

02-Feb-2022

**Kone Oyj** (KNEBV.FI)

Q4 2021 Earnings Call

## CORPORATE PARTICIPANTS

**Natalia Valtasaari**

*Head Of Investor Relations, Kone Oyj*

**Henrik Georg Fredrik Ehrnrooth**

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

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

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## OTHER PARTICIPANTS

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

**Andre Kukhnin**

*Analyst, Credit Suisse Securities (Europe) Ltd.*

**Lucie A. Carrier**

*Analyst, Morgan Stanley & Co. International Plc*

**Miguel Borrega**

*Analyst, Exane SA (United Kingdom)*

**Rizk Maudi**

*Analyst, Jefferies International Ltd.*

**Nick Housden**

*Analyst, RBC Europe Ltd.*

**Alexander Virgo**

*Analyst, Bank of America Merrill Lynch*

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

**Manu M. Rimpelä**

*Analyst, Nordea Bank Abp*

**Tomi Railo**

*Analyst, DNB Bank ASA (United Kingdom)*

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## MANAGEMENT DISCUSSION SECTION

**Natalia Valtasaari**

*Head Of Investor Relations, Kone Oyj*

Good afternoon, and welcome to Kone's Fourth Quarter Earnings Call. I hope everybody is being keeping safe and well. My name is Natalia Valtasaari, I'm Head of Investor Relations here at Kone and I'm joined here today by our President and CEO, Henrik Ehrnrooth; and our CFO, Ilkka Hara. As usual, Henrik will start by going through the key developments in the quarter, business financials and markets. Ilkka will then dive a bit more deeply into the financials. And Henrik will finalize by going through the business outlook and the market outlook before we go into your questions and answers.

So, Henrik, I guess with that, please.

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**Henrik Georg Fredrik Ehrnrooth**

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

Thank you and welcome, everyone. Pleased to see all of you. I'm very happy to present the results for 2021 and Q4. We all know that 2021 was quite an unusual year. With that context, I'm actually very pleased with our performance last year, how we were able to perform in what was actually quite a challenging environment.

Some of the highlights for Q4. Orders received now reached again this high level of last year, which were actually very strong, so we had a good comparison point and got to that level again. So that was good. We had an excellent development in our Services business, that's something I'm very pleased about, I will talk also more about today.

We all know that the supply chain environment remains very challenging. We are making good progress in offsetting actions, I will talk more about them today as well. Also highlight is that our Board of Directors had today post the AGM, a dividend of €1.75 plus an extra dividend of €0.35, so €2.10 in total. So, another strong payout.

As usual, let's start with our key figures for Q4. We had a very solid development in the quarter. As I mentioned, orders received in comparable currencies got to the good level of last year at close to €2.2 billion.

Our order book is at an all-time high at over €8.5 billion and grown 3.8% year-over-year. Our sales was now just shy of €2.8 billion, 1.8% growth in comparable currencies, and our operating income declined by 4.5% – 4.1% to €352 million. Our key performance indicator, adjusted EBIT declined by 5.6% to €359 million and the margin from 14.5% to 13%. So we can really see now that the impact, as we discussed of the supply chain environment is having an impact.

Really the highlight was our extremely strong cash flow once again, at €525 million, super strong. It really shows that we continue to run the business with very good discipline. So that's something I'm very happy about.

EPS at €0.53 compared to €0.55. Now, as we all know, one quarter is very short period of time, and now, we have a full year behind us, so we have a little bit longer perspective. Overall, we had a good year. Orders received grew at a good rate of 7.4% and reached over €8.8 billion. Our sales, we had a new important milestone, our sales exceeded €10 billion for the first time, it was now €10,514 million and grew 5.3%, which I think is good growth in this environment.

Our EBIT – or operating income grew to €1,295 million and our adjusted EBIT grew by just under 5% to €1,310 million and we could see that the margin, we had a very positive development beginning of the year and then the supply chain environment had an impact second half so margin down 0.1 percentage points for the year. Full year cash flow close to last the prior year's exceptional level, I would say €1.8 billion is extremely high, so very pleased about that. And earnings per share of €1.96, so 8% growth in EPS.

Now as I mentioned already, 2021 was an unusual year because of supply chain challenges, because of increase in material costs and so forth. What I'm very pleased with is that we were constantly able to deliver on our customer promises, that's of course critical. Our teams throughout the organization have done a phenomenal job in being able to find solutions to headwinds that we've faced and just being doing an extraordinary job, so I could not be happier with the team's performance than I am and huge thanks to everyone there.

Now, that's our summary of our performance. And then our dividend, as I mentioned in total €2.10, €1.75 plus €0.35 gives a good yield overall, 2.8% based on the share price at the end of the year, and the ordinary and the total dividend 3.3%. So continuous strong payout, this is almost €1.1 billion in total. So, I think that is a very good dividend again.

Now, the way we measure our performance on a longer term basis is through our five strategic targets. That is how we measure whether we make progress in our strategy. And we can see many good areas here. Great place to work, continued high employee engagement, clearly above the high performance benchmarks. Most loyal customers target; very nice, again, improvement, in our Net Promoter Score. So we have a multi-year

improvement here. Faster than market growth, in our Services business we had market-leading growth again, particularly in maintenance business we have the market-leading growth in the maintenance business, and I'll talk about that more today.

In new equipment, we grew in number of units about 9%, which I would say is probably slightly higher than the market, but we're still looking more in detail into that, perhaps where we had the best performance in market share was North America, some parts of Europe and in countries like India.

Best financial performance, our fourth target, it's clear that we are not happy with the development of our EBIT margin. We had a target of improving that. It's clear that there it's being burned, so that's something we are taking very strong action, very high focus for us. At the same time, exceptionally strong cash flow second year in a row, I think that is important and something to put really focus on.

Leader in sustainability, this is not the new thing to us. We have had this target for well over a decade and that's why we have good development here, we have continued to improve our carbon footprint, and we had also improvement in diversity inclusion last year, so we continue to get lot of external recognition for our performance in sustainability. This is not something that is a short term action for us, as I said, we have been developing this for decades already and now doubling down on our focus here.

So that's about our longer term performance. But we thought that we have put a lot of effort into innovation in our Services business over the past years. And we can see that it's paying off. We have innovated a lot when it comes to service offerings, technology, ways of working and business models. And we can see that that is paying off. That's why we have particularly in maintenance the market-leading growth, that's very clear.

What is of course always important to a maintenance business to have a strong new equipment business to feed the base. Last year, we sold 196,000 elevators and escalators, up about 9% year-over-year, it's a good improvement again. Our service base continued to grow about 5%, and was just shy of 1.5 million units. So, when we look at our revenues in maintenance, it was clearly higher than this because of pricing actions, because of value-added services, there we don't see others really doing it that way, but our value-added services is actually driving growth for us. It's a commercial thing. So, both of those are doing well and very good development in modernization again.

China, clearly a focus area. We know that that's where the highest growth area is. And we continue to grow faster than market there as well. 24/7 Connected Services, and now we talk about penetration, we're not only talking about connected units that's much, much higher number, but these are number of units again where [ph] we are commercial contracts (00:09:20) customers are paying for this service. And this I don't think anyone is close to having this many commercial contracts. And it really shows the value that we are providing.

One of the ways we have been driving our growth in our maintenance business has been through our KONE Care offering. I think many of you remember when we launched it back in 2016, started – rolled out in 2017, how we provide much more adaptability to our customers. It's really been important for growth and for pricing. So it really show you the direction than in terms of offering.

Now end of last year, we launched a next stage of this, we call it KONE Care DX, it is for our DX class elevators, the market's first carbon-neutral maintenance and of course fully connected service and through AI improving the experience of our customers and service outcomes. So again, taking the next step here. So this is just a highlight of how innovation has been driving constant improvement in services, both maintenance and modernization and that's of course something we continue focusing a lot on right now.

So that's about Kone's development. Let's talk a little bit about market. Of course, what is important to market is how people are moving around, how elevators are being used. You can see the same data we've now been showing for almost two years during the pandemic. We can see that elevator usage has recovered throughout this year. And that's something we expect to continue. Of course, there's always a little bit seasonality in this.

What is actually interesting when you look on the right-hand side by segment, at first of all, people are moving a lot in and out of their homes, that's usual. However, a lot of people have declared that brick-and-mortar retail is dead. Our data shows something different. Look at this picture. Actually, we are at or above pre-pandemic level in number of elevator starts, i.e., usage of elevators in retail establishments. So we can see that people are back. And I think this is very positive also for our customers in these segments. So this gives us confidence for services, both maintenance and modernization, again, for the coming year.

So then what did happen to the markets in Q4? New equipment markets developed positively in most parts of the world, strongest development in North America and Asia-Pacific outside of China. So good growth in North America, slight growth throughout Europe, Middle East, and Africa. The Chinese market was now stable, which actually I think is a good level given the uncertainty in the market, and we'll talk, of course, about outlook soon as well. And rest of Asia Pacific was very strong. So good recovery throughout Southeast Asia and India.

Service markets, they are very positive. Maintenance markets are continuing to grow as they've done many years. So slight growth in the mature markets and continued good growth in Asia Pacific [indiscernible] (00:12:38) modernization, lot of growth again in Q4 there in all parts of the world, particularly in North America and Asia Pacific. So – and we have captured this growth in a very nice way.

So what about China? As I mentioned, the market was stable year-on-year, and pricing environment continued to be very intense, very strong competition in the market. Ilkka will talk more about pricing, but I think it was important [ph] go-to-market (00:13:11) was stable.

If we look at the total property markets, we can see that macro momentum is slowing overall in the economy, and the financing environment remains extremely tight. So the liquidity restrictions are clearly having a big impact on property developers. At the same time, we can see that towards the end of the year and our beginning of the year, [ph] has already started (00:13:36) taking a more balanced approach to tightening and actually to some easing measures. And we think that that's probably going to – we're going to start seeing that later this year.

And we did see in Q4, of course, the real estate investments, sales volumes and new starts did decline. So that's going to have an impact in the first half of the year, we think the second half is going to be stronger, and I'll talk about that more in detail in the outlook. But if we compare where we are and compare to pre-pandemic levels, I think we're actually still – the markets are at a good level overall.

So that's about our development in the market, and I'll hand over to Ilkka for – talk a little more about our financial development.

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## Ilkka Hara

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

Thank you, Henrik, and also warm welcome on my behalf to this fourth quarter and full year 2021 result announcement webcast. I'll go through our results in more detail from a financial perspective. And I have a good news to share. We've made continued good progress in many fronts in the business.

First, starting with orders received. Orders received for the fourth quarter were at €2,155 million. On a reported basis growth of 4.2%, on a comparable basis growth at 0.4%. It's good to note when comparing our performance that we did book last year in the fourth quarter, a very large order in the modernization business in North America, which is impacting the comparable period. And if I look at our performance – underlying performance, we saw very good performance in Asia-Pacific, North America, as well overall in orders growth in Europe, Middle East, Africa, and also more stable development in overall orders in China.

When we look at the new equipment particularly and especially the important China market, we saw our orders in both units as well as in monetary value declining slightly. And there, we did see mixed, contributed negatively. At the same time, pricing was stable for us, which in the competitive market landscape is actually a good result from my perspective.

If you look at the pricing overall, which has been the focus for us now in this increasing cost environment with an increasing inflation around us, pricing continues to develop positively. I would call out, particularly, our business in North America, as well as in Europe, where we're seeing good continued progress in improving pricing, as well as Asia Pacific, where we start to now see improvement on the pricing front as well.

Then as a result, when we look at our orders received margins, while they declined slightly year-on-year, we now see as a result of the pricing actions, the product cost actions, as well as productivity that is actually improving sequentially. So, our orders received margin from third quarter to fourth quarter is improving. And to me, that's important, that's a leading indicator of the progress we're making on [ph] countering the (00:16:58) cost inflation that we've seen.

Then looking at sales, sales for the quarter was €2.7 billion, growth of 5.6% on a reported basis and on a comparable basis 1.8% growth.

Geographically, we saw 1.1% decline in Americas in sales, in both Europe, Middle East, Africa, we saw growth, as well as in APAC, growth of 1.3% for Europe and for Asia, growth of 3.6%.

Then from a business perspective, new equipment declined 1.1% against previous year's fourth quarter, modernization was more stable. But to me, one of the highlights of the results this quarter, again, is the performance we see in maintenance. Henrik talked about the units growing close to 5% but in sales we grew 7.7%, it's very good performance. There we see contribution also from our new service and solutions such as 24/7 Connected Service contributing positively, as well as pricing which I would say that the best opportunities we've seen in pricing are actually in the maintenance business, also now visible in our revenue growth.

Then to adjusted EBIT development. For the quarter, our adjusted EBIT was €359 million and our adjusted EBIT margin was 13%, down from 14.5%. While we actually saw very good improvement in productivity, good development in service is contributing positively to our profits and profitability. In the fourth quarter, as highlighted earlier, we saw also our increased component and logistics cost impacting more. So, for the quarter, the impact was €75 million, clearly we were successful in delaying the impact of increasing costs in the first half of 2021, now in the second half and particularly in fourth quarter more visible in our results as well.

A few words about that. So, first, when we look at our supply chain, what I'm very pleased we've been able to deliver the customer needs very well throughout the year despite the constraints, especially in logistics and the semiconductor and certain – and also on the component side. And to me that's important, that's something that we will see the value of in the coming years as well with a good response to our customers delivering to their needs throughout the year.

But if I look at three components, we've seen overall a cost impact of €200 million now in 2021 as expected and we expect that headwind to continue also in 2022 of approximately €100 million to €150 million.

Material prices continued to be on an elevated level, although slightly down from the peak levels but as we've talked about this when prices are going up, we can delay the impact. Now we continue to see that especially in the first half of the year, as the comparison point is a lower one. Increases in semiconductors continue to be an issue, both the costs have increased, but also the availability continues to be tight. And we expect during 2020 also that to continue for most of the year, as well as the logistics cost to be on the higher level.

But what are we doing about it at Kone? We've actually seen good progress in our product cost actions and our actions to improve productivity, part of that already visible in fourth quarter, and we expect that to continue and we see those actions having good traction.

Also, pricing, I already talked about, we are moving to the right direction. We just need to do more to counter the inflation, and we are on good track on that. But how are we able to do it? It's all about differentiation. So our new service and solutions are one way for us to differentiate. But also, for example, our DX Class elevators, the DX maintenance and so on are the new service and solutions that enable us to differentiate and have the capability to improve our prices. Actually, from my perspective, we are progressing well here.

Then lastly, to cash flow. And frankly, to me, this is the highlight of the results for last year. €1.8 billion, €525 million is a very good number. Working capital continued to develop positively. And what I would highlight throughout the year and particularly now at the end of the year, the good work we've done on collections contributing positively onto our working capital, so very pleased to see this development for the full year.

But with that, I'll actually then hand over to Henrik to talk about market and business outlook.

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## Henrik Georg Fredrik Ehrnrooth

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

Thanks, Ilkka. So outlook for overall markets for 2022, and let's start with new equipment markets and with China. So in China, we expect the markets in 2022 to remain at a solid level, although below that of 2021, because of the tighter liquidity and the situation we all are aware of. What does this mean in practice? It means that we are going to be down mid to high-single-digits and in practice, it means that the market would be at an equivalent level in number of units to where it was in 2019, and 2019 was [indiscernible] (00:23:11) not a bad year, actually it was a good year. So therefore, we expect markets to be solid and at a good level. As we all know, they've recovered very strongly, growing actually very strongly post-pandemic there. In the rest of the world, we continue to expect markets to continue recovering, which is positive, so good opportunities there.

Strongest growth continues to be in the modernization markets where we expect to see growth in all regions. And maintenance markets, those we expect to return to a pre-pandemic growth trajectory, with slight growth in the mature markets and good growth in Asia Pacific. So same good opportunities as we're seeing there for many, many years. So overall, I would say that the market backdrop for this year is a positive one.

Business outlook, we expect that our sales this year to grow at a good rate between 2% and 7% in comparable currencies. Our EBIT, we expect that to be in the range of €1,180 million to €1,330 million. That, of course, again assumes that foreign exchange rates stay about at the level where they've been in January, then we're going to have a slight tailwind from currencies. But this is a range that we see for this year.

We have a number of positives that continue to drive a very good performance, very solid order book, as you know, it's all-time high level. And we expect a continued good outlook for services and strong performance there. Ilkka talked about the actions we are taking on product cost, productivity and pricing. And we're starting to see good development here. So we expect these to start to have an impact in a positive way towards the latter part of the year on our profits.

As we know, there are also a number of things that are burdening our result, headwind from material component logistics has so far will continue to be high. Last year was roughly €200 million. We see another €100 million to €150 million this year. But remember that in the first half last year, we didn't have much of these headwinds, most of them in the second half. Now, therefore, we're going to see beginning of the year quite a lot of headwind from this. And clearly also the competitive dynamics and liquidity constraints in China have an impact on our outlook and results.

Overall, the good thing is that there's a growth outlook and [indiscernible] (00:25:52) has achieved a lot of things. So that's a positive thing.

So to summarize, continued positive outlook in services, both markets and our own business. We expect that markets are growing in new equipment in all markets, except for China, and also China to be at a solid level although somewhat down. We are making progress in our actions to offset the supply chain constraints or the additional costs that we have. We need to continue, but at least we can see that we are in the right path and sequentially we were able to improve the margins by orders received.

And what is, of course, important to us is we continue to innovate, drive long-term growth and differentiation through value-added services and solutions, very active innovation agenda. We actually have a very interesting year ahead of us from that perspective, so we continue to invest heavily in how we add value to our customers, how we improve our business, and that's something I'm very happy about. We talked more about the impacts it had in our service business so we can see clear results of the actions we've taken over the past years.

With that, we are ready to move over to your questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] We'll take our first question from Klas Bergelind with Citi.

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Thank you. Hi, Henrik and Ilkka, it's Klas at Citi. So, first, a quick one for you Ilkka, I'm trying to understand the exit margin better. From the balance sheet it looks like there was a provision release in the fourth quarter. How much was that exactly and impacted the margin year-over-year and what does it relate to? And I'm trying to understand if this was an FX effect or if that is a clean number which seems to be €12 million, so I will start there?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

I don't think we had anything out of the ordinary in fourth quarter from a provision release point of view. So that's really not a big problem...

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

All right.

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

...for our margins in the fourth quarter.

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Okay.

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Just normal ups and downs in [ph] service (00:28:27) provisions, but nothing particular...

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Okay.

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

...that I would highlight.

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Then onto my real question. So the second one is on [indiscernible] (00:28:38) out of the backlog. And a good to see that the price cost is improving on new orders. But I'm still a bit curious to understand what happened out of the backlog regarding €150 million – €100 million to €150 million of cost inflation before wages, which was roughly what I had. But then the margin at the midpoint is below me, and I was pretty cautious ahead of numbers. So that suggests the pricing was much weaker out of the backlog, considering that you're getting costs not far from me. We know that the China pricing that was flattish on orders, you gave us that. So that must mean that pricing in Europe and Americas was pretty weak, a bit surprising to me. So can you elaborate on pricing Henrik on the new order – on the orders you took throughout 2021?

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**Henrik Georg Fredrik Ehrnrooth**

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

A

Okay, I will provide some context, Ilkka can provide some more details on this. Yes, remember that, for example, I do remember that in Q3, we did say that the margins of our orders received declined. And that's of course what we are then delivering in the first half of the year. So then now in Q4, the impact was more positive, which we'll then have impact on the latter part of next year. So that's, I think, consistent with the timing that we have been talking about.

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**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Maybe to add Henrik's comments, so it's good to note that if you look at our orders development before third quarter, clearly, especially in second quarter, we didn't foresee all the cost increases, so they start to more and more increase throughout the year. So if I look at our orders received for the full year 2021, the margins are down for those. So that's something where the assumptions that we had were more positive at the time when we comment those. And that's the [indiscernible] (00:30:27) the first beginning of the year in 2022 and then easing off towards latter part of 2022.

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**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Yeah. And I'm just thinking given that the cost guide in the P&L is not far from me. And it seems like the underlying drop through then is considerably weak, in particular for the first half. But okay. Then on the – my third and final one is on the China guide. And, Henrik, I noted you said somewhat lower. But when I spoke with Natalia this morning, I sensed mid-single digit to high-single digit down for China unit terms. And I know from one of your peers they said down 5% to 10%. So just want to clarify that and maybe following up on pricing as well, flattish when the market was pretty solid. When the markets falls, it feels like pricing could be down somewhat. What do you think there, Henrik?

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**Henrik Georg Fredrik Ehrnrooth**

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

A

So, first of all, I think what Ilkka also has said mid to high-single digit is what we expect the market to decline. And if that happens, we're going to be at an equivalent level to where we were in 2019. So, that's about where we see Chinese market and particularly more challenging first half and slightly better second half is our outlook at the moment.

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**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Pricing?

**Henrik Georg Fredrik Ehrnrooth**

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

A

Pricing – sorry, pricing in China, yes. Pricing in China, it's – we all know that Chinese market has been very, very competitive both domestic players and also international players. I think that the fact that we're able to keep stable pricing and with the cash flow that we had was a good achievement. As you know, we don't comment on pricing going forward. We know that the international competition will continue. So, we just have to see what the development is then going forward. I think our targets are pretty clear.

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Very, very quick, final one, in your China guide, mid to high-single digit down, do you assume any incremental stimulus from – in China in that number?

**Henrik Georg Fredrik Ehrnrooth**

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

A

I would say perhaps that restrictions won't be quite as tight as they have been up until now.

**Klas H. Bergelind**

*Analyst, Citigroup Global Markets Ltd.*

Q

Thank you.

**Operator:** Our next question comes from Andre Kukhnin with Credit Suisse.

**Andre Kukhnin**

*Analyst, Credit Suisse Securities (Europe) Ltd.*

Q

Hi, good afternoon. Thank you very much for taking my questions. Can I start just with a kind of broader question on your new equipment profitability, business profitability? Just looking at the kind of up to €300 million of raw materials and logistics inflation that you're incurring and most of that is a new equipment, so just around 400 basis points plus impact, which together with initially sort of starting point being around mid-single digit in mature economies, presumes that takes your new equipment margin profitability down towards zero and takes China down meaningfully as well. So just wondered if you could comment on whether you view that as a structural situation going forward, given that the industry saw raw materials and substantial inflation in spot prices, didn't respond to straight away with own pricing. Now there is a response, but not as much traction in China. So I just wanted to check if you see that as structural going forward or do you see scope for new equipment profitability to recover back to kind of mid-single-digit level in mature world going forward?

**Henrik Georg Fredrik Ehrnrooth**

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

A

We haven't given views on what the profitability is on new equipment business. It continues to be a good business even at these levels, but not quite as good that it was before. So clearly margins are down. There's no question about that. We've taken a lot of actions to offset this, so we don't think this is structural. At the same time, we haven't quite increased prices and got the productivity and costs to a level that would offset. But we are making progress in that direction, and that's clearly a very high focus area for us in the coming year. We don't think it's structural, but we have to see how the markets develop and I think we've shown many times that when we put our mind to something we can usually make some impact. And that's what we're trying to do here as well.

**Andre Kukhnin**

*Analyst, Credit Suisse Securities (Europe) Ltd.*

Q

Thank you. And if I may, a couple of just smaller questions. In terms of pricing components for 2022, if we put the service side aside and look at the new equipment only, you've clearly communicated on China being stable with maybe negative mix. But on Europe and North America and Asia Pac, ex-China, what kind of price increases have you been able to achieve in those geographies, kind of rough ballpark numbers?

**Henrik Georg Fredrik Ehrnrooth**

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

A

Do you want to comment on that?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Yeah. First, I just wanted to clarify your question. So, when I comment pricing or we comment pricing, we talk about history, the orders that we booked not forward-looking, but naturally I guess you are asking then what the impact has been to deliveries. But from pricing perspective, for the orders now, particularly in the fourth quarter, so we see good low single-digit improvements in the prices, especially in Europe and North America.

So that's some percentages up in terms of prices. And as said, now, we're starting to see that also in Asia Pacific. China has been more stable throughout the year. So, clearly there, I think that's been something where both pricing as well as payment terms have been the focus on. Especially in the payment terms, I think we've done very good job on top of the pricing that has been stable. So that's the way I'd think about the pricing development, so progress, but not yet enough to counter the headwinds from a cost perspective.

**Henrik Georg Fredrik Ehrnrooth**

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

A

And Andre, you said that you focus mainly on the new equipment business. But, of course, pricing, focus, of course, at all businesses and perhaps in this environment where we are, we have been able to improve our pricing as you've seen in our maintenance business over the past many years. This year, we actually see even better scope for that. So, clearly, there's focus on pricing not only new equipment, but in all of our businesses.

**Andre Kukhnin**

*Analyst, Credit Suisse Securities (Europe) Ltd.*

Q

Got it. Thank you. Thank you. I appreciate it. And just last one on productivity, it's something that we talked about quite a bit in the past and you talked about single-digit percentage of either total cost base, so kind of materials plus contracting cost base. And that does imply quite a substantial number on the bridge, it implies easy to over €100 million, but obviously as we go through on a couple of years of history, and if we look at your guide for this year with all components, it just doesn't add up with that sort of level of productivity being achieved and EBIT to be still down €50 million year-on-year at mid-point with plus €50 million from FX. So I just wanted to check on productivity for 2022. Is that somewhat being held back and it's somewhat related to the measures you've undertaken? And, therefore, maybe we should think about single digit for second half revenue as the new orders are being delivered. Or kind of what is the nuance into productivity on the profit bridge for this year?

**Henrik Georg Fredrik Ehrnrooth**

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

A

I would say that if you look at productivity, of course, in our type of industry, it's very much, now we talk about [ph] major field (00:38:26) productivity, installation and service. That's – you get a few percentage points every year, usually don't get big jumps. We have had a good development there, in particular because our quality has developed very positively. I must say that our quality performance has been really, really good over the past years and that's of course, it was fundamental thing that drives productivity. We expect to continue with the steady and good development in productivity. It's I'm going to say, it's of course low to mid-single digits what you can achieve. And now, of course, you need to get several percent of productivity just to offset costs.

Labor costs are somewhat – and, of course, they go up every year particularly in Asia and other markets, but also in Europe, North America, they're going up every year. Now they go up a little bit more, not dramatically more, but little bit more than in the past, so of course, you need to have a bit more productivity to get there. But I must say that particularly on installing new elevators, productivity has been good and I can see a lot of potential in the service business as well.

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**Andre Kukhnin**

*Analyst, Credit Suisse Securities (Europe) Ltd.*

Q

Great. Thank you very much for your time.

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**Henrik Georg Fredrik Ehnrooth**

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

A

Sure.

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**Operator:** Our next question comes from Lucie Carrier with Morgan Stanley.

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**Lucie A. Carrier**

*Analyst, Morgan Stanley & Co. International Plc*

Q

Hi. Good afternoon, gentlemen. Thanks for taking my question. Apologies to go back to the adjusted EBIT guidance for 2022, but maybe if I can break it down. At the midpoint you're looking roughly for 4% compression or about €50 million reduction in your adjusted EBIT versus 2021. You are guiding for net inflation plus FX headwind of about €75 million, and that compares to €118 million 2021 and you're still guiding for what I would call a comfortable organic growth in 2022, which is fairly equivalent to the one in 2021, if we kind of look organically. So effectively, you're kind of – with the positive FX, you're guiding for about €700 million extra sales in 2022, but you expect €50 million less adjusted EBIT.

So I appreciate the €75 million headwind you're guiding on between the inflation and the FX, but it still seemed quite a lot of compression. So does that mean you're not really expecting any operating leverage in 2022? Or is it more mix related because of the weakness of China? Or is it something else? But just trying to make sense of those numbers because so much incremental sales and that level of EBIT contraction is a bit difficult to follow, I think?

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**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Maybe I'll start there and if you have something to that. So the way I would maybe think about it is that from a growth perspective, that is contributing to our profits positively. But then if you look at inflation that you always have in our labor costs and field costs overall, that is slightly higher than normal and also then clearly we have a headwind coming from this increasing raw materials of €100 million to €150 million on top of that. And productivity is able to help us net some of that inflation. But clearly in this environment, productivity, even though it's a bit

higher than we've seen in the past, it's not enough to counter that. Then the pricing that we talked about has a slight positive impact more towards the latter part of 2022 as those orders that we've now booked start to be in delivery. So in that sense, those are the moving parts in the bridge in the broad scale. So, cost inflation is impacting especially the first half of the year as the comparison point was lower in 2021.

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**Lucie A. Carrier***Analyst, Morgan Stanley & Co. International Plc*

Q

Okay. So if I understand well, you kind of put it down essentially to inflation rather than potentially any mix impact, if I'm understanding correctly?

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**Ilkka Hara***Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Yes. So, the cost inflation, particularly in the raw materials, just continues to be a headwind...

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**Lucie A. Carrier***Analyst, Morgan Stanley & Co. International Plc*

Q

Okay.

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**Ilkka Hara***Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

...in 2022 as well.

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**Lucie A. Carrier***Analyst, Morgan Stanley & Co. International Plc*

Q

Okay. Thank you very much. The second question was around your comment around China. And just maybe if you can help us with some unit number for that market, because I think Otis was kind of guiding mid to high single-digit down for the whole of APAC, but they expected as a result, China to be down more. And if we look back to 2019 levels, unless I'm incorrect, I think it was about 570,000 units installed and it looks about 615,000 this year. So, it looks again that double-digit percentage contraction, if we go back to 2019 level.

So, first of all, I wanted to check that with you around kind of your guidance, which is more mid-to-high single-digit negative rather than low double-digit. And then, if I think about that number, how do you expect this to reflect in your numbers? Is that going to be more reflected on the orders, on the sales? Because actually your sales guidance is quite constructive in this case for the other region in that context considering China is about 30% of your sales?

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**Henrik Georg Fredrik Ehrnrooth***President, Chief Executive Officer & Member-Executive Board, Kone Oyj*

A

So, it's clear that what we're delivering in China, of course, a big part, we have in the order book, okay, a big part in China. We need to continue to order. So, of course, the order book is important and that's – they're very solid. We have a very good order book both in China and rest of the world. So then market, of course, have more impact on orders. But then, in orders, we have to see how is market share going to develop. What is the market going to be?

The numbers, of course, we don't have them exactly at times. But when we looked at them, China market, probably closer to 600,000 units also next year. When we looked at our estimates of units during last year, we

don't have exactly the final numbers. But then, going back to 2019, would be somewhere a mid-to-high single-digit decline, depends a little bit to what numbers you have, we may have slightly different one for each of the year. So, maybe that's something that Natalia can follow-up and her team can follow-up with you.

**Lucie A. Carrier***Analyst, Morgan Stanley & Co. International Plc*

Q

Yeah. That'd be great. Thank you. And just maybe my last question on that, so I guess the follow-up maybe was so you expect the impact that you give on China guidance more on the orders rather than sales, if I understand well?

**Ilkka Hara***Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

I guess our guidance is not about orders, we talk about market and then we have a sales guidance, but we do take into account the development on how we see the orders and when we give the sales guidance.

**Henrik Georg Fredrik Ehrnrooth***President, Chief Executive Officer & Member-Executive Board, Kone Oyj*

A

And with the rotation in China, of course, a lot of what we deliver this year, we also need to order this year. But clearly, in a relative sense, order – it has bigger impact on orders. We still see, I mean, I think the key message is, though, which is important is that market at similar level to 2019, 2019 was not a bad year, it was actually a pretty good year, if you remember how we performed then.

**Lucie A. Carrier***Analyst, Morgan Stanley & Co. International Plc*

Q

Yeah.

**Henrik Georg Fredrik Ehrnrooth***President, Chief Executive Officer & Member-Executive Board, Kone Oyj*

A

So I think that's a lot of new elevators are going to be – and escalators can be sold in that environment.

**Lucie A. Carrier***Analyst, Morgan Stanley & Co. International Plc*

Q

Thank you very much. And just the last question was a more around capital allocation. The ordinary dividend is stable. I appreciate you're doing a special dividend, but this is obviously a little bit lower than what you have done last year. And kind of if I look at the overall return, we're looking at €2.10 for this year, it was €2.25, I think, for last year even though your net cash position has kind of gone up and is now nearly €2.2 billion. So how should we understand that kind of capital allocation on that single year where the overall return is actually down year-on-year?

**Henrik Georg Fredrik Ehrnrooth***President, Chief Executive Officer & Member-Executive Board, Kone Oyj*

A

I would say that the way I know – of course, our board has been deliberating on this is that this is a good payout, almost €1.1 billion. So I think we're paying out quite a lot and paying out an extra again. Now, the point is, yes, we continue to have a very strong balance sheet also after that. Again, it signals that we are very ready for opportunities and want to capture opportunities if and when they come in the market. There hasn't been such big

opportunities in past years. But in an environment like this, I think things can happen and then we want to be ready.

**Lucie A. Carrier**

*Analyst, Morgan Stanley & Co. International Plc*

Understood. Thank you very much.

Q

**Henrik Georg Fredrik Ehnrooth**

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

Thank you.

A

**Operator:** We'll take our next question from Miguel Borrega with BNP Paribas Exane.

**Miguel Borrega**

*Analyst, Exane SA (United Kingdom)*

Hi. Good afternoon, everyone. I've got a couple of questions. The first one again coming back to your guidance for 2022. Can you help us understand the trajectory throughout the next year? Your guidance implies basically around 100 basis points of margin contraction, let's call it at the midpoint. So, if I look at margins in 2021, in the second half, they were also basically down 100 basis points. So, are you assuming a bigger contraction in the first half of 2022? And maybe because the whole of the cost inflation headwinds of €100 million to €150 million will fall in Q1, and then you have broadly flat margins in the second half of next year. Just wanted to understand the difference between Q1, which is usually lower than the rest of the quarters?

Q

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

Yes, and thanks for the question, Miguel. From our perspective, so clearly what I talked about in terms of cost headwinds, as well as how the pricing has been evolving more towards latter part of 2021 then impact to profitability would be clearly more in the first half of the year and towards the latter part of 2022 then see recovery in the margins. So, that's the way I would think about it and that's embedded in the guidance.

A

**Miguel Borrega**

*Analyst, Exane SA (United Kingdom)*

Okay. And then my second question is on your free cash flow, you've had quite a positive working capital inflow in Q4, which traditionally is an outflow. Can you give us some color here? You mentioned timing of payments. Is this related to any specific region or order? And can we expect this to reverse next year? Or are you assuming that working capital will be sustainable at these levels?

Q

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

Well, first, I would say that if I look at – for the last couple of years, we've actually had very good cash flow and positive development from a net working capital perspective. And underlying that, there are many actions across the whole globe and businesses that are contributing. So for example, our collection efforts have actually been developing quite positively.

A

There's – I guess, the only thing I would call out when it comes to our net working capital is that, yes, it's true that there were some large payments where the timing is now in the first quarter of 2022 rather than fourth quarter that

impacted positively, but there are always also items that kind of a quarterly basis fluctuate. So, some impact, but clearly I think overall, all the good work is now visible in the cash flow for the last couple of years. So, that's very positive.

And structurally, I think we have very good payment terms with our customers already, so I don't expect those to improve. I think just being able to keep them, and as we talked about in the case of China, we've been quite successful there and in the rest of the world. And with suppliers as well, I think we have pretty good term. So, it's really something that we can maintain a good net working capital from that perspective.

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**Miguel Borrega**

*Analyst, Exane SA (United Kingdom)*

All right. Thank you.

Q

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**Henrik Georg Fredrik Ehrnrooth**

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

I think we know with cash flow there are always timing differences, and cash flow can fluctuate from quarter-to-quarter, but it's very clear that we wouldn't have had a cash flow even close to what we have unless there would have been fundamentally phenomenal work by our teams and Ilkka's team. So it was just – on any measure, it was very, very strong. And again, it shows the focus and discipline that we've been driving in our business. At the same time, we know that cash flow fluctuates from quarter-to-quarter. Now, two years in a row, very strong. I think that was a lot.

A

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**Miguel Borrega**

*Analyst, Exane SA (United Kingdom)*

Thank you very much.

Q

**Operator:** [Operator Instructions] We'll take our next question from Chris – I'm sorry, Rizk Maidi with Jefferies.

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**Henrik Georg Fredrik Ehrnrooth**

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

We're not able to hear you. Are you on mute?

A

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**Rizk Maidi**

*Analyst, Jefferies International Ltd.*

Yes. Hi. Can you hear me now?

Q

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**Henrik Georg Fredrik Ehrnrooth**

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

Yes.

A

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**Rizk Maidi**

*Analyst, Jefferies International Ltd.*

Yes. Sorry. Yes. So thanks for taking the questions. I have two. Number one is can you give us an indication of your China backlog growth at the end of last year? How much of that is should we think about the conversion of that and the phasing of it into revenues this year? And what are you assuming for revenue growth in China this year within the sort of plus two to plus seven? That's the first one? I'll take the other one later.

Q

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Well, overall, if we look at our development of our order book, it is developing positively more than 3% growth at the all-time high. And I think that's all of the areas contributing to that. We did not see – we saw some growth in order book in China towards latter part of the year last year. And that's giving us a good basis then to deliver the revenue growth for 2022. We don't guide particular market-by-market order book development for the coming year. But it is something which is a good thing to have. And in case of China, the order book rotation is actually the fastest. So also we need more orders and for 2022 to get our sales guidance.

**Rizk Maidi**

*Analyst, Jefferies International Ltd.*

Q

Okay. Thank you. The second one is historically you've been kind enough to give us the China business mix between OE maintenance and modernization. Can you perhaps give us an update there, sort of where you were at the end of last year? And more importantly, I think historically you've told us that the China OE margin which came down more drastically since its 2014-2015 levels is still ahead of the group. Can you just confirm that is still the case, please? Thanks.

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

The product mix – our business mix in China, so it's a bit more than 80% is new equipment and then maybe 15% is maintenance and then the rest is modernization. So that is we see the best growth opportunities in China in modernization. So it's growing from a small base and we continue to see a good double-digit growth in the maintenance business contributing to it. So that's the split.

Now, I forgot your second part of your question.

**Henrik Georg Fredrik Ehrnrooth**

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

A

China margins compared to group margins?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

So China margins are contributing positively to our group margins. But as you said, clearly they – earlier, especially if you look at years before we are more positive than they are today.

**Rizk Maidi**

*Analyst, Jefferies International Ltd.*

Q

Okay. Thank you very much.

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

**Nick Housden**

*Analyst, RBC Europe Ltd.*

Q

Yes. Hi, thank you for taking my questions, I have two. The first one is I'm just looking at slide 26 of the presentation. It looks like you underperformed the market in China in terms of new equipment growth. And I'm just

contrasting that to one of your peers who reported earlier this week, who said that they were gaining market share specifically, thanks to large investments in their sales coverage. So I'm just wondering if from your side, you're noticing a higher level of competition in that market?

**Henrik Georg Fredrik Ehrnrooth**

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

A

As we said, that the competition in China has always been very, very tough. In an environment like this, we focus a lot on having a very disciplined business in China with payment terms and cash flow, which you can really see coming through. Overall, I think last year in China, we developed more or less in line with the market. It is always going to be quarter fluctuation for someone who's as large as we are in China.

So overall, I think we have – we are developing well there. Yes, competition is very, very tight. And if I look at markets last year and said that with our – about 9% growth in new equipment business, both in value and in volume, probably slightly ahead of market. Where did we gain most market share? I would think that was in North America, several European countries, we gained nice market share and then, many Asian markets like India, also in China, we're probably then more or less for the full year in line with the markets.

**Nick Housden**

*Analyst, RBC Europe Ltd.*

Q

Understood. Thanks. And just my second question also on China. In terms of the contribution from infrastructure, my sense is that, towards the middle of Q4, the government opened the taps on infrastructure spending a bit more. Was that your experience and was that helping to offset weaker residential investments?

**Henrik Georg Fredrik Ehrnrooth**

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

A

Infrastructure has continued to be quite active, but perhaps, the segment where there's been most activity has been at residential. So that's absolutely critical in China. There is some infrastructure, but I don't think it was peak now. It was continued to be at a good level, but it's been higher.

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

And clearly, if you look at the segment that, by far, the largest segment is the residential segment. I would say maybe 65% to 70% of the market and infrastructure being clearly smaller, talking about maybe 10% or so. So, clearly, a smaller part of the market.

**Nick Housden**

*Analyst, RBC Europe Ltd.*

Q

Understood. Thank you very much.

**Henrik Georg Fredrik Ehrnrooth**

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

A

Thank you.

**Operator:** And our next question comes from Alexander Virgo with Bank of America.

**Alexander Virgo**

*Analyst, Bank of America Merrill Lynch*



Thanks very much. Good afternoon to you both. Thanks for taking the time to answer the question. I wondered if you could talk a little bit about the broader implications for what we're seeing developed today over the last month and a couple of months in last year. And now, given where we are seeing such significant declines in developer sales in land sales and housing starts, etcetera, surely, the bigger question is really around next year, 2023 and the longer-term implications for the China residential market.

I appreciate you don't and shouldn't provide guidance for 2023. I don't imagine you want to, but I'd appreciate your thoughts from a slightly broader perspective. Are we looking at a structurally lower market? 2019, you're right, was a reasonable year. But I wonder whether that is as strong as it can be in the round from where we are today given the government's stated focus, I suppose, on shifting the economy away from reliance quite so much on construction and residential markets in particular?

**Henrik Georg Fredrik Ehnrooth**

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



Sure. Well, thanks for the question. Of course, it's an important question. What we see is that, still the fundamental demand particularly among – around the big clusters in China continue to be high. It will continue to move in there, upgrade, they start to be a lot of quite big share of the volumes in China on new constructions, actually demolishing and rebuilding and those volumes continue to be high.

So therefore, we expect the markets to continue to be active also in the coming years. Exactly at what level, I think that's too early to say. But structurally, we think that there's plenty of demand. If you think from a growth perspective in the coming years, I mean, I think it's obvious why we are doubling down on services growth that that's where the biggest growth opportunities are. And why can we grow so well in services, it's, of course, because of our very strong position in new equipment.

So that's how we think about it, solid market. Of course it could fluctuate which direction 2023, it's way too early to say. I can't say that, but fundamentally, we believe that there is plenty of demand and then really drive good growth constantly through both maintenance and modernization.

**Alexander Virgo**

*Analyst, Bank of America Merrill Lynch*



Okay. Thank you. And then, just as a follow-up, is there a risk that the competition that you are seeing as being intense on the OE side, given the dynamics that we're seeing in the market over the next 12 to 18 months as everybody adjusts to perhaps something of a new normal? Do you see the competitive dynamics intensifying and getting even more difficult on the service side in the modernization and maintenance side of things? Appreciate your coming from a smaller base, but just thinking about how that competitive dynamic really might change actually and get even more intense on arguably what is meant to be the replacement business in service and maintenance?

**Henrik Georg Fredrik Ehnrooth**

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



I would say Alex here that, to put it in context, of course, I think – I don't think we're the only ones who have focused on driving growth here. The only thing I know is we have very good position here. If you think that we are the leader in maintenance in China and we still have a single-digit market share or mid-single digit market share a little bit above, so the market is hugely fragmented. So there continues to be opportunities to do a really good job.

Also, modernization market is really at its infancy and we can see very strong growth on that in the coming years and still quite fragmented. So I think there are opportunities, and yes, I always think growth markets in competitive markets, some companies will make it, others not, and we are hell-bent to make it here as well.

**Alexander Virgo**

*Analyst, Bank of America Merrill Lynch*

Okay. Thanks very much.

Q

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

And also if you think about the modernization opportunity for us at Kone, we were relatively late comer to China market have been ramping up and growing faster than the rapidly-growing market. So that opportunity for us to modernize the Kone elevators that have been installed in the last 15 years, it is something that is exciting growth opportunity in the coming years for us, clearly something where we know and like to modernize our own equipment at that stage.

A

**Alexander Virgo**

*Analyst, Bank of America Merrill Lynch*

Understood. Thanks very much, gentlemen.

Q

**Henrik Georg Fredrik Ehrnrooth**

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

Thank you.

A

**Operator:** Our next question comes from James Moore with Redburn.

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

Yeah. Hi, everyone. Good afternoon. Thanks for the time. Like Klas, Lucie, Andre, many others on the call, I really struggle to reconcile your EBIT guidance. And I've heard everything you've said so far, but could we focus on some of the unknowns that you haven't broken out? Maybe we could start with labor cost and [ph] fuel (01:03:06) cost inflation. What was the percentage year-on-year inflationary increase in 2021 ,please? And what do you expect in 2022?

Q

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

I think, overall, there's always, as Henrik was talking about earlier, there's always a labor cost inflation. In the more rapidly growing emerging markets, that inflation is higher and then what we've seen is a lower number in the more mature markets in the past. And as long as that's stable, so it is something that you build on and both productivity and pricing perspective, you can counter that as we've said in the past.

A

Now, I have to say that we do expect slightly higher labor cost inflation in the coming year due to the environment where we operate. But it is on top of what we normally see, let's say, a percentage point or so higher than normally. So that's the way I would think about it. We haven't been very specific then on what it is on a normal year.

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

Q

Well, I think in the previous years, Ilkka you've called out a two or three or four and five in the last seven years. So what's normal? Are we talking about four compared to normal of three?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Maybe in the middle there.

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

Q

Okay. So, if we're three and...

**Henrik Georg Fredrik Ehrnrooth**

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

A

Not too far away from the [indiscernible] (01:04:30).

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

Q

Yeah. Okay. That was great. Thanks. So, if we're 3.5, you're talking about €100 million, maybe just a bit more on labor. We've got your €100 million, €150 million of material. We've got your plus 50 of FX. Basically, you are assuming roughly €100 million, €150 million of positive volume, price, and productivity. Could you confirm that that's correct and give us a rough flavor for how that breaks down? I have to say I don't understand why it's so little because you're going to grow revenues [indiscernible] (01:04:59), a normal 20% drop-through, you would expect to be all of that just from volume alone. And you have been talking about positive pricing in Europe and US equipment and in service. And you talk about generally getting productivity, and I just don't understand why you're so low on those three items?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Well, I think your estimates on the cost increases side are rounding up towards the smaller numbers. I was talking about from a material and semiconductor logistics increase, €100 million and €150 million, and then on the labor cost inflation side, it's a bit more than that. Growth is contributing positively and prices start to contribute positively next year. But as I said, we've seen the pricing actions in a more visible now in the latter part of 2021. So, as we deliver those in – the orders that we deliver in 2022 starts to be in the latter part of those orders where the pricing improvements are visible. So, those are the moving parts and the rest, I think, there's not that big items that I would call out other than those.

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

Q

Okay. That's helpful. So, smallest price and the productivity is that also quite small. And is it smaller than previous years?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

No. Productivity is actually improving compared to normal run rate as we said. So, clearly, that's something where in this environment we've actually seen a good progress to consider. But some of that you always need to be able to consider the inflation normally, now the inflation is higher than normally. And although productivity is better, it's not yet enough to consider increases in cost in total.

**James Moore**

*Analyst, Redburn (Europe) Ltd.*

Q

Well, I have to say I still don't get it. But maybe I can come back offline. Thank you very much.

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

Thank you.

**Henrik Georg Fredrik Ehrnrooth**

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

A

Thank you.

**Operator:** Our next question comes from Manu Rimpelä with Nordea.

**Manu M. Rimpelä**

*Analyst, Nordea Bank Abp*

Q

Hi and good afternoon. Sorry to get back to China again. You talked about the pricing environment being stable, if I understood you correctly, in Q4. And then I guess we have a pretty significant inflation. So that doesn't sound to me like you are able to pass on the price or the cost inflation in China at the moment. And why do you think that would be getting any easier if we start seeing volumes eventually in the equipment market falling more during the first half of the year? Just trying to understand why do you think that they will be able to pass on pricing in the following market in China?

**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

I'll start. So I was talking about how oil prices have developed, so they've been stable. And yes, you're right. So costs have increased, so that means that it is something where we've not been able to pass through that cost increase to our customers in China so far. And for the coming or this year, 2022, I said already we're not guiding our prices going forward. So it is something where we need to deal-by-deal, win the deals. And then at the end, we can see what the pricing development was, so we can talk about it historically. Clearly, our goal is to be able to counter the, of course, headwinds with pricing productivity and product cost factors. But clearly, in China, that's not the case here.

**Henrik Georg Fredrik Ehrnrooth**

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

A

I mean, I don't think we've made any comments about pricing going forward. That's something I said we don't – we don't comment on that, and we have to just see how that's going to develop.

**Manu M. Rimpelä**

*Analyst, Nordea Bank Abp*

Q

Maybe then just to better understand the stable pricing in China, so I would imagine that the cost inflation has been pretty significant through the year. So when you said that you're only committing your pricing, so can we say that are you being more or less aggressive than competition? Are you seeing competition trying to gain volumes through pricing? It just sounds to me a bit different, difficult to understand about why prices wouldn't have gone up in the fourth quarter in this [indiscernible] (01:09:06)?

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**Ilkka Hara**

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

A

So, I guess, overall, pricing competition has continued to be quite tough throughout the recent history in China, and it's a balancing act where those that can differentiate can have better pricing and maybe other way around. We focus on what we do, and I always emphasize that in case of China, it's really a combination of pricing as well as payment in terms you have to be able to balance between those two. And I think we've done a good level or good work in the fourth quarter given the competitive nature of the market.

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**Manu M. Rimpelä**

*Analyst, Nordea Bank Abp*

Q

Okay, perfect. Then my second question would be on the cash flow. And if you see lower volumes in China, so I guess your payment terms that they're pretty favorable. So when we think about the kind of net working capital or advances received going into 2022, so do you see that that could turn into a headwind then? I think we've seen a couple of years when you had the negative kind of working capital development, so – and the Chinese market was kind of a stable during those years. So, any comments on that, please?

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**Henrik Georg Fredrik Ehrnrooth**

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

A

Growth in orders with advances does help our working capital. And – but if you look at over the years, a bit longer cycle, I think we've done a pretty good job continuing to see net working capital developing positively. So, , let's see. We don't particularly guide that, but I think the growth does impact net working capital.

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**Manu M. Rimpelä**

*Analyst, Nordea Bank Abp*

Q

Okay. Perfect. Thank you.

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**Operator:** Our next question comes from Tomi Railo with DNB.

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**Tomi Railo**

*Analyst, DNB Bank ASA (United Kingdom)*

Q

Hi, Henrik, Ilkka, Natalia. It's Tomi from DNB. Also a question on China. You mentioned that authorities easing measures would start to help and see some impact later in the year. Can you just briefly mention what concrete signs are you seeing in China in order to put some stimulus to the marketplace? And also, maybe to clarify that you are expecting some help in the latter part of the year from these measures for Chinese market to recover somewhat in the second half?

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**Henrik Georg Fredrik Ehrnrooth**

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

A

So, let me clarify, Tomi, first that we had never talked about stimulus. We've said about perhaps easing some of the restrictions. We have to remember that they are restricting a lot, and perhaps we expect that the restrictions

won't be quite as significant as they are now. And you can see some of that already happening on the liquidity side. That's what we've been talking about.

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**Tomi Railo**

*Analyst, DNB Bank ASA (United Kingdom)*

Q

Yeah. I understand. So second part of the question, are you assuming that these easings of restrictions start to help the market and that you would, anyway, see some help from that in the second part of the year?

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**Henrik Georg Fredrik Ehrnrooth**

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

A

That is correct. That's what we expect. We are expecting significant, but some. Yeah.

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**Operator:** And that is all the time we have for questions today. I'd like to turn the conference back to Henrik and Natalia for any additional or closing remarks.

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**Henrik Georg Fredrik Ehrnrooth**

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

Good. Thank you all for active participation today again. So I thought I could probably just said – say a couple of words here to the end, we had many questions. good questions and thank you for those. If I just summarize what we're talking today, we know that 2021 was an unusual year. We actually performed very strongly in that environment and we had a solid finish to the year. So that's something I'm very happy about. And what I'm also happy about is that we are making progress in the actions to offset the headwinds. Ilkka talks about them. How we're doing on pricing, productivity and product costs that actually sequentially we're now going in the right direction. So that's always what I focus a lot, what is the direction. Our direction is right. We need to do more. But are we going there?

And what I'm actually incredibly pleased with is that we can see that the great work that our services team have been doing on innovation on many aspects is really paying off. And that's why our services business over the past two years has really been improving its performance and really growing at a great rate and really market-leading growth rate there. So that's something we are focused a lot on. And, of course, how we can constantly also differentiate more and more new equipment business also to help us.

So I think we have, from that perspective, a good backdrop. We're seeing the impact and we're very focused on finding all the ways we can to offset some of these headwinds, I said I feel good about where we're going.

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**Natalia Valtasaari**

*Head Of Investor Relations, Kone Oyj*

Thank you, Henrik. Thank you, Ilkka. And thanks to everyone who listened in. Lots of questions, lots of dialogue, and if there was anything that was left unanswered or if you have any follow-ups, as always, please feel free to contact me or someone in the IR team, we're happy to help. So With that, I guess we'll wish you a great rest of the day.

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**Henrik Georg Fredrik Ehrnrooth**

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

Thank you, all.

## Ilkka Hara

*Chief Financial Officer & Member-Executive Board, Kone Oyj*

Thank you.

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