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Kone Oyj (KNEBV.FI)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Sanna Kaje

Vice President - Investor Relations, Kone Oyj

Good morning. Welcome to our Q1 results presentation. I'm Sanna Kaje, KONE's Head of Investor Relations. I have here with me today our President and CEO, Philippe Delorme, who will go through the business highlights. And as always, our CFO, Ilkka Hara who will dig deeper into the market dynamics and financials. Philippe, please.

Philippe Delorme

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

Thank you. Good morning, everyone. It's great to be here with you today. So we are one quarter behind now for me at KONE, I'm happy to be able to share that we've had actually a good start of the year with sales growth at comparable exchange rates and improved profitability. Our resilient business model continue to demonstrate its strength. And the highlight for me in the Q1 results were the over 10% growth in modernization orders and a 9% growth in services sales at comparable exchange rates.

At the same time, we acknowledge still a lot of work to do to get where we want to be. We also published our sustainability report today. And from there, the highlight for me is the progress we made in Scope 1 and 2 emission last year, taking us well on track towards our 2030 ambition. Following the good start of the year, we

have now specified our guidance for the full year and slightly upgraded our market outlook. So now let's take a look at our development in more detail. So of course, we're going to start with the financial highlights.

We had solid orders received in many parts of the world, for example, Americas, India and Southeast Asia. Modernization orders continue to grow by over 10% with positive development across our different areas. And at the same time, China continue to be challenging. Overall, our orders received grew by 1.6% at comparable exchange rates. If we look at sales, we grew by 3% at comparable currencies with continued strong growth in service and modernization, while New Building Solutions sales declined, driven mostly by China.

Importantly, we had the fifth consecutive quarter of adjusted EBIT margin improvement with a 70 bps increase now in Q1, and then cash flow continued to be healthy. Ilkka, elaborate more in the financials in a minute so you'll have more detail around this. And we know you need those details. So now let's look at the business highlights. Let's start first with New Building Solutions where we had important infrastructure project wins. So one good example is the New York City transit, to whom we deliver 20 escalators in five stations. We also delivered the first escalator to our customers from our escalator factory in India in Chennai, where we see very exciting growth opportunities for us.

In service, we had exceptionally strong growth in our service base at 7% year-over-year. This was partly driven by bolt-on acquisition, but we also had a strong organic growth at over 5%. And with regards to digitization, which is very important for us, we passed the 3% connectivity bar in our service base, including both cloud and simple type of connectivity with 24/7 Connected Services approaching 20% penetration. This is important for our ability to scale up digitally enabled services beyond 24/7 Connected Services.

More specifically, we are ramping up a solution that transform the way we do our field service. As one exciting example, in Q1, we launched remote services, which are about solving various tasks remotely. Well, for example, able to do remote rescues and software updates remotely, which really simplify the life of our field technician and of course deliver value for our customers. In modernization, we also had great project wins, such as the modernization of the Milan Metro. And in this type of project, our customers have emphasized a lot the reliability, the ability to deliver, and we take great pride in the trust they have in us.

I'm also very happy to see that we've been able to continue to grow faster than the market in modernization more broadly. Now let's move to sustainability. Today we published our sustainability report, where we share more about our progress in sustainability, such as the externally assured data on carbon emission. We set our science-based target four years ago. And the highlight for me in the last year's progress was the improvement in Scope 1 and 2 emission, taking us well on track towards our 2030 targets of 50% reduction.

One of the key achievements was being the first in the industry to achieve carbon neutral manufacturing globally. For Scope 3, which is important too, we made progress, but there is still a lot of work to do. We have a clear path forward with, for example, making regenerative drives as a standard part of our offering and working on supplier sustainability. In Q1, we also received again important recognition for our sustainability work such as the position on CDP, A List for climate change and a position on CDP's Supplier Engagement Leaderboard. So with that, I would like next to hand over to Ilkka who will go through the markets and the financials. Ilkka, the floor is yours.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Thank you, Philippe, and also a warm welcome on my behalf to this first quarter result announcement webcast. Before I get to the new year of 2024, I'll start and – I'll continue from where Philippe left and talk a bit about the market in 2023. As always, in the first quarter, we give you our estimate of the market development in the

previous year. So first, we estimate the global elevator, escalator market in 2023 to be a bit below 1 million units in total. And this puts the whole service market in units to be also a bit shy of 25 million in total, at the end of the year.

Our position in this market, in all service markets in Americas, Greater China, Europe as well as in Asia-Pacific, Middle East and Africa improved. And we also improved our market position in New Building Solutions in three out of the four markets. In Europe, our New Building Solutions market position declined slightly, but we continue to be on a strong number two position in 2023. Then an important note, we don't talk so much about the modernization market as it is more difficult to accurately estimate it. But out of these 25 million units that are in service, our estimate is that close to 10 million of those are over 20 years old. So that's the modernization opportunity, vast opportunity that we see in the market and also in the modernization, we estimate to have gained share in last year. So good development overall for KONE.

Then to this year and how did we see the markets develop in the first quarter? So first, we are seeing that the New Building Solutions market is gradually stabilizing in the western markets. And while we continue to see a difficult environment in China. We also see and continue to see the positive market environment for services and modernization across areas with the highest growth in the Asian markets. So Asia-Pacific, Middle East, Africa, as well as in China.

But I would also highlight the modernization that it's not – it is also a strong market with double-digit growth in North America and Europe. Then to KONE and how did we perform in the first quarter when looking at the financials. Starting with orders received, which for the quarter were €2,236 million, which on a comparable basis is a growth of 1.6%; on a reported basis, a decline of 1.2%. New Building Solutions declined slightly. Of course, the China market is driving, it is difficult and driving negative performance, but we've seen actually a good performance across all other areas to contribute to a good outcome.

In services and modernization, our order growth continues to be on a strong trend and we see double-digit growth in our orders. To me, one of the maybe the most important notes on this page is that we continue to see our margin of orders received to be stable both year-on-year and quarter-on-quarter. So we continue our pricing discipline that we've had in the last quarters and very pleased to see that margins continue to be stable.

Then to sales. Sales for the quarter were just shy of €2.6 billion on a comparable basis, a growth of 2.7% and on a reported basis, a growth of 0.5%. New Building Solutions sales declined 4.2%. Modernization grew at a good speed of 5.3%. And maybe the highlight this quarter is the continued good growth in our services business at 9%. Geographically, our highest growth was in Asia-Pacific, Middle East, Africa at 8.9%, but also Americas grew strongly at 7.9%.

In Europe, sales grew 2.2%, then in China, sales declined 4.9%. Then to adjusted EBIT and as Philippe already highlighted, so fifth consecutive quarter of improvement in our profitability. Our adjusted EBIT for the quarter was €262 million and our adjusted EBIT percentage was 10.2. So a improvement from 9.5%, 70 basis point improvement. So, very happy to see the trend continuing. What is helping us to get to this results? First, continue to see the better pricing coming through in deliveries with a good growth in services and modernization, the business line mix contributes positively. And the savings from operating model renewal enable us to mitigate the broad based inflation we see in our cost base, but a good outcome continuing to improve the profitability while we're able to grow our sales.

Then to cash flow, which was just shy of €400 million, a solid number to start the year with. And from a net working capital perspective, we continue to improve the working capital from the end of the year with accounts

receivable coming down, contributing positively as well as advanced payments always at the beginning of the year having a positive impact. Our accounts payable came down as well as then advanced payments in China in the New Building Solutions.

Then about markets and business outlook for the remainder of the year. So starting with our market outlook, which we updated and upgraded for North America and Europe. So based on what we've now seen, we estimate the New Building Solutions in North America and Europe to be more stable. At the same time, we did in the beginning of the year say China market to be in units down 5% to 10%. Now, our estimate is closer to that 10%. In modernization, we also upgraded the market for North America to be on a high-single-digit growth for the year.

So, this is providing us good opportunities for growth. And now out of the 12 markets that we see here, only 1 is actually declining and 11 of them provide us stability or growth in this year. Then to KONE's business outlook for the year, which we also specified. We expect our sales to grow from 0% to 5%. When you measure at the comparable exchange rates for the year. And we expect our adjusted EBIT margin to be in the range of 11.5% to 12.3%. And this is assuming the exchange rates to remain at the April level where there's a limited impact to our results.

What is supporting our performance is clearly the strong growth in services and modernization, better pricing coming through in deliveries. We have a strong order book to deliver and also to save rest of the savings from operating model renewal are supporting. Then at the same time what is burdening our performance is the decline in New Building Solutions market in China, the persistent cost inflation impacting our cost base as well as our decision to slightly increase our investments to R&D and IT. And with that, I'll ask Philippe to close the presentation.

Philippe Delorme

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

Thank you, Ilkka. So to summarize and be really going through the key points, so we had a good start of the year with sales growth and improved profitability. Strong growth, as you can see in service and modernization that were the key highlights for me of this first quarter. Ilkka also mentioned so the positive outlook for the majority of our markets, which is a good news. And with all of these and as a combination of these, we have a good starting point for 2024. And I'd like to say again a big thank you for everyone at KONE for delivering the results in Q1. And with that, we are ready to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Kindly limit your questions to one question and one follow-up per person. Thank you. We will take the first question from line Klas Bergelind from Citi. The line is open now. Please go ahead.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

Thank you, Philippe. Hi, Ilkka. Klas at Citi. So my first question I had was on the service growth of 9%, 7% unit growth, including the recent acquisitions, particularly in Europe. That's obviously great to see. But the flipside of that is that price mix came in at 2% to get to 9%. That's obviously still positive, but against wage inflation of around 5% this year or had expected a bit more from the sort of automatic price close that you typically get at the start of the year. So Philippe, can we please break this down or what is service pricing outside of China, in China, and how much did 24/7 contribute with? I'll stop here. Thanks.

Philippe Delorme

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

A

I'm going to leave it first to Ilkka to give you a detailed answer. And I might complement on the more strategic side.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yes, that's fine. So first, I'm very happy with the unit growth that we're seeing. So both the organic unit growth as well as then how we've been able to continue to add these bolt-on acquisitions to our maintenance base. Also, we have actually seen good development from a pricing and escalations this year. And from a price versus cost perspective are in a good position to mitigate with productivity the cost inflation into our results.

So from that perspective, I actually feel good with what we know now in the beginning of the year. Then of course, behind those numbers there's a lot of mix. So the growth that comes in China has a lower price compared to the more mature markets where the price per unit this higher. But I don't think we've gone too much in detail to give all of the mix. But clearly from our perspective, we are clearly, positively – feel positive about the escalations that we've seen and the inflation that we've seen. So a good start from that perspective.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

That's good that you feel good about price costs. Yeah, that's all I care about. Thank you. And my second one I had was on the new order margin. I'm thinking ahead here a bit longer term, Philippe, it's good that it's stable year-over-year, as I think some people expected a decline given the negative price mix in China. But how should we think about margin expansion a bit further out? I appreciate you don't have a clear, hard cost cutting mandate, including layoffs. It's more about accelerating productivity and growth. But unless we start to see better pricing or much better end markets, I'm sort of curious around what should drive the margin expansion [ph] or go (00:18:39) beyond 2024? Again, new order margin is stable and needs to improve at some point. I know perhaps not fair asking beyond this year when you're guiding for 2024 here, but I'll give it a try. Thank you.

Philippe Delorme

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

I think I'm going to leave that one to Ilkka too.

A

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Maybe you can talk a bit after me on the growth and...

A

Philippe Delorme

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

Sure.

A

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

... and the profitability...

A

Philippe Delorme

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

Sure.

A

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

...at the end on a more broader level.

A

Philippe Delorme

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

Yeah.

A

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

But clearly from our perspective in this market, when we talk about orders margin, by the way, we don't only talk about NBS, it is the combination of the businesses. But it is a good outcome to have stable margins when we see many of the markets been down and normally with a lower volumes, there's more competition and focus on prices. So I actually – I'm very pleased with what our teams have done to get to this stable outlook. But I think what is important to note that where we see a growth, it is about services growing now at 9% and an accelerated growth going forward. And also that we see a good opportunities to continue to grow on a much higher level than we've seen in the past our modernization business.

A

And with this mix shift, we actually always and start to see the positive impact to our profitability and what we know about the modernization market that it's also a market where with a good sales being able to deliver to customer value – deliver the value that the customers are looking for. Actually, your pricing leverage is much higher than in NBS, where in many cases you have a professional buyer that sources the suppliers to your site and it is a very competitive market.

So I actually think we have a lot of good ingredients to continue working on the profitability also in a more forward looking manner, but maybe you want to comment a bit.

Philippe Delorme

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

A

No. Just to complement because we have a lot of question on NBS. But actually just a reminder and you see it in the figures, but modern services are greater part of our business than NBS. And with the trend we have every year, we become, let's say, a more resilient model with more modern and more services, where I think we've seen across the cycle very resilient market trends and very resilient performance from KONE.

Now on NBS, we always look at the glass half empty and the market that are negative or stable. I just would like also to mention the APM (sic) [APMEA] (00:21:18) market where actually our teams is delivering extremely well. First, there is great market. So I've been traveling intensively being in the Middle East, being in India, Southeast Asia, very good market condition. I think we've been commenting on this and very good performance of the KONE team at – so commercial performance, very good. Also coming with fairly healthy margin. So that all goes in the direction of helping our margin improvement.

So we will drive scalable growth, I would say primarily modernization and services are the prime engine, but in NBS then we want to be granular by area to really make the most of the market expansion where we see them. And APM (sic) [APMEA] (00:22:06) in that regard is a great example.

Klas H. Bergelind

Analyst, Citigroup Global Markets Ltd.

Q

Thank you.

Operator: Okay. We will take the next question from line Ben Heelan from Bank of America. The line is open now. Please go ahead.

Benjamin Heelan

Analyst, BofA Securities

Q

Hi. Yes, good morning and thanks for the questions. I wanted to ask first around North America and Europe and the change in business outlook there just in the last couple of months. I mean, is there anything in particular that you've seen that has driven that? Has it been more incoming from clients? Has it been the order flow that you're expecting? That would be the first one.

And then secondly, on the guidance that you've given around sales, the 0% to 5% constant currency, given your kind of in the middle of the range at the end of Q1 to get to either the bottom or the top of that range, it would imply like a decent deceleration or a decent acceleration in the last nine months of the year. So I'm just trying to understand exactly what are the dynamics that would drive you to the top or the bottom end [ph] of that (00:23:08) guidance range? Thank you.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Okay. And let's try to do one question at a time. It's always easier for us to also make sure that we answer in an accurate manner each of the questions. So I think on the first on the market, what do we see differently. I guess, in US, what I would highlight is maybe the more resilient economy than one would have expected, giving us more confidence to see the markets stabilizing there. And of course, we don't have a crystal ball. So it's our best estimate of that.

What is consistent across both Europe and North America has been that there's underlying activity with customers, creation of opportunities has continued. It's more the question that, hey, which ones of those opportunities actually get to a decision point and will take you forward. So I think there's a lot of fundamental need, for example, for affordable housing underlying the market.

In Europe, I would say that it's more mixed bag. So if we look at more the south and maybe also parts of the eastern part of Europe, there the market activity is clearly higher, whereas than in the Central and North Europe, we are still waiting to see the market to start to get to stabilization. So it's a bit more nuanced picture and – so that's behind our thinking and of course, let's see how well we estimate the market, but that's our best view at this stage.

Then your second question was on the variance, hey, what would lead us to be on the high side of the guidance or at the low side? Of course, one a big part of our business is very, very resilient, which is the services part. So it is quite predictable. And yes, we can do a better job to drive it up with orders and spare parts and the pricing and so forth. But it's quite predictable. It is more about how are the construction sites, modernization sites progressing more generally, and that obviously is dependent on our customers' ability to take them forward.

And we've seen actually in the last years more variance around that. So some of the sites progressed, some of them are delayed and we're dependent on that. So that's a fundamental unknown.

In orders, we pretty much have the orders in our order book for NBS that we will deliver on this year. So it's more about the sites progressing. In modernization, we'll likely still book during this quarter orders that we will start to deliver in this year. So there's a bit of variance coming from orders in our guidance as well.

And then maybe the fastest moving market in the world is the NBS in China, where clearly at least the history has been that it can move up or down quite quickly. And a big part of that, in my mind comes from how do we see the consumer sentiment developing, as well as the liquidity situation with our customers where and actions that the government has been taking. So more of the things going the right way, then we're more closer to the 5% than opposite of course, is true for the 0%.

Benjamin Heelan

Analyst, BofA Securities



Okay, great. Very clear. Thank you.

Operator: Thank you. We will take the next question from the line Vlad Sergievskii from Barclays. The line is open now. Please go ahead.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.



Yeah, good morning. Thank you very much for taking my questions. I'll ask first on the cash flow. It looks like the biggest positive driver within working capital was actually accruals in this particular quarter. And when I think about that accruals normally [ph] peaks (00:27:08) since you want historically full year and then declines through the course of the year, would you be able to give some color what line item was actually behind those accruals which developed so positively and whether you expect that developments continue through the rest of the year, please?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yeah. The main driver is us invoicing our services business in many markets in the first quarter and then impacting the accruals going forward, which will then come down during the year.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

[ph] That's clear (00:27:42) and thank you very much. And could I ask a more strategic question about capital allocation? You do continue to distribute close to 100% of earnings in dividends, which is probably on the higher side compared to the broader industrial universe we are looking at. At the same time in the past year, net cash position continues to moderately come down. Would you see this close to 100% earnings distribution is still the right strategy in the light of lower growth cash position and in the light of potential strategic optionality, which you, I assume, would want to maintain?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, first, we do have quite a strong balance sheet. And as we right now and I think that has been a historical strength of KONE to have a quite strong cash balance sheet that enables us to focus on making the right business decisions for our customers and strategically making the decisions as they come.

And it is true that in the past few years we've distributed high percentage of our dividends out. And from our perspective, we've been very clear if we want to improve our profitability, grow our profit, and I think that's the way to us to improve also then cash flow and be able to then have a choice how much of that we want to distribute as dividends. At the end, it's a board decision, so let's see how that develops. But my job is to improve first the profits and then the cash flow and make a choice are difficult for the board.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Thank you. And maybe the last [indiscernible] (00:29:33) excluding the bolt-on M&A, would you be able to comment that what do you think happening to your service market share in China and outside of China?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

We improved market share that, as I said, in service business last year.

Vlad Sergievskii

Analyst, Barclays Capital Securities Ltd.

Q

Thank you very much.

Operator: Thank you. [Operator Instructions] We will take the next question from line John Kim from Deutsche Bank. The line is open now. Please go ahead.

John Kim

Analyst, Deutsche Bank AG

Q

Hi. Good morning. Thanks for the opportunity. If we could shift focus a bit and just speak about market dynamics in China, can you help us understand how competitor reaction has been to your products? Kind of call it from Q4, onward from memory, you introduced a cheaper, more cost-effective product in the region with lower cost to serve. I just wondering what the competitive response has been? Have people or operators been able to compete effectively against that?

And secondly, on China, can you give us a sense on market dynamics by tier or customer segment today? It does feel like infrastructure is switching a bit more [indiscernible] (00:30:55), maybe not to the region [indiscernible] (00:30:57). Thank you.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Maybe I'll start with the market and maybe you can comment, you've just been in China as well as how strong our team executing and in general, we focus on our own work and not commenting our competitors work. So but from a market perspective, so in China, activity in lower tier cities and cities closer to those is higher. And the further away from the coastline to Tier 3, 4 cities there, the activity is lower.

And from a market segment point of view, of course, we talk a lot about the market, which is largely about residential buildings being difficult. So that really gives you an idea how is the residential building activity. But there is also infrastructure office market. And depending on the location and the appetite based on the location, it is more active or less active. So where there is a demand for buildings and a healthy need, for example, shopping malls. There continues to be activity and in locations where there's less traffic, then of course the opposite is true as well. So the closer you get to coastal, the bigger cities, that's where the activity is maybe better. But...

Philippe Delorme

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

A

Yeah.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

...but overall [ph] situation (00:32:32)

Philippe Delorme

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

A

Maybe to complement also on market dynamics so let's – and the execution. So first of all, we see the China government being very active to support the activity. We don't see the reaction yet on New Building Solutions, but we clearly see the reaction on modernization and it starts to be a significant part of the market and that's actually a part of the market where we spend a lot of time and where we think we gain market share. So that's one. And we are optimizing our setup and our offers to be able to respond to that part of the market. So that's one.

Second one in services, we believe we are leading the way in digitizing the whole service environment between our field technicians and 24/7 and being able to remotely support and manage our elevators. And we see actually quite a bit of attention here and we'll keep driving market toward that goal.

And then I would say on NBS, I mean, you understand, I guess you understand the market condition, which are not easy. We are aggressively adapting our cost base, especially our product cost base to make sure we stay competitive. And we are also adjusting our cost to make sure that we can respond to market condition, that

indeed a bit – are fairly tough at this point of time. And with this, we are gaining market share and I've been in China already once. I'm going to be in China again in the month of May. I'm very impressed by what we have here.

John Kim

Analyst, Deutsche Bank AG

Q

Okay. Very helpful. Thank you.

Operator: Thank you. We will take the next question from line of Tomi Railo from DNB. The line is open now. Please go ahead.

Tomi Railo

Analyst, DNB Bank ASA (United Kingdom)

Q

Hi this is – can you hear me?

Philippe Delorme

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

A

Yes.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yes.

Tomi Railo

Analyst, DNB Bank ASA (United Kingdom)

Q

Yes. Hi. This is Tomi Railo from DNB. Firstly, just confirming the one of the previous questions was the outlook lift for North America and EMEA. If I frame it, was it more so that the market didn't sell as much as you expected. You referred to resilience or stabilization or that the market is actually starting to improve [indiscernible] (00:34:52)

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

First, I would highlight that we now report the markets in a new way. So it's Europe comment, not EMEA. Africa is now part of the Asia-Pacific. But I think my answer is yes, it's both. So a bit more stable Q1 – a more stabilized in Q1 and as well as we expect better than that development in the latter quarters to get to the stable outlook.

Tomi Railo

Analyst, DNB Bank ASA (United Kingdom)

Q

Thank you. And second question, if I may. After two quarters of strong order intake growth in China for you, a small decline now, are you becoming or have you become less or more concerned about that – maybe more concerned about the pricing in China and your hunger for growth in volume terms?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, first, what is true is that the order book rotation in China has somewhat slowed down. And what I've been very pleased about the team doing is really been focused on cash flow. So making sure that whatever we deliver,

we also feel confident that we paid for. And that's of course then putting a pressure on the customers that we deal with. That's a higher risk customer than we're really on a cash basis, dealing with them and so on.

So we continue to do a good job identifying those when we book orders and then before making a delivery, ensuring that. But really, the trick is to have good management of that. At the end of the day, both orders and deliveries are important. And I think as Philippe has already said, I think our team is doing a really good job in this market to compete in that market.

Philippe Delorme

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

A

And maybe to complement we are not only very discipline on credit management, stuff like this, but we don't take orders if we don't have down payment, which we believe is very important. Practices in China are vary, but we are extremely disciplined in how we are taking orders and therefore how we are dealing with customers to make sure that we get paid. And fair enough, the market is going through tough condition, but in the end, cash is what matters the most.

Tomi Railo

Analyst, DNB Bank ASA (United Kingdom)

Q

Thank you very much.

Operator: Thank you. We will take the next question from line Panu Laitinmaki from Danske Bank. The line is open now. Please go ahead.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

Yes, thank you. I would have two questions. Firstly, on China, what was the sales split in Q1 between new equipment, service and modernization and how did the margin look like compared to the rest of the group?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

We actually haven't given a quarterly split because it fluctuates a lot than first quarter with Chinese New Year. The size of the NBS revenue is always a lot lower, but if you think about last year, so NBS was 75% and about 20% was services and modernization was more than 5%. So clearly in this quarter, we see modernization and services contributing a bigger part than on a full-year basis. And a margin perspective with a lower volumes in NBS, of course, that does impact our margins in terms of capacity utilization on a quarterly basis. But that's something that we tend to see every year in China due to Chinese New Year holidays.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

Okay. Thank you. Secondly, just on the margin improvement you saw in Q1, I mean, how did this split – how did you see this in the different businesses, the new equipment outside China most likely improved, but what about the service? So did that change a lot year-on-year or was that kind of group impact mostly from mix with services growing more than the rest?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

So twofold. So we saw the pricing in delivery is contributing positively. And of course, the bigger part of that is NBS, even though longer rotation in order book, we saw big chunk of the modernization upside already materializing in earlier quarters, but both have a similar pattern. And then the business line mix was the main contributor. So pricing and the business line mix main contributors to this result.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

So to put it differently, the modernization and service margin didn't change that much like year-on-year?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Not that much.

Panu Laitinmäki

Analyst, Danske Bank A/S (Finland)

Q

Okay. Thank you.

Operator: Thank you. [Operator Instructions] Kindly limit your questions to one question and one follow-up question per person. Thank you. The next line will be open by Nick Housden from RBC Capital Markets. Thank you.

Nick Housden

Analyst, RBC Europe Ltd.

Q

Yes, hi. Thank you for taking my questions. My first one is on net working capital. Could you just remind us how the net working capital dynamics differ across the various business lines and how we should think about the overall level of net working capital as the business shifts away from NBS? Thanks.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

We mostly get paid in advance in all the businesses, then the rest comes from order book rotation cycle and – so that's over a broad comment. And from our perspective, of course, our goal is to continue to drive that to be more negative on an ongoing basis. I see less opportunities to improve our payment terms with customers are quite good already. And then the variation comes from the growth of the businesses in orders.

And then at the same time where I continue to see a good opportunities to drive better performances in collection so we can collect more efficiently, but also with our suppliers really working on payment terms with our suppliers where a lot of the work we are now doing centralizing supply chain to one organization in the last July and working more strategically, it gives us an opportunity to drive improvement there. For example, this quarter we saw the opposite, so our payables went down. So I think there's ample opportunity to do that there. But of course, I mean, it is about growth at the end, the negative net working capital.

Nick Housden

Analyst, RBC Europe Ltd.

Q

Okay. Very clear. And then just to follow up on the stable order intake margin, so modernization orders are outgrowing NBS. And again, I think you've said in the past that modernization is a higher margin than NBS. So if

the overall margin is stable, is it the right way to think about it that the NBS margin with [indiscernible] (00:42:17), is that a fair interpretation?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

No. What we comment is apples-to-apples comparison. So I take the mix out in my comments. So overall order margin in outside of China were more stable. In China, pricing came down, we're able to mitigate some of that with the product cost reductions that Philippe was earlier talking about it. But in China, our margin in orders received was down.

Nick Housden

Analyst, RBC Europe Ltd.

Q

Okay. Great. Thanks very much.

Operator: Thank you. We will take the next question from line Miguel Borrega from BNP Paribas. The line is open now. Please go ahead.

Miguel Borrega

Analyst, Exane BNP Paribas

Q

Hi. Good morning, everyone. Two questions for me. Just want to understand the top line guidance, 0% to 5% having just done 2.7% in Q1, you obviously have strong growth from Q4 in China so probably that will flow through to the P&L in Q2 and Q3. And now you're also upgrading the market outlook in North America and Europe to stable. So, why are you being so conservative on your own numbers at this stage?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, it's our best estimate. But first, the market outlook really is about future orders. So if you think about we upgraded in NBS market this year, those orders will have a order rotation that will more mainly impact 2025, 2026 and 2027 in the case of North America. So it's not so much about sales. In modernization you could argue that – you could see some of that impacting our sales this year. So that's one thing.

Then I already highlighted, when it comes to China that the order book rotation in the NBS part of the business has slowed down somewhat. So the growth that you are referring to in fourth quarter is maybe taking a bit more longer time to impact sales in general. But yes, we did have a good start for the year and the variance, as I already highlighted in an earlier question, is really about how can we take our NBS and modernization business forward? And there it is about customer sites, been able to see the progress. And that's where the variances besides overall development in China, which tends to be something which evolves quite quickly. But it is our estimate that we believe that gives a fair picture of the business at this stage.

Miguel Borrega

Analyst, Exane BNP Paribas

Q

Thank you, Ilkka. And then just a follow-up, on modernization, sales growth has obviously decelerated from the last few, but order intake was quite strong. So just wanted some color on the growth outlook that you see over the coming quarters. If you expect the reacceleration in modernization, whether pricing or margins of these orders have suffered any pressure? Thank you very much.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Maybe I'll take the first part and you can talk a bit about the modernization opportunity in more broadly. So first, the growth in order is the important part and we've seen very good growth for many quarters now in the modernization and also in this quarter.

Then it is true that on a quarterly basis, the sales do vary more than that. And it's also good to note that in last year's first quarter, we grew 20%, if I remember correctly. So the comparison point is also quite tough. But with this order growth, we do expect that there's a good opportunity to continue to drive a good growth in our sales in the modernization business.

But maybe you want to say...

Philippe Delorme

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

A

No...

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

...a few words about the modernization...

Philippe Delorme

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

A

I think of I've talked about it in the slide presentation, but modernization is a major growth opportunity for us. That's a place where we will even reinforce our focus. I see success. I see success, I frankly see even more opportunities to replicate more best practices across the company, drive more innovation. So we will be reporting and working repeatedly and every quarter I wouldn't say boringly, but we are going to be coming to modernization all the time. And I expect that the market will be good across the cycle and I will push our team to be fairly strongly pushy on that part of the market.

Miguel Borrega

Analyst, Exane BNP Paribas

Q

And any deterioration in the pricing or margins of those orders? Thank you.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

No, the simple answer. So I think we've seen quite a good pricing discipline, I would say. And also when we talk about product cost, of course, we're working on product cost in all the businesses and we see opportunities there. I think what is most complicated about the modernization is that it is individual projects and it is working in an existing building. So how you're able to understand the customer needs, how you support the use of the building and how you do the construction work. There's actually a lot of value that we can bring in and that gives you also then ample leverage to talk about pricing. So I think there's a lot of opportunities to also improve there. But simple answer right now is that the margins are quite stable and we see a good volume with a good margin.

Operator: Thank you. We will take the next question from line Tom Skogman from Carnegie. The line is open now. Please go ahead.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yes, hi, this is Tom from Carnegie. You talked a lot about opportunities in modernization. So but I wonder whether you are prepared to improve the cash variance here a bit. What is the share of service and modernization out of total group EBIT? I know that your key competitors are providing this number in some way at least. Do we talk about more than 70% or more than 75% of group EBIT coming from these less cyclical businesses?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, as you well know, I think at least officially, I wouldn't use plural of giving the profitability that we of course, thinking about how to going forward report, we used one segment reporting approach. But I think it's good to note that if we look at the overall profit for KONE, so 80% of our profits come from service and modernization. So that's really the profit generator for our business. And we continue to see opportunities to drive profitability up in modernization as we get more and more scale with the growth. So that's something where we see good opportunities to do so.

And from a profitability perspective, services, it's more profitable. But clearly modernization also is a good profit generating business and the development opportunity is there in the coming years are actually quite good.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yeah. Thank you. That helps a lot. So 80% of total profits from service and modernization and modernization profitability is better than equipment, if I remember from historical from comment.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yes.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

So, just to get some feeling about it?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yes. And that's a...

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

And then China share of earnings [ph] was (00:50:26) – the margin in China compared to group, do want to give some comments on that also?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Well, when if I look at the last year, we had approximately 25% of our profit sales in China and less than that in profits. So clearly where we've talked about the decline in China, but also the profitability been quite – the competitive nature of the NBS market has led the profits to profitability and profits to decrease in NBS. So also the

share of China is declined. So 80% from modernization and services. China sales are 25% and then less than that in profits if I look at a annualized number. And also in China, a bigger and bigger part of the profits is generated in services and modernization, so that shift is happening as we see also the sales shifting there.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yeah. And then a final to Philippe. I wonder in service, I mean, if you would highlight three ways to push just the profitability in service, what would those be? Or whether one year [indiscernible] (00:51:42), let's say 5 to 10 years ahead?

Philippe Delorme

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

A

So I would say two only.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

I was waiting that you can – maybe wait for the question before answering.

Philippe Delorme

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

A

Thank you for the question. So to me, the most powerful enabler of the service transformation is digitization. And digitization in two ways. One, getting to a stronger connectivity of our customers to make sure we deliver more value for them, better uptime, better transparency on what's happening.

By the way, to translate this into something that talks to you, which is retention and profit, we clearly see that when our customers are connecting the retention, the churn is much better. So that's one and that's very clear. And I think where we do good, we see very positive outcome in terms of retention, in term of commercial performance. So that's one.

Second point is using digital technology to drive field operation. I've been 30 years in the building industry and I'm still surprised to see some lagging in efficiency in the way. Any specialty, whether electrical, HVAC or elevators, would do their job. There is a big opportunity to be more efficient, to be more efficient, to go to site, plan your visit. And when on site, know exactly what you will find. Know exactly which spare parts you should come up with. Know exactly which operation you should do. Know exactly the health status of the elevator before going there, drive better safety.

So here again, I've been traveling extensively in the company, seeing very, very good practices here and there. Now, what we have to do is scale it ruthlessly across the company to mine this potential. And I see a lot of opportunities. So two.

Tom Skogman

Analyst, Carnegie Investment Bank AB (Finland)

Q

Thank you.

Operator: Thank you. We will take the next question from line Mikael Doepel from Nordea. The line is open now. Please go ahead.

Mikael Doepel

Analyst, Nordea Bank Abp

Q

Thank you. A couple of follow-up questions still on China, if I may. I think in the report you said that the pricing and mix together was 10% negative effect from the average new equipment prices in China. And just wondering about the split between the two. Is it fair to assume 50/50 or something else? Perhaps you could give some more color there?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

I think this is something where it's not an absolute science to try to differentiate between the two in an industry where we actually have unique projects which are vastly different in size. But clearly the price has been under a heavy competition and has declined and mix towards a smaller elevators, lower buildings is not helping it. So both are contributing to it. But I would say the prices are higher one.

Philippe Delorme

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

A

I would just like to complement. So I have not counted how many questions on China. There were many. Just look at the figures of KONE as we speak, like compare the figures of China and Americas. I don't think we have many question on Americas and Americas is the market where actually we see a better trend, where actually we start to be sizable and we have great growth. We've not talked much about APM (sic) [APMEA] (00:55:22), which actually is another great market where we have great performance. All of these to say and maybe it's just perception is I understand that the perception for KONE has been – I mean and we've been big historically in China, we're still big in China, but I think we've over the past years considerably rebalanced. We've digested actually a – I wouldn't say hard lending in China, but a decrease of our share of business in China while actually keep delivering and be sound financially.

We will keep being very disciplined in China, being commercially aggressive or not being crazy and being very responsible on cash. But we will also grow our business elsewhere and we see many opportunities as well. By the way, there's also opportunity in China, but just would like to either the ice or rebalance a bit the points because in the end China is less than 25% of our sales. The curve are moving very quickly because indeed you see the trends like APM (sic) [APMEA] (00:56:26) is growing pretty fast. Americas has been doing a very good job in Q1. We are doing a very good job on profitability in our different areas. So just to put things in perspective that we have all our – I mean, we are very attentive to China and we want to be one responsible but also learn from China to be very fit in the market. But we also are very focused on our other opportunities, market opportunities, and we believe that we are doing pretty well.

Just to reset the stage and make sure we correct the perception about KONE, which actually has considerably rebalanced this portfolio to de-risk and really build in resilience with now the vast majority – let's say the majority of our business going with resilience, baked in with modernization and services. But we welcome question on China though, of course we are happy to respond to any questions you will have.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

A

Yeah.

Mikael Doepel

Analyst, Nordea Bank Abp



Okay. So if that's the case, then maybe I can put in one more on China and then I'm done with it. But this is maybe a bit of a longer term thing as well. And I guess it comes down to the opportunity set you mentioned and maybe it also relates to your wins or gains on the new equipment side in China. But I was wondering in terms of the conversion rates for new installations to the maintenance base in China, what are your targets there? I mean, we're hearing from some of your competitors, they talk about the 10 percentage point improvement target, which is quite a lot. But I mean, that could make quite a big difference for your business as well if you are able to do something similar. I'm just wondering what kind of ambitions you have on that side of the business and how you could improve it?

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj



We see good opportunities to drive conversion up with the digitalize as we talked about earlier. And I think it's good to note that China is not one thing. So actually the conversions are much higher when you go towards the coastal area and vice versa lower when you go to more remote places. So I think there's a lot of detail behind it, but simple answer is that with digital we can actually have a good opportunity to drive conversions up in the business in the long run.

Mikael Doepel

Analyst, Nordea Bank Abp



Okay, that's clear. Thank you very much.

Operator: Thank you. It appears no further questions in the queue. I will hand it back over to your host for closing remarks.

Sanna Kaje

Vice President - Investor Relations, Kone Oyj

Thank you. Time to wrap up. Thank You, Philippe. Thank you, Ilkka, and thanks for all the great questions. If you have any more, we are of course, happy to help, so please reach out.

One final thing I would like to remind you of is still on the saving the date for Capital Markets Day. So that is planned to be held in Helsinki on September 27. Thank you. Have a nice day.

Philippe Delorme

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

Thank you, everyone.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Thank you.

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