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Kone Oyj (KNEBV.FI)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

Sanna Kaje

Vice President- Strategy & Market Intelligence and Interim Head-Investor Relations, Kone Oyj

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Philippe Delorme

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

OTHER PARTICIPANTS

Andre Kukhnin

Analyst, UBS AG (London Branch)

Rizk Maudi

Analyst, Jefferies International Ltd.

Daniela Costa

Analyst, Goldman Sachs International

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Nick Housden

Analyst, RBC Capital Markets

Miguel Borrega

Analyst, BNP Paribas SA (London Branch)

MANAGEMENT DISCUSSION SECTION

Sanna Kaje

Vice President- Strategy & Market Intelligence and Interim Head-Investor Relations, Kone Oyj

Good morning. Welcome to KONE's Q3 2024 Results Announcement. I'm Sanna Kaje, Head of KONE's Investor Relations. I have here with me today our President and CEO, Philippe Delorme.

Philippe Delorme

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

Good morning.

Sanna Kaje

Vice President- Strategy & Market Intelligence and Interim Head-Investor Relations, Kone Oyj

And CFO, Ilkka Hara. Philippe will first go through the highlights of the quarter and say a couple of words on the strategy, and Ilkka will then talk more about the market development and financials. Philippe, please.

Philippe Delorme

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

Thank you, Sanna. Good morning, everyone. So, as usual, I'll start by summarizing the highlights from the quarter, which was in many ways an important and exciting one, but didn't come without some challenges too.

The big highlight for us was the launch of our new strategy in September, which was very well received by both our employees and customers, and gives a clear mid-term direction for our business.

I'm also very happy to share that the strong momentum we've seen in Service and Modernization continued also in Q3. We saw a gain, close to 10% service sales growth and around 20% growth in Modernization orders at comparable currencies. From a geographic perspective, we made really good progress in Americas, Europe, Asia-Pacific, Middle East and Africa, with a combined sales growth of around 10% and comparable currencies. Unfortunately, the headwinds in China intensified and our sales declined by 20% in the area. And profitability declined as well.

With that, we specified again our business outlook for 2024 and expect now sales to grow by 0 to 3% as comparable exchange rates and adjusted EBIT margin to be within the range of 11.5% to 11.9%. Now, let's take a look at all of this in more detail, and let's start with the financial highlights.

Firstly, I'd like to say that we had a pretty good development in our orders received with 5.5% growth at comparable exchange rates. I'm especially happy, similarly to Q2, that we had double-digit growth in orders in three of our four areas. In China, as I said, the market became increasingly difficult, and our orders declined by over 20%. Our sales grew by 1.1% at comparable currencies in the quarter. On a positive note, service continued to grow strongly at close to 10% rate, and modernization by over 10%.

However, the challenging situation in China was also reflected in sales and there, our sales declined by 20%.

If we look at EBIT, our adjusted EBIT margin improved by 10 basis point from the previous year. There was positive progress on many fronts, but the difficult market conditions in China impacted us negatively. We have also identified points of attention where we need to improve our performance and have launched performance improvement initiative to accelerate profitability improvement, while specifically executing pricing task forces, sales and operations excellence at branch level and amplification of procurement efficiency. And Ilkka will elaborate more on the financial in this part.

As said, one of the big highlights for us in the quarter was the launch of our new strategy. I've been extremely happy and energized by all the excitement around the launch and the eagerness of people to start executing on the strategy from day-one. I won't go through the detail of the strategy now as we discussed it at our Investor Day, but I wanted to repeat a couple points on what we are after. So, firstly, we want to have a simple, a simple strategy that drives scalable growth. And Ilkka will recap what it means financially.

We also want to transform KONE into a more resilient business with Service and Modernization as a key driver of our earning growth. And hopefully, what we're showing is demonstrating this. And finally, we believe that an important lever for succeeding in the execution of the strategy is to adapt our culture towards more courage, speed and simplicity, which is a very high point of attention for the executive team.

An important part of our strategic ambition is to lead the industry in innovation and sustainability. And here, we have some great news to share on our progress.

In September, we had an important launch for the taller building, KONE High-Rise MiniSpace DX. This new offering is both – is valid for both new building and modernization and is a result of a significant hardware and software innovation combined. The product is extremely energy efficient and enables more rentable floor space in the building as well as a longer life cycle. It has also inbuilt connectivity with advanced predictive analytics for smart maintenance.

We have also been actively rolling out our innovation for digitally enabled services. We have now reached 35% of connectivity in our Service base and have rolled out dynamic maintenance, which is a key enabler for productivity to eight countries, and remote service to 10 countries, and we'll continue to push for higher connectivity penetration and rollout of the digital enablers at speed, also, in the coming quarters.

I would like also to share again a few exciting customer references, as we do every time. Firstly, I want to share a new building solution example from the residential segment. We tend to talk a lot about the large project, but there is actually a lot of exciting things happening also in the smaller projects. The specific case is a wooden building project from the Netherlands, where we are providing prefabricating elevators for the sustainable buildings. The total lead time for the project is less than a year, so stronger – faster lead time and the installation time is also half, almost half of what's typical, resulting in significant productivity at the site.

The second reference is a high-rise project from Australia that actually I could witness. I was in Australia two weeks ago where ground was broken this summer. The residential tower will feature the new KONE High-Rise MiniSpace DX with UltraRope as the first customer project for the new offering. So, a great success here. The customer was impressed by our unique innovation capabilities, and I must say I'm very happy to see the traction of this new innovation.

The two other references represent different types of modernization. In the US, KONE will modernize 40 elevators and 2 escalators at the Harry Reid International Airport in Las Vegas, which ranks one of the busiest airport in the countries. KONE's well-established relationships through an existing maintenance contract was key to helping us understand and meet the customer needs.

The final case is from China, where we upgraded a 20-year-old non-KONE elevators with KONE as half replacement solution. So, we retain some of the existing structure and focused on efficient project management which brought more sustainability and fast installation time. The building users benefit from the increased elevator capacity, improved ride comfort and with KONE 24/7 Connected Services, it also improves the safety of the elevators.

We also received some delighting external recognition in the quarter. KONE SiteFlow, which is a digital innovation, was recognized for innovation excellence at the 2024 Council for Tall Buildings and Urban Habitat. And in the same event, KONE was also recognized for equity, diversity and inclusion best practices. And we were again also on Forbes World's Best Employers List, which is in line with our strategic ambition to be the number-one choice for both our employees and customers.

Now, I will hand over to Ilkka, who will go through the market developments and financials.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Thank you, Philippe, and also welcome on my behalf to this result announcement webcast. Let's next look at how our markets are developing in Q3. In the third quarter, the market actually was quite similar to what we saw in the first quarters with a couple of things to highlight. In the New Building Solutions, the market stabilization in Americas and in Europe solidified, with even some pickup in activity in Americas.

On the other hand, in China, the market weakened further. Consumers continue to be hesitant to buy new apartments, and the prolongation of this is making the liquidity situation of the project property developers increasingly difficult.

In Services and Modernization, the markets continued to develop positively across all areas. Overall, the Asia-Pacific, Middle East, Africa market continued to face the most positive market environment with plenty of opportunities in all of the businesses.

Then, let's look at the Q3 financials, and I'll start with orders received. As Philippe already highlighted, our orders grew at the double-digit rate in three of our four areas at the comparable exchange rates. Overall, our orders received grew by 5.5% in the quarter, which to me was a good achievement given the market environment. We had strong orders in Modernization with growth of 20%, but also very good progress in New Building Solutions in most parts of the world.

In China, the New Building Solutions orders declined by over 15% in units and significantly more in monetary value. Our margin of orders received declined slightly, driven by China. In the rest of the world, we saw slight improvement in the margins.

Then let's look at sales. Overall, our sales grew 1.1% at comparable currencies in Q3. Our New Building Solutions sales declined by 9.3% as a result of the slow construction market in China. On the positive side, we saw again strong development in Services with 9.6% growth and in Modernization with 10.5% growth.

Geographically, we saw strong growth in Americas at 11.6%, 6.3% growth in Europe, and 15.8% growth in Asia-Pacific, Middle East and Africa, at the comparable currencies. All together, these three areas grew by around 10% at the comparable exchange rates, which to me was one of the highlights for the quarter.

In China, we saw slow order book rotation due to a slowness in the construction market, but also because we continue to manage the deliveries very tightly to ensure cash flow. As a result, our sales declined by 19.7% at comparable currencies in Greater China. The Services and Modernization sales have continued to develop positively also in that part of the world.

Then let's move to adjusted EBIT and profitability. Our adjusted EBIT margin continued to develop positively and improved 10 basis points compared to a year ago. And our adjusted EBIT was €319 million. The positive drivers for profitability were better margin in our New Building Solutions and Modernization deliveries outside of China, as well as a favorable business mix.

On the negative side, we continued to face broad-based inflation, but the single biggest headwind for us was the margin decline in China. In China, we continue to be strongly focused on product cost reductions, and overall, adjusting to this harsh market reality. We also increased our provisions for bad debt, and this had a negative impact of around €20 million on our adjusted EBIT in the quarter. As Philippe mentioned, we're also launching global performance improvement initiatives to accelerate the margin improvement going forward.

Then finally, our most important metric, cash flow. We had a solid cash flow from operations in the quarter at €345 million, which was a bit above last year's level. Year-to-date, our cash flow is slightly down from previous year. Our working capital continues to be strongly negative, although now slightly less negative than in the beginning of the year. We've seen positive development in our accounts payable while our inventories have increased somewhat. Also, our accounts receivables have increased slightly outside of China.

Then let's look at the market and business outlook for the year. Our market outlook for 2024 remains unchanged, and for 11 out of our 12 markets, the outlook continues to be positive or stable. Modernization markets are expected to remain very active, and the outlook is positive also in Services. In New Building Solutions, the market

continues to be mixed with a stable outlook for North America and Europe; growth expected in Asia-Pacific, Middle East and Africa; and China market remained difficult.

Then to our business outlook. As Philippe said, we have specified our guidance for the year slightly after the – we have three quarters behind us. We now expect our sales to grow by 0 to 3% at comparable exchange rates in 2024, while previously the range was from 0 to 4%. The adjusted EBIT margin is now expected to be in the range of 11.5% to 11.9%, while previously the range was from 11.5% to 12.2%. The key reason for us lowering the guidance range from the top end is the increasingly difficult market environment we're facing in China.

Overall, the drivers supporting our performance are the continued strong growth in both Services and Modernization; improved margins coming through in deliveries outside China; the strong order book and the savings from operating model renewal, which we saw in the first half of the year.

The drivers burdening our performance are declining New Building Solutions market in China and globally the persistent cost inflation we're facing.

To close my part, I wanted to recap the new mid-term targets that we introduced for 2027 in our Capital Markets Day and to say a couple of words of the 2025 outlook. So, first, for the period of 2025 to 2027, we're targeting mid-single-digit annual sales growth driven by close to 10% growth in Services and a double-digit growth in Modernization. In the New Building Solutions, we expect low single-digit growth outside of China, and in China, we expect the market to decline further. For profitability, our target is to reach 13% to 14% adjusted EBIT margin by 2027.

In 2025, we expect Services and Modernization businesses to continue to develop positively, and we have a solid order book now of our New Building Solutions in most part of the world. We also expect to start to see the first results from the performance improvement initiatives towards the end of 2025. However, there are some headwinds as well, with the Chinese New Building Solutions market expected to continue to be difficult, and wage inflation to persist.

Overall, we target a margin improvement also next year, but the margin improvement is expected to accelerate towards 2027, as the impact of the performance improvement initiative fully kicks in and the negative impact from China gradually fades.

I would next like to hand over back to Philippe to summarize our presentation. Please, Philippe.

Philippe Delorme

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

Thank you, Ilkka. So, to summarize, we are now getting into full swing with our new strategy which has created a lot of excitement among our stakeholders. We are happy to show another quarter of strong growth in the resilient Service and Modernization businesses, and we expect that to continue also in the coming quarters in line with our new strategy.

When we look at our markets, the outlook is mostly positive, while the Chinese New Building Solutions market continues to be increasingly difficult. We are ramping up clear and focused performance initiatives to support delivery of our 13% to 14% adjusted EBIT margin by 2025 – sorry, 2027. I would like again to say a big thank-you to everyone at KONE for their hard work demonstrated in the third quarter.

And with that, we are ready for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you very much, sir. [Operator Instructions] The first question will be coming from Andre Kukhnin calling from UBS. Please go ahead.

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

Good morning. Thank you for taking my questions and follow-up. Maybe I'll start with the follow-up. Just on the backlog margin evolution, you commented that it's down slightly year-on-year. Could you comment on how it's developed sequentially in Q3?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Can you repeat the beginning, you're talking about orders margin or what did you ask?

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

Sorry, order intake margin, yeah, you said it's down slightly year-on-year. Could you comment on how it's developed sequentially, quarter-on-quarter? And how is the backlog margin developing, please?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

So, sequentially, it's slightly down as well as we've commented in the past, and driven by China, where we see continued pressure on margins despite the actions we're taking on the product cost side that we – Philippe was talking about. And on order book, as I've said before, the order book of course fluctuates quite a bit, depending on the contracts that you're signing, whether they're major projects or more quicker rotating. But on – it is on a good level in order book. And outside of China, we continue to book slightly higher margins in orders that we are delivering. In China, it's the opposite.

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

Thank you very much. And if I may, just briefly, a question. On your comments on the pickup in activity in Americas, could you elaborate on that in terms of whether this is US or Canada, I guess South America is not relevant for you, and where are you seeing that and whether that is indicative of a trend or just a quarterly phenomenon?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yeah. So, it's good to – so, first we are commenting the markets where we are active. So, it's a comment about Canada, US and Mexico. And given the size, it's a lot of – the comment is really mainly about US. And second, which is good to remember that the volumes in US are quite low, although the value per unit is quite high, so the swings in the market when we comment the market activity in units can be fluctuating.

And in the third quarter, we did see positive development in the market. Also, part of the impact was coming from few larger major projects where there are quite a few units being ordered. So, overall market continues to be stabilizing, and this quarter was very good. But, for the full year, our outlook was on the market to be stable. I consider that to be a start. Then let's see how it develops, where there are many moving parts still.

Philippe Delorme

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

A

And maybe to build on your answer, so just stating maybe one thing that's obvious, but I'll make it clear, which is now, the Americas is our second area, and it has taken the space of China. And when you look over a longer period of time, there's been an amazing job to drive the margin up and to drive a superior growth compared to market. So, we are very proud of our team in Americas, we are supporting them fully, and we see actually very good output out of now the second geography for KONE.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yeah. That's actually a good point. That's a big milestone for the...

Philippe Delorme

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

A

Yeah.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

...team in Americas to be a second biggest area for us in terms of sales.

Andre Kukhnin

Analyst, UBS AG (London Branch)

Q

That's really helpful. Thank you very much to both of you.

Philippe Delorme

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

A

Thanks.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Thanks, Andre.

Operator: Thank you. Our next question will be coming from Daniela Costa of Goldman Sachs. Please go ahead.

Daniela Costa

Analyst, Goldman Sachs International

Q

Hi. Good morning. I have two questions. I'll ask them one at a time. The first one sort of like relates to China, basically. And can you comment on if China is still profitable, and given the pricing trends that you and your peers

have been flagging in China and the situation, is – do you see a possible outcome that maybe next year China will not be profitable? Or do you have actions that you can take immediately now to prevent that?

Philippe Delorme

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

A

So, maybe I can start, which is, yes, China is profitable, but it's lower than the company average. And we clearly see the mix of the business shifting. So, we see Services and Modernization growing on average quite close to double digits, while actually we've been pretty explicit on our trends in New Building Solutions, where the three business lines are profitable. And maybe you want to complement on the actions going forward.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yes. And definitely in this market environment, we continue to take actions in our cost base as well aligned with the market. And the aim is to be able – our aim is definitely to be profitable. And I think we have good actions to support that. Maybe on top of what Philippe was saying, that of course, in this type of markets, what's really important is the structure how you operate, but especially on the product cost, really be ruthless in driving product cost reductions. And really look at it from a perspective of what the market – customer needs are.

And what I'm very happy about with our team in China, who by the way, does a great job in this market environment, is that the product cost reductions that we've seen have been 3x of what we've seen in the past, and we continue to see opportunities for that going forward. So, that's also one part of the actions that we're taking too, in this market environment.

Philippe Delorme

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

A

And...

Daniela Costa

Analyst, Goldman Sachs International

Q

Thank you, my...

Philippe Delorme

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

A

And cash, and cash is our guiding principle. I mean, you know this, but KONE has a very strong cash culture. But I would say I'm impressed every time I engage with the China team on the discipline we have in cash, in tough market conditions. So, we are prudent. We always privilege cash to anything else and we intend to keep doing that going forward.

Daniela Costa

Analyst, Goldman Sachs International

Q

Thank you. My second question maybe relates to some of the things that Ilkka was also talking about, but just going back to the CMD, and you – where you had the bridge to get to the 13% to 14% margin, and also tying that up with the 2025 commentary that you just gave, the bridge had two parts – three parts, basically, had the ones related to like product costs and what digitization and modularity in the individual business units, had the business mix, which you just gave a comment on that, and that will take time – does its time to shift, and then how the big bar that was 100 basis points of performance initiatives.

Can you give us a little bit more color exactly on what those performance initiatives are and whether they're more back-end loaded, they're more linear through the period? Just trying to tie up how you get to the 2027, given the commentary on 2025.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yeah. And actually gave a bigger, bigger expectation than that. I think it was 150 basis points for the performance initiatives. And then of course, we have a choice then to reinvest some of the benefits back to the business if we so decide. So, that's then the net 100 basis points that you're referring to.

But, on the initiatives, Philippe talked about them. I'm sure he's going to comment next. He's quite passionate about them. They will take some time to have impact. So, we expect to start to see the impacts towards the end of 2025. And then throughout the period to 2027, the strategy, if you think about the performance initiatives, they will continue to deliver positively as well as then some of the things like the mix change, digitalization, providing improvement in profitability for Services and so forth.

They continue to ramp up towards – with accelerating speed, towards the end of the 2027. That was my main message on that one. But, I think, Philippe, if you want to comment a bit about the performance initiative.

Philippe Delorme

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

A

So, the performance initiative, we gave some details in the Capital Market Day. They are nothing fancy, but we know things that work, and that work in a playbook of driving efficiencies or pricing. There is an opportunity to do a better job, more data-driven on pricing, sales and operational excellence at branch level, we think that we can drive a better discipline across the board to excel better on the execution at the Elementary unit of KONE, which is a branch, so a team of 20, 30 people following a region, a district.

There are tons of best practices across KONE, but we are not always very good to document them, and make sure that we do execute systematically and have a passion of excellence and execution.

And the last one is procurement. And procurement, we've launched a work on procurement that we call Fuel for Growth, a little more than a year ago. We think we have an opportunity to accelerate this in China, but also out of China. And these three, on top of a very strong attention on our global cost, we believe can yield into the 150 basis point opportunity. Some of it would then be reinvested into the growth because we need to invest in digital, but we want to have this space so that we can also adapt and maneuver with market conditions that we know will be changing.

Daniela Costa

Analyst, Goldman Sachs International

Q

Thank you for that.

Operator: Thank you, ma'am. We'll now move to Vlad Sergievskii of Barclays. Please go ahead.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Good morning.

Philippe Delorme

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

A

Good morning.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Thank you for taking my question. I'll start with free cash flow, if I may. Equity free cash flow [ph] conversion (00:29:26) below 100% this quarter, which leaves room for improvement from KONE's historical standards, I would say. Do you think you will be able to make progress to improve cash conversion [ph] either in (00:29:37) Q4 or in 2025? So, 100% or maybe above, where it's historically been for KONE before 2021? So, that's the first question.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Simplify the question, can we improve and are we aiming to do? Definitely so. And on cash flow, we don't guide quarters. And I think actually on a quarterly level, there's always fluctuations, but definitely that is a focus as Philippe was referring in context of China, but also outside of China. So, definitely that's the goal.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

[indiscernible] (00:30:16) maybe I can follow-up on that. What would be the key levers for you to pull to actually improve it?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, of course, the main lever is to make more profits. So, that's why want to grow and grow profitability, but also equally in the working capital, we see opportunities to improve. And I guess I was commenting then also in CMD and they haven't changed. So, we see opportunities in extending our payables which are, where there's clearly opportunities.

The collection outside of China, we have large businesses with opportunities to collect faster. And there we see the biggest opportunities. On customer payment terms, we have a quite a good payment terms across all businesses. So, maybe less improvement opportunity there.

And then lastly, I guess on the other items on CapEx and M&A. On CapEx, we are quite low CapEx, if you look at the pure CapEx around 1%. It fluctuates a bit, but not much and that's been enough for the business. We don't see other than the investments that we're making for CapEx in terms of optionality in manufacturing footprint, which is already included in the actuals and continues on that speed to be major differences.

And in M&A, we are then, if opportunities come to consolidate to these bolt-on acquisitions and good opportunities that we want to continue, lately we've actually had quite a lot of positive opportunities there. Market looks promising, but that's of course a choice that we make based on what's available.

Philippe Delorme

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

A

And value creation.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Yeah. Yeah, definitely.

A

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Excellent. Thank you very much. And if I can follow-up – not a follow-up, the second question will be on Modernization...

Q

Philippe Delorme

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

On what?

A

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Would you be able to comment what – on Modernization, please.

Q

Philippe Delorme

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

Yeah.

A

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Would you be able to comment what volume and pricing developments separately are you seeing in China Modernization market? And whether you think Modernization will continue to be your most profitable business in China over the medium-term and the long-term?

Q

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Yeah. Maybe I'll take in the reverse order, the questions, because I think Philippe will want to comment on the Modernization opportunity, which was the first part. So, it – Modernization continues to be the most profitable business we have in China, and more stable business in terms of profitability while it is growing.

A

And then from a unit and price perspective, that's something that I very seldomly comment when it comes to Modernization, because there's so many things in Modernization. So, starting from parcel modernization, more full replacement of elevators. So, it makes less sense. On a pricing environment, of course, China continues to be quite competitive overall, but in Modernization, I would say that the pricing environment has been more stable definitely than in NBS lately. But maybe, you want to comment on the Modernization.

Philippe Delorme

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

Just bigger picture context, which is there are 10 million elevators in China, out of 25 million in the world, of which in China, 1.2 million are more than 15-year-old. These 1.2 million elevators by 2030 will become more than 3 million. So, you make the math of the unit number growth, and you look at how the is being addressed. There's ample opportunity for everyone.

A

We think China actually will also be a market where the agility and the capacity to respond to real customer needs will be tested. In that context, we believe Chinese being very pragmatic and maybe being a bit more ruthless on cost, partial modernization would be more important. And we think that we actually on that front have a pretty good way of addressing the market, which may be explain why we have been so consistent to delivering modernization well in China.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Hey, maybe, Vlad, I could still summarize my answer, because I realized that I was quite lengthy. So, we talk about China margins overall have come down and are below group average. That's the comment we made earlier. But it is not because of Modernization. That margin is stable, it's because of NBS both the volume as well as the profitability coming down. Just to be clear.

Philippe Delorme

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

A

Good catch.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Excellent. Thanks very much for all the details, gentlemen.

Philippe Delorme

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

A

Happy to do so.

Operator: Thank you very much for your question, sir. I'm sorry to interrupt you, sir. Our next question will be coming from Miguel Borrega calling from BNP Paribas. Please go ahead. Your line is open.

Miguel Borrega

Analyst, BNP Paribas SA (London Branch)

Q

Hi. Good morning, everyone. Thanks for taking my questions. The first one just around China. I remember you having very strong order growth in Q4 of last year. When would you expect that to flow through the P&L? Since China sales over Q2 and Q3 are still down 20%. So, would you [ph] still dare (00:35:34) to come through over the next coming quarters and to boost growth in China, or not really?

And then, I can ask the second question. On the full-year guidance, you mentioned the reason for the cut was an increasingly difficult China market, but the reality is, the cut is the same as the bad debt provision in Q3. So, in other words, have you changed your expectations for Q4? Thank you very much.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

That's a good question. Yeah. So, I'll start with China orders development in last year and what we see in deliveries. And I will – so, China market is very dynamic and what we see is that order book rotation is slowing down and that's been consistently happening now for some time. But equally, we are selective and prudent, focusing on cash.

So, as customers place orders, we do continue to make checks during the time of getting to the delivery to manage credit risk. And in some cases, more cash basis, but in most cases, in – you need to make prepayments before we deliver. And as the liquidity is constrained, then, of course, that slows down further or makes us more selective in which orders we're delivering.

So, there's a maybe less correlation than in the past on this order rotation as such.

Philippe Delorme

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

A

And that's where prudence is, and it could be apparently impacting our P&L. But we are back to the square rule of cash versus kind of visible short-term volume that actually would not deliver cash. So, I think this point of behavior is very important and we are very, very attached to it.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Then the second part was that, hey, why and how did we change, and what the impact is on the fourth quarter? So, of course, there are many moving parts in the business. And this time it happened to be similar numbers. And clearly the driver for the – cutting the top end of the guidance range was the continued weakness in the NBS market. But I would not have direct causality on how you proposed.

Operator: Thank you for your question, sir. We'll now move to Rizk Maida of Jefferies. Please go ahead.

Rizk Maida

Analyst, Jefferies International Ltd.

Q

Yes. Thanks for your time and for taking the questions. I have two and I'll take them one at a time. So, maybe just on, so, again on China, I know it's a smaller part of the business, but sorry to come back to this. Price mix drop in excess of 10% in a quarter where you've actually underperformed the market when it comes to volumes, I rarely see sort of this sort of situation. I think this downturn compared to the previous ones, I think you always said that your competitors have actually less levers to be more aggressive on pricing, because, you know, they're not making as much margins as they've done before. Can you just maybe talk about this overall sort of pricing dynamics?

And just maybe to link this with the previous question, we've seen it in other markets when new equipment becomes weak for an extended period of time, we see price deceleration spreading into other segments, maintenance and modernization, what makes you think is not going to happen this time?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, if I start and then maybe you continue it from there. So, I would – and I've said this before, that on orders particularly, single quarters can fluctuate. And if you look at the nine months of the year, the picture in terms of us and the market is much more stable as a result. So, in single quarters, we can be above or below the market development in terms of volume. But your comment in terms of price pressure in the market and also mix contributed negatively. So, it depends what's being constructed, and now it's more the low end. So it is true. So, it is a very competitive and challenging market right now and that's very visible in our orders received for – in the quarter.

Then on the pricing pressure. In China, it's been always the most competitive market when it comes to pricing across all businesses. Of course, in the past, the NBS business has been the larger part of our commentary because of its size. But now increasingly we see impact of Services and Modernization as they're growing fast to be part of the commentary. And both businesses have always been competitive in pricing. But I think from a pricing pressure perspective, we've seen more stability in those two businesses so far.

Philippe Delorme

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

A

Maybe to illustrate, I was mentioning on Modernization, the fact that we are, on partial modernization, talking about smaller projects. Given the size of the opportunity in Modernization, there is less – there are less people. I mean, people in context of market tension will tend to look at the big price. And actually, when you go after the smaller project where there are less people watching, and it's also more about customer intimacy, where we have actually a pretty large service base that allow us to have those leads on this elevator that's kind of getting old and there is a partial modernization opportunity where actually we have the service contract, we have the relationship. And therefore, the competitive intensity is less.

Now, I think, Ilkka said it, it's a competitive market. And on your point on the NBS and orders and so on, we are clearly given the market trend and the liquidity tension. We are being more intentional with our team to say we want to put somewhat of a floor on our profitability and will privilege profit to volume. So, we are adapting our self in market condition with again prudence and cash as the guiding principle, to make sure that we protect the interest of the company.

Rizk Maida

Analyst, Jefferies International Ltd.

Q

Thank you very much. This is very helpful. The second one – and again, thank you for giving us a little bit of early comment on 2025 because that's really the main debate, I guess, for us this morning. Just maybe if I could ask you on some of the items in the EBIT that you actually know from today – I know you don't have a crystal ball on a lot of things, and a lot of things can change between now and then, but can you assess or could you give us an assessment of roughly how much savings when you think about those performance initiatives that you talked about, you estimating to achieve basically next year?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

So, first, I think we've been now working with a new strategy, about three or four weeks...

Philippe Delorme

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

A

Long time.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

A long time. No, but seriously speaking, of course, we have been preparing for this, but it's not been out there within the company or externally for a long time. So, there's a lot of work we need to still do to both. We know what we want to do, but how we do it and how quickly can we get it done. And it always takes time to work, for example, the sales and...

Philippe Delorme

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

A

Yeah.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

...operational excellence, the work branch by branch or region by region through it. So, we expect the savings to be starting towards the end of 2025. And of course, as we mature, we'll give more details about those initiatives in the coming quarters.

Rizk Maudi

Analyst, Jefferies International Ltd.

Q

Perfect. Thank you.

Operator: Thank you, sir. The next question will be coming from Klas Bergelind of Citi. Please go ahead.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

Thank you. Hi, to Philippe and Ilkka [indiscernible] (00:43:55). I was a bit late on the call, so maybe you've covered some of this already. First on the Modernization business in China. It's the best margin in China at the moment, but we're hearing of incremental price pressure also in Mod. You've obviously done a great job in improving the Mod margin since 2020 for the group. You want to improve it further. It would look like – it's sort of a pretty good step up, if China is obviously with that €1 billion of growth ambition that you had Philippe, if this margin will be under pressure, or do you think you can keep the margin there at the current level in China Mod, despite a very competitive market? That's my first one.

Philippe Delorme

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

A

Well, I guess there is a lot – on Modernization, I think we tried to explain that in the Capital Market Day, but there are two types. There is one which is a full modernization, which, the attribute of that business are not too far from NBS from new construction. And then the partial Mod. I think in both, but especially in partial Mod, we want to standardize and come with this concept of [ph] pixel kits (00:45:02) or whatever you call it, but go with very standardized value proposition that takes a part of the value proposition of the full modernization, but make it stand out.

And by doing this, we believe we can execute better, be actually more cost-competitive, more replicable, and therefore, hold our margin to – I mean, be easier to sell for our sales force, and therefore, be more efficient from a cost standpoint, but from a cost to deploy standpoint. And I think also on pricing here, having in mind that these – the smaller project are indeed, they are a lot linked with customer intimacy and so on, for us to be able to evidence a value-based pricing is probably also an opportunity in China and outside of China, where we've not totally maxed out our potential.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

And I already, Klas, if you were late, I was expecting your question, but now it's here. I already commented to a question that, in our decline in margins in China is not because of Modernization. It's because of NBS volumes

and margin coming down. And despite China always been challenging on pricing, we've seen more stable margins in Modernization side and pricing supporting that.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

Yeah. And this is a good – Philippe, this is a good bridge into my second question on Modernization and the offering. You made a very good impression at the Capital Markets Day that you – or at least I felt that you're relatively unique in terms of the increased standardization, partial modernization, all these kits. There are some peers though, that are reporting very strong growth, it's very similar to you this quarter. And are talking about [ph] that they've introduced (00:46:48) these standardized kits also into the market.

So, could you just remind us again – and you were leading in the whole sort of standardization and equipment 20, 25 years ago, I think you have a strong position. And [ph] I was (00:47:03) curious to hear your sort of USP versus some of the competition out there on the Mod business. Thank you.

Philippe Delorme

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

A

Not sure I get the question.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

So, how do you compare us...

Philippe Delorme

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

A

And rest of the competition...

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

...in terms of modularity and modernization. Maybe, hey, one...

Philippe Delorme

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

A

Yeah.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

...if I may, first. So, I think it's good to remember, if you remember the blue dot and the huge box of pink around it, that there's ample opportunity. None of us are modernizing, or the industry as such is not modernizing nearly enough. And of course, there's a competition, but it's also a demand generation. So, it's a bit of both. And the main opportunity for us is actually to generate the demand. But maybe you want to comment on.

Philippe Delorme

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

A

Yeah. We rarely comment on competition, so I suggest you challenge them on that one. But what's clear is that this modernization transformation has not started this year. It has started actually many years ago. And I think we

got momentum because we've been working on it for quite some time. And really, where I've seen some acceleration is more on the partial modernization, where I mean, we are always watching competitors. We do believe that actually we are doing pretty well here. But I think we could do better. And we could – we should do better.

So, we are doing well, but we are – the reason why we make it a shift and say it's a big priority is actually we think we can be even more focused and even better and we are determined to be better.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

Thank you.

Operator: Thank you very much, sir. We'll now move to Nick Housden of RBC. Please go ahead. Your line is open.

Nick Housden

Analyst, RBC Capital Markets

Q

Yes. Hi. Thank you for taking my questions. They're both on the Service business. Firstly, how much did M&A contribute to the 9.6% Service growth in Q3? And then secondly, can you just comment on whether you're seeing any pricing pressure on Services in China, and maybe just quantify that for us. Thank you.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

So, in the Services growth out of close to 10% growth, our unit growth was roughly 7%, including M&A. M&A had positive impact, but still the organic growth was the main driver for the growth. And then to China. So, of course, the market continues to be challenging from a pricing perspective, as I said earlier. But I think from our perspective, the Service prices have been definitely more stable than we have seen in, for example in NBS business. So, yes, there is pressure because the economy is weak. But we can also have been able to sustain quite well the margins.

Nick Housden

Analyst, RBC Capital Markets

Q

Okay. Thank you very much.

Operator: Thank you very much, sir. We do not appear to have any further questions at this time. And I'll turn the call back over to Sanna for any additional or closing remarks. Thank you.

Sanna Kaje

Vice President- Strategy & Market Intelligence and Interim Head-Investor Relations, Kone Oyj

Thank you. Thanks, Philippe. Thanks, Ilkka, and...

Philippe Delorme

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

Thank you.

Sanna Kaje

Vice President- Strategy & Market Intelligence and Interim Head-Investor Relations, Kone Oyj

...thank you for all of the great questions again. And if there's any more questions, please reach out to us at Investor Relations. But with that, I think we're ready to close. So, have a lovely rest of the day.

Philippe Delorme

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

Thank you so much.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Thank you.

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