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Kone Oyj (KNEBV.FI)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Sanna Kaje

Vice President, Investor Relations, Kone Oyj

Good morning and welcome to KONE's Q4 and Full-Year 2023 Result Webcast. I'm Sanna Kaje, KONE's Interim Head of Investor Relations while Natalia is on parental leave. I have here with me today our new President and CEO, Philippe Delorme, who will go through the quarter and full-year highlights; and also, as usual, Ilkka Hara, our CFO, who will then dig deeper into the market dynamics and financials.

With that, Philippe, the floor is yours.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

Thank you very much, Sanna. Hi, everyone. It's a pleasure to be here. So, as you probably know, I've now been with the company for around a month, which is not very long. So, I'm starting to discover what's so great about this company. Of course, meeting a lot of people, meeting a lot of customer, but acknowledging that there is still a lot for me still to learn. So, now let's look at the highlights of what we want to share with you.

And I'm really happy that I get to start my role by being able to share with you that KONE had actually a pretty strong finish for 2023 and is well positioned for 2024. As a result of this, the board is proposing to keep the dividend stable at €1.75 per class B share. And for all of this, I really want to say a big thank you to everyone at KONE for making it happen. And I want to single out, of course, Henrik, for all his super valuable support, making the transition smooth and actually bringing a very strong legacy to the company. Now, let's dive into Q4.

All in all, I think you've seen the figure already, but we are going to go into more detail. We had a strong finish to the year. Our orders, which is really a highlight, received very strong growth across all businesses and all area. Altogether, we grew by 11% at comparable currency. And Ilkka will present in more detail the highlight of this.

Our sales grew by 1% at comparable currency with no surprise, continued growth in Service, very strong growth in Modernization. New Building Solutions sales declined on the back of weak construction markets in many part of the world. And with a good work on margin and cost, EBIT margin continue to improve and cash flow has been strong. Now, let's look at the full year 2023.

I would say we did well in a challenging market environment and we've proven our resilience. So, we saw improving momentum in orders received toward the latter part of the year. Q3 was strong, Q4 is strong again, and we're able to take some market share, which is something we decided to do. Sales grew by 5% at comparable currencies, demonstrating the resilience of our business in a tough environment. And that came with a 150 basis points improvement in adjusted EBIT margin and a solid cash conversion. So, all-in-all, I would say that we are on the right track.

Now, let's look at some highlights of the business, and we'll start with Services, which is a very important business for KONE. A record level of units was added to our Service base. And we also kept good progress on our 24/7 Connected Services penetration. And we are now close to 20% penetration of our Service base.

Modernization, a very strong highlight of our results with over 20% growth at comparable currencies is in sales, which really shows our competitiveness and the abundance of opportunity in the business across the world.

New Building Solutions, order book remained stable at comparable exchange rates, which again is a good performance considering the uncertainty of the market.

Sustainability, that's a topic that's very important for us that's very close to my heart. And here again some good achievements in, first of all, if we look at the progress we made in Science Based Targets last year, we were the first in the industry to reach carbon-neutral manufacturing units and by publishing the first Environmental Product Declaration for our partial modernization solution, taking the total number of our Environmental Product Declaration to 21, which I believe really puts us in a leading position in our industry.

We also made progress in other key sustainability metrics. If we start with diversity, the share of women at director level rose to 25.2% from 23.5%. And on safety, which is a very important metric for us in sustainability, our Industrial Injury Frequency Rate was a record low at 1.1, which is something we are really happy and very proud of. At the same time, it's clear that we still have a long way to go in all these areas. But we are very committed to pushing for progress year after year and leading the way in our industry in sustainability. You will hear more and you will read more about us in our Sustainability Report, which will come in Q2, and we'll share more detail by then.

So, if we now look at maybe a longer-term perspective, you know our strategic target, that's the way we measure our progress more on the long term. So, the two first one, we don't have any fresher data, I will not comment. But let's take the three next one in term of growth.

Our target is to grow faster than the market. And we did this in all our businesses last year. For best financial performance, our profitability is back on an improved trend and cash generation is solid. And last but not the least, we've made progress in sustainability to be a leader in this field. And I think we've shown in the previous slide that we've done great progress in all area of sustainability.

Now, let's talk a bit about our operating model. And I really would like to highlight here that we are well positioned for the future. You probably remember that we announced that we will be renewing our operating model in the beginning of last year, beginning of 2023. The new structure has been put in place in July, so six months after. And the action targeting the announced €100 million saving were completed by the end of the year 2023.

So, what it means is that in the new area base or operating model, we are closer to our customer than ever before and able to make faster decision, which is really important in this world. And the global function on the other end provide us competitiveness, speed, and scale. So, a very good achievement here.

Now, the last point I wanted to cover is about people. So, in Q4, we made two important appointment to the Executive Board. The first one is Nicolas Alchal who was previously our Managing Director or KONE Middle East, Turkey, and Africa and is appointed as Executive Vice President for Strategy & Transformation, but he'll take the role in January 1, 2025. And in the period of 2024, he will actually be the Interim Vice President, Executive Vice President for Europe as Karla Lindahl, who is currently our leader for Europe, will go on maternity leave very soon. And that mean that for 2024, we will have an interim leadership on Strategy & Transformation with Kaori Uehigashi who will be taking the role coming from BCG. But actually, before BCG, Kaori had a long career at KONE, so she knows the company very well, but she also has an outside-in perspective, which is precious to really lead the next step strategy for KONE. So, I would like to warmly thank and welcome Nicolas and Kaori onboard of the Executive Board.

And now, I'd like to invite Ilkka, so that we can go into more detail on the market and the financial development. Ilkka, the floor is yours.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Thank you. Thank you. Also, warm welcome on my behalf to this fourth quarter result announcement webcast.

I'll start how we – the market where we operated in in the fourth quarter before then digging into our financials in more detail. But let's start, as I said, on markets in fourth quarter.

Overall, we continue to see good growth opportunities in the market. So, 9 out of the 12 end markets continue to grow. While the overall higher interest rate environment is impacting our markets in North America and Europe, Middle East, Africa particularly, we see Europe, Middle East – Europe continuing to decline slightly whereas in Middle East and Africa the development is more stable. Asia-Pacific, outside of China, continues to grow strongly, particularly the markets in India and in Southeast Asia. In China, we saw our New Building Solutions market declining at the end of the last year.

Driven by the overall consumer confidence, which continues to be low, we see the similar trend as previously with completions being on a good level whereas then the more leading indicators, real estate investment, starts being on a lower level continues.

Then to Service, Service market continues to provide good opportunities, growing everywhere in the world. And the strongest growth in Service market is in Asia-Pacific and in China. And as already highlighted by Philippe earlier, the Modernization market continues to grow globally. Europe, Middle East, Africa, Asia-Pacific, and China having the strongest growth. Also, North America continues to grow and is on a good level.

So, how did we then do in this market environment? So, I'll start going through our financials with orders received. Orders received in the fourth quarter continued to show a strong order growth across businesses as well as areas. When measured in comparable currencies, we grew 10.5%, leading to a €2,049 million in the fourth quarter. Currencies continued to be a headwind and the reported growth was 5.4%. The strongest growth from an area perspective was in Asia-Pacific and China. China grew more than 10% orders in the quarter, and by math, also the Asia-Pacific actually grew more stronger than that. Europe and Middle East, Africa, as well as Americas also grew strongly in the quarter.

Our margin for the quarter continued to be stable and on a good level when measured both year-on-year and quarter-on-quarter. We saw similar development in pricing, as we've seen in the last quarter prior to this, so more stable pricing environment in the rest of the world. And in China, the market continues to be competitive and prices were down. At the same time in China, our product cost reduction efforts as well as the overall cost environment has enabled us to mitigate the – some of the pricing development when we look at the margins for orders received. But overall, in this market environment, I consider this stable development to be a very good one.

Then to sales, sales for the quarter were €2,810 million and we had excellent growth in Service and Modernization across all regions. When measured on a comparable basis, we grew 0.7%; and on a reported basis, 3.5% decline. When we look at geographies, the strongest growth was in Americas; Europe, Middle East, Africa grew 6.8%; and Asia-Pacific including China declined by 9.8%, where China declined as a result of the decline in orders received in earlier quarters.

Then from a business perspective, we saw a decline in New Building Solutions of 11.1%, but in Services we continue the strong growth now at 8.3%, which is very good rate in my mind. And also in this quarter, the highlight of the quarter from a revenue growth perspective is Modernization. So, 19.5% growth in Modernization business is a very good rate. Then to adjusted EBIT and profitability, so the adjusted EBIT for the quarter was €359 million and our adjusted EBIT margin was 12.8%, up from previous year's 12.5%.

And when I look at the components contributing to this development, the strong growth in both Service and Modernization sales continue to contribute positively, also from a mix – profitability mix perspective. We continue to see the improved price/cost dynamics contributing positively, as well as the savings that Philippe talked about from the operating model renewal also contributing positively. Fixed cost absorption was a negative given the sales development, and we continue to see the inflation impacting negatively our cost base.

Then cash flow, and I always say that one quarter is a short time to measure cash flow, but now for the year we had €1,485 million of cash flow. And clearly that's a good outcome, and also fourth quarter continued to be strong from a cash flow perspective and cash [ph] trans perspect (00:15:25). Our working capital continued to be broadly stable, especially when you take out the impacts of currencies. Accounts receivable continue to come down and contributed positively. And as I noted in earlier quarters, so accounts payable was a negative contributor but I would say that the payables are actually now on a fairly low level. So, from a net working capital perspective, of course, a good outcome to be stable.

Then it is also the year end, so the board has made the dividend proposal to our AGM later in February, and the proposal is to pay €1.75 per class B share dividend, which is stable compared to last year. Our dividend payout ratio continues to be good, 98%, compared to the earnings per share, and the yield is 3.88%.

Then looking forward and how do we see the markets and the business outlook for 2024, first, market outlook continues to show that we have 9 of our 12 end markets growing. We see New Building Solutions market declining in North America, Europe, in both where the interest rates continue to be on a high level. What I would highlight here is that compared to the last year, we are expecting North America market to be slightly better, so declining slightly but better than what we've seen in the end of the year.

In China, we expect the market to be down 5% to 10%, and we continue to see good opportunities in Asia-Pacific, Middle East and Africa. And as you note, now we've changed the structure of our geographies to reflect our operating model renewal structure. So, Europe is alone and the Middle East and Africa is included to Asia-Pacific. So, please note that when you do the apples-to-apples comparison, so it's slightly different.

In Service, we continue to see good growth opportunities. The more mature markets, North America and Europe, continue to grow. Asia-Pacific, Middle East, Africa as well as China had the strongest growth in Service. And as already highlighted by Philippe talking about the Modernization performance, that market continues to provide a good backdrop for further growth. Europe continues to grow strongly. Asia-Pacific, Middle East and Africa and China continue to have the highest growth rate, and also North America continues to grow. And it's good to note, as I said, that the market is on a very good level, so it's growing from a good base in 2024.

Then to KONE's performance in 2024, we expect our sales to be stable or to grow slightly when measured at the comparable exchange rates in 2024, and the improvement in adjusted EBIT margin is expected to continue in 2024, albeit with less tailwinds than in 2023. As I talked about, we had a raw material tailwind of a more than €100 million in 2023 so we expect more neutral development into 2024.

What is supporting our performance? First, we had a strong growth in Service and Modernization contributing positively. We continue to have a strong order book with better pricing coming through in deliveries into 2024. Also, the rest of the savings from operating model renewal will contribute positively. At the same time, what's burdening our performance is the decline in New Building Solutions market in China and what I would say uncertainty also in Europe and North America. We continue to see persistent cost inflation impacting negatively, and then we made a decision to slightly increase our investment into R&D and IT in 2024.

But with that, I'll hand over back to Philippe to close the presentation before the Q&A.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

Thank you, Ilkka. So, to summarize, Q4 – oh, it's not moving. Yes, it is. So, we were – Q4 was a strong finish to the year and we were especially pleased with the excellent performance and continued growth in Service and Modernization. The strong order book across business and the positive outlook in the majority of our market, 9 out of 12, we repeat, give us also a solid base for 2024. So, again on behalf of the leadership, I'd like once more to say a big thank you to everyone at KONE for this, and I guess now we are ready to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We kindly ask you to limit your number – the number of your questions to one, plus one follow-up question. [Operator Instructions] First question comes from Daniela Costa from Goldman Sachs. Please go ahead.

Q

Hi. This is actually [ph] Evan (00:21:09) on behalf of Daniela. So, the first question's – and morning, all. First question, wonder, is on the margins, you said on orders you've received is stable year-over-year, but you also comment on strong pricing competitiveness in China and we're seeing steel price a bit – coming up a bit now. Do you think margins can stay stable in China in 2024? And also how much more pricing you're willing to give back to get more market share there? Thank you.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Well, I guess we will continue to report back on our commercial strategies as we have actually seen the quarters fall out. So, it's not something I would comment going forward when it comes to pricing. But as said, pricing continues to be quite tough in China, but at the same time, I would highlight the fact that we've been able to drive very good product cost reduction actions, in particular in China that mitigate the impact there.

But let's see how well we do into 2024. I think both the productivity that we want to drive as well as we, of course, want to continue to be very diligent in way we do pricing going forward as we've done in the past. So then we'll come back on the results when we first time report our first quarter.

Q

Okay. Can I actually follow up on that? This is maybe more for Philippe. So, in terms of understanding your thinking on how the company can de-risk from a bit high concentration of sales in China or how you think the group margin can improve from here given the end market environment. Thank you.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Well, I guess I'm one month into the company so you'll take my answer with a pinch of salt. But China – first of all, China in this industry is the biggest market by far and we don't see strategically KONE not taking China center stage for our strategy. It's a big market, it's a market where we are well positioned, and it's also, in our view, a fitness lab that helps us also to be competitive in other places in the world. So, we are not going away anytime soon from China.

Now, with that in mind, the market has been down. The New Building Solutions market, by the way, has been down because Modernization and Service are up and there are some policies that are supporting this, especially on Modernization. But today, understand that China represent roughly 25% of our business. So you know the figures better than me but in the past years it was more. We'll see our market develop but let's say our strategic attention to China will remain.

And as Ilkka said, we will be extremely watchful of our competitiveness and our cost competitiveness to make sure that we stay in line with the market practices and, if we push on the commercial side, that we have the competitiveness that we need to protect our margins.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

We want to exercise the fitness that you ordered to the whole company.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Yes, indeed. Yes, indeed.

Q

Thank you.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Thank you.

Operator: And our next question comes from James Moore from Redburn Atlantic. Please go ahead.

James Moore

Analyst, Redburn Partners

Q

Yeah. Good morning, everybody. And, Philippe, nice to talk to you again.

[indiscernible] (00:24:40)

James Moore

Analyst, Redburn Partners

Q

Maybe just one on China and one on the margin bridge. Just on China, it looks like your volumes were up a lot versus the market down high single digits, and that's the second quarter in a row of significant market outperformance and it looks like your second half volumes are nearly 20% above your first half volumes. Why do you think that is when stocks continue to fall, unsold housing inventory continues to rise, mortgage and commercial property lending continue to fall? And could you tie that into your outlook for 2024? I see you have the market down high single digits. Do you think you can continue to outperform like this? And really, what's driving that? That's the first question. Maybe come back to the second?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Thank you. Let's do the questions one by one, it's much easier for us to answer them. So, first, maybe I'll start then...

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Yes.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

...on China. So, indeed, we have done very good job in second half and I – really proud of the team in China, how we've been able to fight in this difficult market and continue to grow much faster than the market. I think one part of the answer that you also do need to take into account, that if you look at the comparison points coming out from the lockdowns in 2022, so we did have some weaker quarters there as we were one of the companies impact – the lockdowns, and then we're trying to deliver on the orders we already had. So, it did have an impact to our orders in 2022.

So, part of it, it's a comparison point. But yes, indeed, we've been able to capture the opportunities where they are and done a good job there, so that's good. And Philippe went through the strategic targets, one of them being able to grow faster than the market. So, definitely, we are aiming to grow faster than the market. How well we will do then, happy to report back in the coming quarters.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

And maybe to complement, so I've been 11 years in Asia and I've been in China quite a bit in my past professional life. I was in China two weeks ago and I think we have a great team. I've been very impressed. I spent a lot of time with our customers in China two weeks ago, many, many customers. We had some sales kickoff. I had the chance to meet with the team, with a leader we have in China. We have a great team and that's a part of the explanation of the result, I would say. Great leaders deliver great performance.

James Moore

Analyst, Redburn Partners

Q

Great. And if I could switch to the margin bridge for 2024, I wondered if you could just help us talk through some of the components. I'm just going to go through some things that have been said in the past where we talked about revenue, pricing up low single digit, can we do that? Would it be similar to 2023? Raw materials, I think you

talked about a slight tailwind, so that's a low double-digit number. Savings, are we still €30 million done last year and another €70 million this year?

FX, I would expect stable. I'd be interested in – do you still think wage goes from 4.5% to 5.5%? I thought I'd do a public service and just throw it out there to see if we could get that sort of out of the way.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Good...

[indiscernible] (00:28:07)

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

...the Excel file, please.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Yes. I'll do my best, but as you know, we give the guidance on overall level. But I'll try to go through the housekeeping items in – to clarify. So, first, on operating model renewal impact, so we're actually closer to [ph] €50 million (00:28:33) in 2023 and a bit more than [ph] €50 million (00:28:33) then expected in 2024 P&L. On raw materials, it's a slight tailwind, so not – some tens of millions but not more than that. And FX is not a big impact into 2024 at this stage. Sanna will give you the exact number, but I think it's something like €15 million, we can come back to that.

And so those are the key drivers from a housekeeping point of view. But like you said, where we see good tailwind and supporting our performance, we continue to see good opportunities to grow our Service business as well as the Modernization business. As I said earlier, we have a very strong order book to deliver on and continue to have an order book where we have a positive price/cost dynamics then visible in the deliveries into 2023. So, there are also good things that are supporting our performance, but it is early into the year and there are many outcomes that we expect then. But this is how we see the year for KONE.

James Moore

Analyst, Redburn Partners

Thank you very much. Ilkka, just to clarify, that's minus €15 million, not plus €15 million for the currency?

Ilkka Hara

Chief Financial Officer, Kone Oyj

Yes.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

Good catch.

James Moore

Analyst, Redburn Partners

Yeah. Thank you. Thank you very much.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Thank you.

Operator: We will now move to our next question from Andre Kukhnin from UBS. Please go ahead.

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

Yes. Good morning. Thank you very much for taking my questions, follow-up, I'll go one by one as well. Philippe, also nice to be back in touch again. Just wanted to broaden out that question then, I know it's only one month into the job but maybe you could share with us what is the list of your key priorities for the next 12 to 24 months. Is there anything that needs to be changed at KONE immediately? And maybe if you could share your view on the 16% margin target that the company has.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Okay. So as you said, I'm one month into the company so I will...

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

Yeah.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

My first priority is very clear, it's to learn the company. And what I can share so far is probably not going to be a major surprise to all of you, that this is a fantastic company. This is a company that has extremely strong fundamentals, that has a culture that is unique, that has a very strong shareholder in the back, which is the Herlin family, which helps with a lot of long-term thinking which is really important. So, that's what I've seen so far meeting a lot of people, meeting a lot of customers.

What my next priority is going to be is as I learn to start thinking about the next round of the strategy, so our current strategy cycle will end in 2024 and we are already starting to think through what would be the next round, very early to say, but what I can say is that I see a lot of potential in this company. The first things where – it's more on the cultural side and the soft side, but as the company is very solid, from time to time, it privilege perfection to speed. And I think at a time where the environment is very volatile, privileging speed to perfection actually is a better route for better output. So, that's probably the first point of – you might find it a bit intangible but I think it's very important.

And everywhere I go, I'm asking a few questions on, could we that very good stuff slightly faster and what kind of output could we drive there? For the rest, to share my views on, let's say, more details and, let's say, adjusted directions, very early to say. We will have a Capital Market (sic) [Markets] (00:32:39) Day in September where we will go into more detail. I will probably come with some thoughts when we do our results in – at the end of Q1, but this is what I can say at this point of time.

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

That's really helpful. Thank you. If I may use the follow-up for a question on labor inflation versus maintenance contract indexing, I guess more for Ilkka, could you just run us through what was that kind of gross inflation in 2023 because you said you expect it to be higher in 2024? And then in terms of maintenance contract indexing against that, do you expect that kind of inflation catch-up in 2024 given that it was still pretty healthy in 2023 or will there be a gap?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

I guess to try to give you a directional support, of course, there's many moving parts when you look at the markets and different developments of salaries, but we are expecting more than 5% labor cost inflation in 2024 which is up from 2023. But, of course, we have many labor negotiations with unions ongoing and this is something where we're – that's our estimate at this point. And what I can say so far has been that we've done a very good job, in my mind, in pricing and services and have been able to mitigate the cost impact with pricing.

And as you referred, in many markets, we have contracts which are tied to the past inflation so it comes through somewhat delayed. There's also many markets where we then have a choice how much we escalate, and I think we've been quite aggressive on that if I look at the 2023. So, I think we have a good chance of being able to mitigate labor cost with productivity as well as pricing, but let's see how well we do.

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

Thank you very much.

Operator: Our next question comes from Andrew Wilson from JPMorgan.

Andrew Wilson

Analyst, JPMorgan Securities Plc

Q

Hi. Good morning. Thanks for taking my question. If I can start with just – just one on China and it's a broader question, and we kind of appreciate going back and forth on price and the market share, but if it's not price that's helping to drive some of the share, and I'm sure some of it is and, obviously, you're balancing that and helped by the lower costs, can you just talk about some of the other initiatives that's led to what's obviously been a very dramatic outperformance versus the market, which is, okay, might not be a surprise versus history but is a surprise versus maybe the last two years or so when it's felt like it's been closer to market trend? I'm just trying to understand kind of what's actually going on in the ground which is driving to that – driving that change more recently.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Maybe I'll start. You were there recently, so if you have more color from the travel. So, I think if I look at the broader context, what has been important in China and what the team has done really well has been able to, first, understand where are the growth opportunities in the market, which are the customers that are doing better, and really focus on those opportunities to drive growth. And that's number one. And that has meant finding new customers, also new partners to be able to do it.

And then as I've always said, pricing is not a central decision, it's about really understanding in nuance deal by deal that, hey, what is the right competitiveness and pricing? And, of course, in the market you have competitors, there is a market price. But overall, I think we've done a good job being able to drive our go-to-market to end to these results and, of course, the combination of those actions that gets to where we are. And I wouldn't be too much comfortable to disclose the magic juice in our go-to-market in more detail, but that's really what the team has done well.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

And maybe to complement, and again I'm learning the company, but I've seen some interesting tactics and strategy on go-to-market and leveraging partners versus going ourself; interesting digital innovation, which actually help us to be more visible and more predictable, with our partner, drive our service better; and as I think Ilkka said, good commercial tactic on the ground, which is hard to copy, with good leadership, yeah.

Andrew Wilson

Analyst, JPMorgan Securities Plc

Q

Yes, very helpful. Can I just – it's a possibly a clarification on one of Ilkka's comments just with regards to 2024 margin. Am I right in thinking that you said that price/cost will be positive in 2024? And if that is the case, can you help sort of – at least indicatively, kind of the quantum of price contribution that you expect to see coming through kind of 2024 and 2023 given what I imagine is obviously a better price backlog than it was certainly a year or so ago?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

So my comment was about what's boosting our performance. And we continue to have order book where we deliver, over time, orders which have increased in margins when measured in price/cost ratio. So, that was the comment, so it's more about the order book and the past performance coming into deliveries.

Andrew Wilson

Analyst, JPMorgan Securities Plc

Q

Sorry. So, that would be past performance coming into deliveries in 2024 or coming in, in 2023 and 2024?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

In 2023, in 2024, and in some markets, to 2025.

Andrew Wilson

Analyst, JPMorgan Securities Plc

Q

That's extremely helpful. Thank you very much.

Operator: The next question comes from Aurelio Calderon from Morgan Stanley. Please go ahead.

Aurelio Calderon Tejedor

Analyst, Morgan Stanley & Co. International Plc

Q

Hi. Good morning, Philippe, Ilkka. Thanks for taking my questions. The first one is around the unit growth that you've seen in Service. I'm obviously quite curious to know if that's being you gaining market share from other

OEMs or you taking share from independents because I know the dynamics have been changing quite a bit over the last few years. If I can start there, please.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

I can start. So, indeed, we've had a very good performance in unit growth, as was highlighted by Philippe in the presentation. And also, in my mind, it's good to remember that we've seen, at the same time, market in China contributing less in conversion, so as the NBS market is – been coming down. But I think it's a combination of many things. So if you think about the Service business, it is about serving every customer every day well, which you then see in the end result. So, it's million things going right every day.

If I look at things that are contributing positively, top-down, clearly, first, with 24/7 connectivity, we've been able to do, increasingly, better job for our customers, provide better outcomes, and we've seen retention going up across the markets driven by this digitality. And that's one component. We've continued to see good capture in terms of conversions, and also we've seen acquisitions contributing to growth positively as well. But I think in essence, many things going the right way has resulted in us being able to drive good unit growth.

Aurelio Calderon Tejedor

Analyst, Morgan Stanley & Co. International Plc

Q

That's helpful. Thank you. And the second question is more of a follow-up on the earlier questions on wage inflation, escalation clauses and so on, but switching to kind of the New Building Solutions business. I wonder if you can help us understand what has changed now versus, say, two or three years ago. Have your contracts changed in any way? What gives us confidence that price/cost is going to continue to be favorable on those orders that you've taken, that we're now going to see a spike in inflation but then obviously puts margins under pressure? Has anything changed or is it just obviously costs not going through the roof again?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Well, first, it is our view right now. And so, of course, there is a world where costs would go up and then the comment would change. But that is our best view to 2024 and so that's number one fact. Then have we changed our contracts with our customers? So, it is fair that we've had more contracts where there's actually a clause where we're going to then, based on a cost index, go back to our customers. That's one thing.

If I look at our capability to manage our supply chain, our costs, our agreements with suppliers and also product cost reduction efforts, I think the last two years have taught a lot to us as well as the industry. So, I think we have a – quite a good way of dealing with it. But it doesn't mean that it would be certain. So, it is our view right now and let's see how it turns out into 2024.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

And the last factor to mention is innovation. We can innovate and help actually our solution to be more competitive. We have a lot of ideas in the backpack to come up with better stuff, stuff that will be easier to install, that will be more compact and so on. So, we'll – I think KONE has had an history of innovation and bringing solution that are practical for our customers to help safety but to also help cost competitiveness, and we will be committed in the future to make sure that we keep bringing to the market those type of solution.

Aurelio Calderon Tejedor

Analyst, Morgan Stanley & Co. International Plc



That's very clear. Thank you very much.

Operator: Our next question comes from Klas Bergelind from Citi. Please go ahead.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.



Thank you. Hi, Philippe and Ilkka, Klas at Citi. So, I was late on the call, maybe you touched on this, but I'm trying to understand the comment of less tailwinds to the margin in 2024. I would assume that this is mainly from the lower impact from raw material and logistics. Because certainly, there are several incremental tailwinds, I would assume as well. You would see incremental savings from the €100 million program, the under absorption from China declining this year in the second half should level off, and you still see, as you just alluded to, I think, the price/cost coming through out of the backlog in developed markets. If you could comment, Ilkka, on these sort of more positive incrementals, at least as I see it. Thank you.

Ilkka Hara

Chief Financial Officer, Kone Oyj



Simply yes. So, you're right, and the comment on tail – headwind – less tailwinds is really related to the fact that in 2023 we did have a tailwind coming out of raw materials and component cost of more than €100 million. We expect less in 2024. There's some tailwind, but not much.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.



Okay. Very clear. My second one is on the China order growth. I mean, it's great to see that you are outperforming like this. But it obviously also mean that when we back out the price mix, it is weak again as you're outgrowing. Will that impact the margin negatively into 2024 or is the margin in China as such still relatively stable, i.e., price mix down, but you also have deflation in China, so maybe the margin doesn't change that much? Thank you. 44:46

Ilkka Hara

Chief Financial Officer, Kone Oyj



So, the orders that we are booking – so margin is slightly down, but we've been able to mitigate with productivity and overall cost environment, the impact somewhat of the pricing in the market. So, you're right, but we haven't been able to fully mitigate it. And, of course, we continue to be working hard also on the productivity side going forward to be able to catch up.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.



All right. My very quick final one is on the Service side or maintenance. I'm keen to understand what kind of sort of portfolio growth, i.e., units that you're sort of baking into guidance? I mean, you should have some visibility here and also on the price mix. Obviously, I think wages are still going up. You talked a little bit about the escalation clauses. But if you just like can sort of understand how Modernization will develop. But if you just look at the sort of the maintenance implied growth unit versus price mix, any sort of indication would be very helpful.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Well, I guess, we are expecting to grow our Service business going forward well as well. So, probably 2023 was exceptionally high number, but clearly faster than what the trend line has been. Part of that is good unit growth, and we continue to be expecting that with this inflation rate that the pricing plus the digital is contributing positively to it. So, I don't think I have a detailed comment to make on the individual components. But I think, on all of those, we continue to be focused on driving good growth.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

Thank you very much.

Operator: We will now take our next question from Panu Laitinmäki from Danske Bank.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

Yes. Thank you. I just wanted to clarify on some numbers on China that we have discussed earlier. So, how much roughly was service and new equipment sales in China? And then, how did the margin compare to the group and also like equipment and Service margin in China?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

So, out of the sales in China, 75% is on NBS, so New Building Solutions, and about 20% is Service, and about 5% is Modernization. So, 75/25 in the way you asked. And overall margins for our China business are slightly below the group average, but not much at this stage. That would be my comment how much in detail I want to go. In the businesses, the structure of the margins has not changed much. So, we continue to have highest margins in Modernization followed by Service and then NBS.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

Okay. Thank you. If I also can ask on the cost outlook for 2024. I mean, you now flagged higher IT and R&D costs just on the magnitude [ph] of piece (00:48:10) and how does it compare to the €100 million savings of which I assume like maybe €70 million is still to become in 2024. So, I mean, is the net still positive on cost savings and this higher costs or how should we think about this?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Of course, there's many other items in the costs as well, but the R&D and IT increase, we're talking about some tens of millions, so it's not in the same magnitude. And in operating model renewal, we expect a bit more than €50 million still coming into P&L in 2024.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

So, did you get €50 million already in 2023?

Ilkka Hara

Chief Financial Officer, Kone Oyj

Not quite, but quite close.

A

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Okay. Thank you.

Q

Operator: Thank you. We kindly remind you to limit the number of your questions to one, one plus follow-on. Thank you. We'll now move to our next question from Ben Heelan from Bank of America.

Benjamin Heelan

Analyst, Bank of America Merrill Lynch

Yes. Morning, guys. Thank you for taking my questions. I wanted to ask a little bit on the regional outlook. So, first, you'd given some color in the past in terms of how Northern Europe and how Southern Europe were performing. I just wondered if you could give us a bit of color there there and how you see those two regions differentiate in 2024.

Q

And then, you sounded somewhat more positive on the US. Still expecting it down, but a bit slightly improving or maybe it was kind of your tone. Just if you could give a little bit of color in terms of what's driving that. Are you starting to see more incoming from developers, etcetera? How should we be thinking about that? Thank you.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Within Europe, the most impacted markets in NBS have been more the central and north or Nordics, I would say, so Germany, Finland, Sweden, and so on. Whereas the New Building Solutions market, which was really your question, has been more resilient, I would say, in South Europe and Middle East and Africa were more stable in the fourth quarter. So, I don't think the dynamics have changed as such when we look at the end of the year 2023.

A

And I think I was very explicit that we did see – we are seeing slightly better market environment in NBS in North America. So, end of the year, it was significantly down. And when we look at the whole year, 2024, we expect the NBS market in North America to be slightly down. So, a bit better market environment.

Benjamin Heelan

Analyst, Bank of America Merrill Lynch

And in Northern Europe versus Southern Europe into 2024, I mean, how are you seeing that?

Q

Ilkka Hara

Chief Financial Officer, Kone Oyj

Well, we expect the overall market in Europe to be slightly down. Let's see how it develops between the regions. But I expect a similar trend going forward between the different subsegments of the Europe. But most of the market, of course, is in those, so that's why it's so important to get to Nordics and Germany.

A

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

We see some encouraging signs on the east of Europe.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Yeah.

A

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

So, that's...

A

Ilkka Hara

Chief Financial Officer, Kone Oyj

Yeah.

A

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

... [ph] responding in also south (00:51:47).

A

Ilkka Hara

Chief Financial Officer, Kone Oyj

Yeah.

A

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

But you know the rule of the game, which is it's pretty cyclical market. So, the first market that went down are probably the first one that will come up or stabilize.

A

Ilkka Hara

Chief Financial Officer, Kone Oyj

Yeah.

A

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

So, with that, you might have a part of the answer. Now, we would love to have a crystal ball on exactly when things are going to be moving. But there are rules, the game of the market, that do not change whatever, let's say, application you serve. Then how fast is the market rebound is another one.

A

What we can say that in Europe there is still a healthy trend on Modernization. Slowing down a little bit in countries like Italy, but being rather healthy because the mega trend behind is the all-energy retrofit and all the money that is being fueled by European Commission on energy retrofit, EPBD and so on, which are driving some strong need for building renovations.

Benjamin Heelan

Analyst, Bank of America Merrill Lynch

Yeah.

Q

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

And maybe one thing to add to your question as well is what's interesting is that when I look at our CRM system and look at the opportunities being created, in those markets which are down in Europe, we continue to see quite a good healthy rate of opportunities. So, there is a lot of projects, which don't get then decided and got moved forward. So, in case the market environment is more favorable, then there's a good funnel of these opportunities than can then nudge forward. But let's see how it turns out to be, but that's our best view for 2024.

Benjamin Heelan

Analyst, Bank of America Merrill Lynch

Q

Great. Thank you for the color.

Operator: Our next question comes from Tom Skogman from Carnegie. Please go ahead.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yes. Good morning. This is Tom Skogman from Carnegie. I would like to ask your new CEO. I mean, you have hundreds of offices and you can look at different types of KPIs and ways to improve operational efficiency. So, with your background, perhaps you have already identified some things you could change in this field.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Not yet. And, again, I'm back to what I said, which is that's the company that [ph] strikes as being (00:54:12) – having very, very strong fundamentals, very strong operation, very strong resilience baked in. I mean, the key figures – we keep asking on NBS, but the true reality is that 55% of our business is Modernization and Service, and there is resiliency baked in that part of the business.

So, what am I looking at most at this point of time is probably more on what would drive the differentiation of the company tomorrow. So, I'm spending a lot of time with salespeople, but I'm also spending a lot of time with people building our innovation whether digital or non-digital. I see there an opportunity to go faster. So, I see very exciting stuff. But my question is more to the team, how could we scale faster the fantastic thing that I see in the company.

So, that's where I sit after four weeks in the company, so please leave me some time. But what I can tell you that I see a solid company and I see some opportunities, and I'll share my views slightly later once I'm a bit more grounded.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. That's fair. Thank you. And then, on SG&A cost, I mean, you will have now a second year with sharp sales declines in certain parts of Europe and the US. What is your kind of tactic here? Is it will really focus on the upcoming recovery or will you try to protect the margin by lowering SG&A cost in these markets where you will see sharp sales decline?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Well, first, I think on a more KONE level, one of the by-products of the operating model renewal is that we have leaner teams that are able to go to the market in a more cost-effective manner. So, that's about the savings. And, of course, KONE does, market-by-market, constantly look at the market opportunity and adjust our operations to the market realities.

But if I look at the total SG&A and of course this is something, which we only share the total head count for KONE. But if I look at the white collar worker head count separately, that is actually coming down and reflecting also the more tougher market environment where then the growth is more on the Modernization side and, of course, mainly on the Service side where we continue to grow quite nicely. So, it is something we continuously adjust and assess market by market given the environment.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. And then finally, it sounds like China is now injecting a lot of liquidity into the system. I mean, how will this change your [indiscernible] (00:57:18) operators' kind of behavior? Is it time to increase the risk level to go to perhaps more risky developers and say we are happy to take your order, etcetera?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Well, I think, first, which I'm actually really proud of, is how our team in China has been handling, throughout the last years when the crisis has been ongoing, from a credit perspective, the discipline between commercial terms, payment terms, assessing the risk with the customer, and then finding the right balance with prices in that environment. And it's also visible in our receivables coming down on overall level as a result. So, I think we've been able to navigate that environment quite well, and I expect that to be the case going forward as well.

Yes, there is more liquidity in the market. And, at the same time, what I would still emphasize when I look at the China is this consumer confidence that I believe that that needs to be improving, so that we can start to see more improvement in the leading indicators, land acquisitions, construction starts, and real estate investments. But, of course, liquidity is one enabler for then building activity.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

But we will absolutely stay very disciplined in our commercial practice in China, if that was the question.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. Thank you.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Thanks.

Operator: And our next question comes from Vlad Sergievskii from Barclays. Please go ahead.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Yeah. Good morning. Thank you very much for taking my two questions. I'll start with the strategic one. Historically, KONE has been the company with reliable, progressive dividend that frankly grew almost every year and cash position that grew almost every year as well. In recent years now, you kept regular dividend flat for four years in a row and net cash position declined considerably this year for the second year in a row.

My question is what do you think should be conditions for you to restart progressive dividend growth and to see net cash position starting to grow again? That's the first one. And I'll ask the second one, which is much quicker, which is simply related to your margins [indiscernible] (00:59:51) orders. You said it's stable year-over-year. Are there any regional differences or it's all stable across the board? Thank you very much.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Well, of course, at the end, dividend is a decision by – or a proposal is a decision by the board and approval is for the AGM. And over the years, we've been able to grow the dividend quite nicely. And, yes, now, lately, the development in dividend has been more stable. But also we've done two exceptional dividends in between and actually a year where our results did come down but dividend didn't come down.

So, I think I expect the board to value this stability and growth on the dividend going forward as well. And our job is to make sure that we create a business that increases profits and cash flow continuously to enable that. But at the end, capital structure is a board decision as such.

Then on the comments on the margins. I repeat, I guess for one or two questions, I just said the same thing that for orders margins, we did see margins for orders coming down slightly in China as the pricing was coming down, but we're able to mitigate part of that with product cost reductions in the quarter. In rest of the world, the margins were performing better and were more stable.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Understood. Thank you very much.

Operator: Our next question comes from Nick Housden from RBC Capital Markets.

Nick Housden

Analyst, RBC Capital Markets

Q

Yes. Hi. Thank you for taking my two questions. The first one is just looking at the outlook in the context of the existing new equipment backlog. So, based on where the backlog is at the end of 2023, I'm just wondering what kind of sales growth you're expecting for equipment in the various regions. Presumably, China new equipment sales will be down in 2024. But I'm wondering about Europe and North America where backlog conversion is slower. And I think one of the peers has been saying that they would expect to see a little bit of growth in those regions.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Of course, we don't give guidance on our sales by geography. But one way to look at it is our commentary on orders received in the past quarters. And the fastest order book rotation is in China. So, we will get a tailwind from the strong growth in Q3, Q4 from orders then to deliveries. And of course then we do need to get new orders in 2024 then to be delivered in latter part.

Whereas then in North America, the order book rotation is slower, especially in NBS. So, we already have an order book that will carry us over to 2025, especially on the NBS side on average. And, in Europe, it's somewhere in between. So, that's how I would look at it and model it in terms of geographies.

Nick Housden

Analyst, RBC Capital Markets

Q

Very helpful. Then just a quick second question is about the margin of Modernization and how much that should benefit from scale economies. As they go from 17% of sales to 25%, how much more profitable would you expect it to become?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Of course, scale matters. And I would also say that not only the scale, but I think we've learned a lot when it comes to pricing in the last two years. It was the fastest business to recover in margins when the cost went up. And I think that's something that we continue to need to use as a [ph] muscle (01:04:08). But I expect scaling, but it's also good to remember that it is a business that gets the same scale as in NBS when – manufacturing perspective. So, same factories and many times same products, especially when we do more holistic Modernization projects. So, some scale of course you expect from fixed cost, but let's see how much we get.

Nick Housden

Analyst, RBC Capital Markets

Q

Great. Thanks very much.

Operator: Thank you. And our last question today will be from Antti Kansanen from SEB. Please go ahead.

Antti Kansanen

Analyst, Skandinaviska Enskilda Banken AB (Finland)

Q

Yeah. Hi, guys. Thanks for taking my questions. The first one is a bit of a clarification on China. I mean, it's [ph] their burdening (01:05:01) your performance going into 2024. But as you kind of highlighted your commercial strategy, it's now working. You're increased your orders on second half of last year and the comps are quite easy for first half of this year. So, is this a comment more on the margin in China or is it kind of just a conservatism around what you can do on H1 orders? Just wanted to get a bit clarity on that one.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

It is a comment on the market.

Antti Kansanen

Analyst, Skandinaviska Enskilda Banken AB (Finland)

Q

I do appreciate it. But in terms of markets, you have clearly shown that your strategy is working and you can outgrow the market on the second half and the comps are easy on the first half of this year, and that's pretty much your China deliveries for 2024. So, is it a comment on the pricing pressures, the competitive pricing, or is it the volume comment that is [ph] burdening (01:05:55) the results?

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

It's all of the above. Of course, it's easier – as I've said previously, it's much easier to gain share in a growing market. Now, we've been able to gain share in a declining market, that's not easy. And part of that, of course, the comparison point. But, overall, we continue to see a challenging market environment for NBS in China. So, that's more [ph] the burdening (01:06:23) the results comment.

Antti, did we lose you?

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

A

Probably not.

Ilkka Hara

Chief Financial Officer, Kone Oyj

A

Sorry, Sanna.

Sanna Kaje

Vice President, Investor Relations, Kone Oyj

Yeah. Maybe it's time to close. Thank you, Philippe.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

Thank you.

Sanna Kaje

Vice President, Investor Relations, Kone Oyj

Thank you, Ilkka, and thanks for all the great questions from the line. And if you still have some follow-ups, we are, of course, happy to support from the IR team.

Maybe the final point I wanted to still mention that I think Philippe also said is that please save the date already for the Capital Markets Day, which we plan to have on the September 27, 2024. So, with that, thank you and have a lovely weekend.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Thanks, everyone.

Philippe Delorme

President, Chief Executive Officer & member-Executive Board, Kone Oyj

Thank you.

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