes are an integral part of these financial statements.

Honeywell Savings and Ownership Plan

Statement of Changes in Net Assets Available for Benefits**for the Year Ended December 31, 2017**

	2017 (dollars in millions)
Additions to net assets attributable to:	
Interest income from notes receivable from participants	\$ 2
Investment gain from Plan interest in Honeywell Savings and Ownership Plan Master Trust	2,642
Contributions:	
Participating employees	370
The Company, net of forfeitures	172
Roll-over contributions	28
Total contributions	570
Total additions	3,214
Deductions from net assets attributable to:	
Benefits paid to participants	(1,384)
Plan expenses	(4)
Total deductions	(1,388)
Net increase in net assets before Plan transfers	1,826
Plan transfers to Honeywell Savings and Ownership Plan	404
Total increase in net assets after Plan transfers	2,230
Net assets available for benefits:	
Beginning of year	13,299
End of year	\$ 15,529

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The accompanying notes are an integral part of these financial statements.

Honeywell Savings and Ownership Plan

Notes to Financial Statements

1. Description of the Plan

General

The Honeywell Savings and Ownership Plan (the “Plan”) is a defined contribution plan for certain employees of Honeywell International Inc. (the “Company”). It is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended, (“ERISA”) and the Internal Revenue Code (“Code”). The following represents a summary of key provisions of the Plan but does not purport to be complete and is qualified in its entirety by the terms of the Plan. Participants should refer to the Plan document for a more complete description of the Plan’s provisions.

Administration

The Company’s Vice President of Compensation and Benefits is the Plan Administrator and has full discretionary authority to manage and control the operation and administration of the Plan, including the power to interpret provisions of the Plan and to promulgate policies and procedures for the Plan’s administration and to delegate administration of the Plan. The Savings Plan Investment Committee has the power and authority to enter into agreements with the trustee to provide for the investment of Plan assets and to appoint investment managers to direct such trustee, as appropriate. The day to day administration of the Plan is handled by Voya Financial. The trustee and custodian of the Plan is The Northern Trust Company (the “Trustee”).

Effective April 1, 2018, the day to day administration of the Plan moved from Voya Financial to Fidelity Investments Institutional Operations Company.

Contributions and Vesting

Participants are permitted to contribute from 1 percent to 30 percent of their “base pay” as defined in the Plan during each pay period, subject to certain restrictions for “highly compensated employees”, as defined in the Plan. Participants may elect to make contributions to the Plan in any combination of before-tax, after-tax and Roth 401(k) contributions and may direct those contributions into any investment option available within the Plan. The combined before-tax and Roth 401(k) contributions may not exceed \$18,000 annually. In addition to regular before-tax, after-tax or Roth 401(k) contributions, eligible participants may also contribute up to \$6,000 annually in catch-up contributions if they are or will attain age 50 by December 31st and are contributing at least 8 percent in before-tax contributions and/or Roth contributions to the Plan, or have contributed the maximum regular before-tax contributions to the Plan.

Generally, the Company matching contribution does not begin until the first pay period following the employee's completion of one year of service with the Company. The Company matching contributions are made to the eligible participants' accounts each pay period that employee contributions are made to the Plan. Depending on the rate designated for the participant's Participating Unit, as defined below, the Company makes contributions with respect to a participant's contributions up to a maximum of 8 percent of a participant's base pay. The Company does not match catch-up contributions. All of the Company's matching contributions are initially invested in the Honeywell Common Stock Fund. Vested participants may subsequently direct such matching contributions into any investment option available within the Plan.

A Participating Unit is a group of employees which has been designated as participating in the Plan. The Company may contribute on behalf of each participant between 0 percent and 75 percent of such participant's contribution to the Plan, depending upon the rate designated for the participant's Participating Unit.

There are two forms of Company matching contributions as follows: (i) variable Company matching contributions and (ii) non-variable Company matching contributions. Participating Units whose

Honeywell Savings and Ownership Plan

Notes to Financial Statements

employees are covered by collective bargaining agreements or government contracts, the terms of which may change the Company match from time to time, receive the variable Company matching contributions, unless the collective bargaining agreement or government contract provides that the employees are eligible for the non-variable Company matching contributions. Participating Units whose employees are not covered by collective bargaining agreements or government contracts (unless the collective bargaining agreement or government contract provides otherwise) are generally eligible for the non-variable Company matching contributions.

Participating Units covered by a non-variable match receive basic matching contributions whereby the Company matches 37.5 percent of the first 8 percent of base pay that the participant contributes to the Plan (excluding rollover and catch-up contributions) following one year of vesting service. Once the participant participates in the Plan for 60 months after completing one year of vesting service, the Company makes matching contributions in the amount of 75 percent of the first 8 percent of base pay that the participant contributes to the Plan (excluding rollover and catch-up contributions).

Effective on or about April 6, 2018, Honeywell enhanced the non-variable match formula in the Plan for eligible participants.

For those currently at 75 percent of the first 8 percent of eligible pay (maximum 6 percent match), the match will increase to 87.5 percent of the first 8 percent (maximum 7 percent match).

For those currently at 37.5 percent of the first 8 percent of eligible pay (maximum 3 percent match), the match will increase to 43.75 percent of the first 8 percent (maximum 3.5 percent match).

In addition, effective on or about April 6, 2018 employer matching contributions for the non-variable match participants will be made annually in a lump sum by the end of the January following the calendar year-end. Participants must be actively employed on December 15th, are disabled or are deceased to receive such match. There is no minimum service requirement to receive the annual match.

Effective July 1, 2017, certain individuals previously employed by Elster Solutions, LLC or Eclipse, Inc. will receive employer matching contributions at a rate of 75% (previously 50%) of the first 8% of base pay deferred, but will no longer receive a 2% supplemental employer contribution.

Effective January 1, 2014, certain individuals who became Honeywell employees via acquisitions prior to January 1, 2013, receive basic Company matching contributions whereby the Company matches 75 percent of the first 8 percent of base pay that the participant contributes to the Plan (excluding rollover and catch-up contributions) once the participant has completed one year of vesting service.

Effective January 1, 2013, eligible employees who are employed by a Participating Unit covered by a non-variable match and who were hired on or after January 1, 2013, receive basic matching contributions whereby the Company matches 75 percent of the first 8 percent of base pay that the participant contributes to the Plan (excluding rollover and catch-up contributions) once the participant has completed one year of vesting service.

Participants have a full and immediate vested interest in the portion of their accounts contributed by them and the earnings on such contributions. A participant will become 100 percent vested in any Company contributions upon completion of three years of vesting service or upon attainment of age

Honeywell Savings and Ownership Plan

Notes to Financial Statements

65 while an employee of the Company or an affiliated company. In addition, a participant's account will become 100 percent vested if the participant's termination with the Company or an affiliated company was due to any one of the following (i) retirement under the terms of a Honeywell pension plan in which the participant participates; (ii) disability (as defined under the plan provisions); (iii) death; (iv) a reduction in force or layoff (as determined by the Company); or (v) a participant's business unit is sold or divested. A participant will also become 100 percent vested in any Company contributions in the event the Company terminates or permanently discontinues contributions to the Plan.

Participant Accounts

Each participant's account is credited with the participant's contribution and allocations of (1) the Company's matching contribution, if applicable, and (2) investment earnings, and charged with an allocation of investment losses and administrative expenses. The allocation is based on participants' account balances as defined in the Plan document. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account.

Notes Receivable from Participants

No new loans are permitted from the Plan. Interest rates for loans outstanding at December 31, 2017 were between 2.5% and 10.5% and at December 31, 2016, were between 3.25% and 10.5%.

Termination

Although it has not expressed intent to do so, the Company has the right under the Plan document to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of a partial or full Plan termination, all Plan funds must be used in accordance with the terms of the Plan.

Distribution of Benefits

Upon termination of service with the Company, if a participant's vested account balance is \$1,000 or less (including any rollover contributions), the entire vested amount in the participant's account can be distributed to the participant in a single payment, without his or her consent, unless the participant affirmatively elects to have the benefit rolled over to an eligible retirement plan.

If the vested amount in a participant's account is greater than \$1,000 but less than \$5,000 (excluding any rollover contributions), the participant's account will be automatically rolled over to a traditional IRA with the Voya Life Insurance and Annuity Company, unless the participant affirmatively elects to receive the amount in a single payment or have it rolled over to an eligible retirement plan.

If the participant's vested account balance exceeds \$5,000 (excluding any rollover contributions), the balance in the account will remain in the Plan and shall be distributed (1) at the participant's request, (2) when the participant attains age seventy and one-half (70-1/2), through the payment of minimum required distributions, as defined by the Plan, or (3) upon the participant's death, whichever is earliest. When a participant dies, if his or her spouse is the beneficiary, the spouse may remain in the Plan under the same conditions as previously described for the participant. Otherwise, the entire amount in the participant's account is distributed in a single payment to the participant's beneficiary(ies).

Forfeitures

Forfeitures of the Company's contributions and earnings thereon due to terminations and withdrawals reduce contributions otherwise due from the Company. Company contributions made to the Plan were reduced by approximately \$1.8 million due to forfeited nonvested accounts for the year ended December 31, 2017.

Honeywell Savings and Ownership Plan

Notes to Financial Statements

2. Significant Accounting Policies

Basis of Accounting

The financial statements of the Plan are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") using the accrual basis of accounting.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Investment Valuation

For investment and administrative purposes, the Plan's assets are held in the Honeywell Savings and Ownership Plan Master Trust ("Master Trust") along with the assets of the Honeywell Puerto Rico Savings and Ownership Plan, the Honeywell Secured Benefit Plan and the Intermec FSSP Spinoff Plan. The Plan's investment in the Master Trust represents the Plan's interest in the net assets of the Master Trust. The Plan's investment is stated at fair value and is based on the beginning of year value of the Plan's interest in the Master Trust plus actual Plan contributions, transfer of assets from other plan(s), and allocated investment income / (loss) less actual Plan distributions.

Notes Receivable from Participants

Notes receivable from participants are valued at cost plus accrued unpaid interest.

Payment of Benefits

Withdrawals and distributions to participants are recorded when paid.

Expenses

Most expenses relating to the administration of the Master Trust and managing the funds established thereunder are borne by the participating plans.

Recent Accounting Pronouncements

In February 2017, the Financial Accounting Standards Board issued Accounting Standard Update 2017-06 that clarifies presentation requirements for a plan's interest in a master trust and requires more detailed disclosures of the plan's interest in the master trust. Under the new guidance, a plan's interest in master trust balances and activities needs to be presented on the face of the plan's financial statements. Balances in the statement of net assets and activities in the statement of changes in net assets should be shown net, as a single line item for each interest in a master trust. The guidance is effective for fiscal years beginning after December 15, 2018; however, early adoption is permitted. Plan management is currently evaluating the impact of this guidance on the Plan's financial statements.

3. Interest in Honeywell Savings and Ownership Plan Master Trust

The Plan's investment is held in the Master Trust, which is commingled with the assets of the Honeywell Puerto Rico Savings and Ownership Plan, the Honeywell Secured Benefit Plan and the Intermec FSSP Spinoff Plan. Each participating plan's interest in the Master Trust is divided based on the participants' investment elections. At December 31, 2017 and 2016, the Plan's interest in the net assets of the Master Trust was 99.0% and 98.9%, respectively. The allocation of income and expenses is based upon each plan's specific interests in the underlying plan investments, which are based upon participant-direction and Company direction of the investments.

Honeywell Savings and Ownership Plan

Notes to Financial Statements

The Master Trust is comprised of the following types of investments, at fair value, as of December 31, 2017 and 2016:

	2017	2016
	(dollars in millions)	
Collective Trust Funds	\$7,926	\$6,220
Honeywell Common Stock	4,760	3,813
Common Stocks (Separately Managed Portfolios)	954	1,165
Fixed Income Investments (Separately Managed Portfolios)	2,021	2,248
Total Investments, at fair value	15,661	13,446
Due from (to) broker on pending trades	2	(10)
Net assets of the Master Trust	\$15,663	\$13,436

The Master Trust's net appreciation and investment income for the year ended December 31, 2017 is as follows:

	2017 (dollars in millions)
Net appreciation in fair value of investments	\$ 2,585
Dividend and interest income	70
Total investment income and net appreciation	\$ 2,655

Investment Valuation and Income Recognition – Master Trust

Master Trust investments are stated at fair value. Interest income is recorded on the accrual basis, and dividend income is recorded on the ex-dividend date. Purchases and sales of securities are recorded on a trade-date basis. Net appreciation/(depreciation) consists of both realized gains/(losses) on investments bought, sold and matured, as well as the change in unrealized gains/(losses) on investments held during the year.

From time to time, investment managers may use derivative financial instruments including foreign exchange forward and futures contracts. Derivative instruments are used primarily to mitigate exposure to foreign exchange rate and

interest rate fluctuations as well as manage the investment composition in the portfolio. The Master Trust held no derivative instruments as of December 31, 2017 and 2016.

Determination of Fair Value

The accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value.

The Master Trust valuation methodologies for assets and liabilities measured at fair value are described below. The methods described as follows may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Master Trust believes its valuation methods are appropriate and consistent with other market

Honeywell Savings and Ownership Plan

Notes to Financial Statements

participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Valuation Hierarchy

The accounting guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The following is a description of the valuation methodologies used for financial instruments measured at fair value. There have been no changes in the methodologies used at December 31, 2017 and 2016.

Honeywell International Inc. common stock and other common stocks

Honeywell International Inc. common stock is valued at the closing price reported on the New York Stock Exchange Composite Transaction Tape. Other common stocks are valued at the closing price reported on the principal market on which the respective securities are traded. Honeywell International Inc. common stock and other common stocks are all classified within level 1 of the valuation hierarchy.

Collective Trust Funds

Collective Trusts funds are investment vehicles utilized as the target date funds, equity index funds, investment grade bond fund, and global REIT fund. These funds permit daily subscriptions and redemption of units. These investments are valued using net asset values (“NAV”) provided by the administrator of the underlying fund. The NAV is based on the value of the underlying assets owned by the fund, less its liabilities, divided by the number of units outstanding.

Collective Trust funds measured at fair value using net asset value per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in the hierarchy tables for Collective Trust funds are intended to permit reconciliation of the Master Trust’s total investments, at fair value presented in Note 3.

Honeywell Savings and Ownership Plan

Notes to Financial Statements***Fixed Income Investments***

Fixed income securities (other than commercial mortgage backed securities) are valued at the regular close of trading on each valuation date at the evaluated bid prices supplied by pricing vendors or brokers, if any, whose prices reflect broker/dealer supplied valuations and electronic data processing techniques. Commercial mortgage backed securities are valued using pool-specific pricing. The pool-specific pricing is provided by the pricing vendors and typically they use Interactive Data for these investments. Fixed income securities, including corporate bonds, U.S. government and federal agencies, Non U.S. government, municipal bonds, commercial paper, bank deposits, asset-backed securities and commercial mortgage backed securities are classified within Level 2 of the valuation hierarchy.

The following tables present the Master Trust's assets measured at fair value as of December 31, 2017 and 2016, by the fair value hierarchy.

	2017		
	Level	Level	Total
	1	2	
	(dollars in millions)		
Common Stocks	\$5,714	\$-	\$5,714
Fixed Income Investments:			
Asset Backed Securities	-	336	336
Bank Deposits	-	69	69
Commercial Mortgage Backed Securities	-	6	6
Corporate Bonds	-	744	744
U.S. Government and Federal Agencies	-	363	363
Municipal Bonds	-	135	135
Non US Government	-	96	96
Commercial Paper	-	272	272
	\$5,714	\$2,021	
Collective Trust Funds			7,926
Total Investments			\$15,661

Honeywell Savings and Ownership Plan

Notes to Financial Statements

	2016		
	Level	Level	Total
	1	2	
	<i>(dollars in millions)</i>		
Common Stocks	\$4,978	\$-	\$4,978
Fixed Income Investments:			
Asset Backed Securities	-	295	295
Bank Deposits	-	171	171
Commercial Mortgage Backed Securities	-	4	4
Corporate Bonds	-	745	745
U.S. Government and Federal Agencies	-	553	553
Municipal Bonds	-	205	205
Non US Government	-	122	122
Commercial Paper	-	153	153
	\$4,978	\$2,248	
Collective Trust Funds			6,220
Total Investments			\$13,446

4. Assets Transfers

During the year ended December 31, 2017, assets valued at approximately \$404 million was transferred to the Plan in connection with the acquisition of several Companies.

5. Party-In-Interest Transactions

The Master Trust is invested in the Company's common stock, which qualifies as a party-in-interest transaction. During the year ended December 31, 2017, the Master Trust's investment in the Company's common stock included purchases of approximately \$159 million, sales of approximately \$475 million, realized gains of approximately \$254 million, unrealized gains of approximately \$1,016 million and dividend income of approximately \$70 million. The Master Trust invests in short term investment funds managed by the Trustee. These investments qualify as party-in-interest transactions. As described in Note 2 – "Expenses", the Plan paid certain expenses related to Plan operation and investment activity to the Trustee.

The Company is both the plan sponsor and a party to the Master Trust, therefore the Master Trust investment and the Plan's interest of \$4.7 billion in the Company's common stock qualifies as a related party transaction, along with the dividend income of \$70 million earned by thi corporation engaged in designing, manufacturing, marketing and supporting server networking solutions for manufacturers of storage systems, internet traffic management systems, security appliances and other manufacturers providing a variety of server-based systems (Server Networking

Products). It also offers a broad range of its traditional PC cards, PCI cards and USB products.

In these financial statements the terms Company or Silicom refer to Silicom Ltd. and its wholly owned subsidiary, Silicom Connectivity Solutions, Inc., whereas the term subsidiary refers to Silicom Connectivity Solutions, Inc., a wholly owned subsidiary of Silicom Ltd.

Silicom markets its products directly, through (i) Original Equipment Manufacturers (OEMs) which sell the Company s connectivity products under their own private labels or incorporate the Company s products into their products, (ii) its US-based subsidiary and (iii) a worldwide network of independent distributors.

Most of the Company s raw materials are readily available, but certain key components are currently available from only one source and others are available from a limited number of sources.

B. Basis of Presentation

The accompanying condensed interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information [and contain all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial information included therein]. It is suggested that these financial statements be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 20-F for the year ended December 31, 2006. Results for the interim period presented are not necessarily indicative of the results to be expected for the full year.

Note 2 Significant Accounting Policies

Use of Estimates and Assumptions

The preparation of the Condensed Interim Consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Condensed Interim Consolidated financial statements, and the reported amounts of revenue and expenses during the reporting years. Actual results may vary from these estimates.

Note 3 Inventories

	June 30, 2007	December 31, 2006
	US\$ in thousands	US\$ in thousands
Raw materials and components	\$ 1,571	\$ 1,265
Work in progress	\$ 4,440	\$ 2,397
Finished goods	\$ 55	\$ 77
	<u>\$ 6,066</u>	<u>\$ 3,739</u>

Note 4 Share-based compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123 (revised 2004), Share-Based Payment (Statement 123R). This Statement requires compensation cost relating to share-based payments to be recognized in the financial statements and measured based on grant date fair value of the award. Under the fair value method, the estimated fair value of awards is recognized on a straight-line basis over the requisite service period, which is generally the vesting period. The Company elected the modified-prospective transition method and therefore prior periods were not restated. Under the modified-prospective transition method, compensation costs recognized as of January 1, 2006, include also compensation costs for all share-based payments granted prior to, but not yet vested, as of January 1, 2006. The effect of the implementation of SFAS 123R was to increase expenses by US\$ 72 thousand and US\$ 36 thousand in the six months and three months ended June 30, 2006, respectively, and by US\$ 26 thousand and US\$ 13 thousands in the six months and three months ended June 30, 2007, respectively, which changed income before taxes on income and net income to the aforementioned periods by the same amounts, respectively. The basic and diluted income per ordinary share effect was a decrease of US\$ 0.01 and US\$ 0.00 in the six months and three months ended June 30, 2006, respectively, and US\$ 0.00 and US\$ 0.00 in the six months and three months ended June 30, 2007, respectively.

Note 5 Events in the current period

A. As of June 30, 2007, approximately 233 thousand option certificates (Series 1) were exercised. As a result, net proceeds to the Company were approximately US\$ 2 million.

B. In May 2007, the company conducted a private placement, pursuant to which the company issued to certain accredited investors and qualified institutional purchasers 875,000 ordinary shares at a purchase price of \$20.50 per share and warrants to purchase up to 218,750 ordinary shares at an exercise price of \$28.25 per share. The warrants issued to the investors will expire in July 2010. Net proceeds from the private placement were approximately \$16.7 million, net of \$1.2 million of issuance costs. In addition, the company issued to the placement agents warrants to purchase up to an aggregate of 10,937 ordinary shares on the same terms as the warrants issued to the investors.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

THE INFORMATION CONTAINED IN THIS SECTION SHOULD BE READ IN CONJUNCTION WITH (1) OUR UNAUDITED CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS AS OF JUNE 30, 2007 AND FOR THE SIX MONTHS THEN ENDED AND RELATED NOTES INCLUDED IN THIS REPORT AND (2) OUR AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES INCLUDED IN OUR ANNUAL REPORT ON FORM 20-F FOR THE YEAR ENDED DECEMBER 31, 2006 AND THE OTHER INFORMATION CONTAINED IN SUCH ANNUAL REPORT AND (3) OUR REPORT OF FORM 6-K, FILED JULY 23, 2007.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of total revenues for the periods indicated.

	Six Months Ended June 30,	
	2006	2007
Sales	100%	100%
Cost of sales	61.90	60.27
Gross profit	38.10	39.73
Research and development costs, gross	13.12	8.39
Less grant participation	(0.04)	---
Research and development costs, net	13.16	8.39
Selling and marketing expenses	7.17	6.18
General and administrative expenses	5.98	4.28
Operating Income	11.79	20.88
Financial income, net	0.74	2.78
Income before taxes on income	12.53	23.66
Taxes on income	---	1.44
Net Income	12.53	22.22

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Sales for the six months ended June 30, 2007 increased by 83.0% to \$12,666 thousand compared to \$6,922 thousand for the six months ended June 30, 2006, mainly due to Design Wins which matured during the six months ended June 30, 2007 and due to additional Design Wins that were secured, all of which were related to our Server Adapters and Server Bypass Adapters.

Gross profit for the six months ended June 30, 2007 was \$5,032 thousand compared to \$2,637 thousand for the six months ended June 30, 2006. Gross profit as percentage of sales for the six months ended June 30, 2007 was 39.7%, compared to 38.1% for the six months ended June 30, 2006. Our gross profit is largely dependent on the mix of products we sell during a specific period. The slightly higher gross profit percentage for the six months ended June 30, 2007 was primarily a result of such a change to the mix of sold products.

Research and development expenses, gross, for the six months ended June 30, 2007 increased by 17.1% to \$1,063 thousand compared to \$908 thousand for the six months ended June 30, 2006. This increase was mainly attributed to our continued investment in new product development, enhancements to existing products, and the development of new networking and connectivity technologies.

Selling and marketing expenses for the six months ended June 30, 2007 increased by 57.7% to \$782 thousand compared to \$496 thousand for the six months ended June 30, 2006, mainly due to our continued investment in the promotion of our server networking products.

General and administrative expenses for the six months ended June 30, 2007 increased by 30.9% to \$542 thousand compared to \$414 thousand for the six months ended June 30, 2006, mainly due to the growth in our activity as demonstrated by the increase in our sales which amounted to 83.0%.

Financial income for the six months ended June 30, 2007 increased by 590.2% to \$352 thousands compared to \$51 thousands for the six months ended June 30, 2006. The increase was primarily a result of an increase in funds available for investments.

In the six months ended June 30, 2007 we made a provision for current income tax of \$200 thousands and recorded an increase of a deferred income tax of \$17 thousands compared to no such provision for income tax or deferred tax assets in the six months ended June 30, 2006.

Net income for the six months ended June 30, 2007 was \$2,814 thousand compared to a net income of \$867 thousand for the six months ended June 30, 2006, mainly due to our higher sales for the six months ended June 30, 2007.

Impact of Inflation and Devaluation on Results of Operations, Liabilities and Assets

Since the institution by the Israeli government of an economic recovery program for the halting of high inflation rates in 1985, inflation, while continuing, has been significantly reduced and the rate of devaluation has been substantially diminished. Since the majority of our revenues are denominated and paid in U.S. dollars, we believe that inflation and fluctuations in the U.S. dollar exchange rate have not had a material effect on our revenue to date. Inflation in Israel and the Israeli currency as well as U.S. dollar exchange rate fluctuations, do however, have some effect on our expenses and, as a result, on our net income/loss. The cost of our Israeli operations, as expressed in U.S. dollars, is influenced by the extent to which any increase in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a devaluation of the NIS in relation to the U.S. dollar.

We do not presently engage in any hedging or other transactions intended to manage the risks relating to foreign currency exchange rate or interest rate fluctuations.

Liquidity and Capital Resources

As of June 30, 2007, we had working capital of \$26,235 thousand and our current ratio (current assets to current liabilities) was 5.94. Since inception, our operations have been funded through capital contributions, research and development grants and cash flow from operations. Cash and cash equivalents as of June 30, 2007 increased by \$9,252 thousand to \$13,765 thousand compared with \$4,513 thousand as of December 31, 2006. Short-term investments increased by \$5,740 thousand, long-term investments increased by \$5,323 thousand. The net increase of \$20,315 thousand in these three balance sheet items during the six months ended June 30, 2007 was mainly due to the net proceeds provided by the private placement of 875,000 ordinary shares completed in May 2007, by the exercise of warrants and options and due to the net cash provided by operating activities.

Trade receivables increased to \$4,181 thousand as of June 30, 2007 from \$3,277 thousand as of December 31, 2006, mainly due to the significant increase in sales in the second quarter of 2007, as compared to sales in the fourth quarter of 2006. Other receivables increased from \$301 thousand to \$721 thousand.

Cash provided by operating activities during the six months ended June 30, 2007 amounted to \$1,135 thousand compared to cash used by operating activities in the amount of \$157 thousand during the six months ended June 30, 2006. The cash provided by operating activities during the six months ended June 30, 2007 was mainly the result of our positive operating income. The figure is lower than the actual operating income due to the fact that as sales grow, we are required to devote more resources to inventories and manufacturing activities, before collection of payments from customers.

Inventories increased from \$3,739 thousand as of December 31, 2006 to \$6,066 thousand as of June 30, 2007, mainly due to the fact that as our sales grow and customers demand receipt of products within a number of weeks following the issuance of purchase orders, we are required to be ready to deliver our products in accordance with our customers' expectations.

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Capital expenditures on property and equipment during the six months ended June 30, 2007 were \$221 thousand compared with \$126 thousand during the six months ended June 30, 2006, mainly due to the fact that during the six months ended June 30, 2007 we increased investment in development and testing tools for our new product lines of server networking cards.

In January 2006, we completed an offering and sale of 10,000 units in Israel, composed of 800,000 of our ordinary shares and 400,000 warrants, pursuant to a prospectus filed with the Israeli Securities Authority and the Tel-Aviv Stock Exchange. The sale of units resulted in net proceeds of approximately \$5.6 million. As of June 30, 2007, approximately 233 thousand warrants were exercised, resulting in additional proceeds of approximately \$2.0 million. Exercise of additional warrants in the future will contribute additional proceeds of up to approximately \$1.4 million.

In May 2007, we conducted a private placement, pursuant to which we issued to certain accredited investors and qualified institutional purchasers 875,000 ordinary shares at a purchase price of \$20.50 per share and warrants to purchase up to 218,750 ordinary shares at an exercise price of \$28.25 per share. The warrants issued to the investors will expire in July 2010. Net proceeds from the private placement were approximately \$16.7 million, net of \$1.2 million of issuance costs. We issued to the placement agents warrants to purchase up to an aggregate of 10,937 ordinary shares on the same terms as the warrants issued to the investors.

Trade payables increased from \$2,481 thousand as of December 31, 2006 to \$4,210 thousand as of June 30, 2007, mainly due to our increased sales, which resulted in increased operating expenses. Other payables and accrued liabilities increased from \$971 thousand as of December 31, 2006 to \$1,100 thousand as of June 30, 2007.