01-Jun-2022

Kone Oyj (KNEBV.FI)

Capital Markets Day

CORPORATE PARTICIPANTS

Natalia Valtasaari
Head-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

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

OTHER PARTICIPANTS

Daniela Costa
Analyst, Goldman Sachs International

Miguel Borrega
Analyst, Exane BNP Paribas

Andrew Wilson
Analyst, JPMorgan Securities Plc

Philip Gottschalk
Analyst, Trium Capital.

Panu Laitinmäki
Analyst, Danske Bank A/S (Finland)

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)

Tomi Railo
Analyst, DNB Bank ASA (United Kingdom)

Antti Kansanen
Analyst, Skandinaviska Enskilda Banken AB (Finland)

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Guillaume Dalibot
Analyst, Katko Capital

Erkki Vesola
Analyst, Inderes Oyj (Research Firm)

Anders Idborg
Analyst, ABG Sundal Collier Ltd

MANAGEMENT DISCUSSION SECTION

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

Good morning and welcome to KONE's Capital Markets Day 2022. My name's Natalia Valtasaari, I'm Head of Investor Relations at KONE, and I'm very pleased to see so many of you in the audience. It's been a while since we've been able to arrange this type of event, so I think at least I'm a little bit excited. I hope you are too. We do have quite a few people following on the line, so welcome to everyone on the webcast as well.

It has been an eventful couple of years and, while today we will be talking about some of the shorter term actions that we're taking to kind of address the changes in our market environment and our business context, we are also taking the opportunity to maybe take a bit of a step back; provide a bit more insight into what's going on in our market environment; talk about how we're positioning ourselves for the growth opportunities that we see; and of course, talk about how we're executing on our Sustainable Success with Customers strategy.

I'm very pleased to have quite a few of our EXB members. We have a great lineup of speakers today but we're also joined by a few of our other executive board members, so I wanted to take the opportunity to introduce everyone. We have Henrik Ehrnrooth, I'm sure you'll know, our President and CEO; Ilkka Hara, our CFO, also speaking; then Tomio Pihkala, Head of our New Equipment business; Hugues Delval, Head of our Services business (sic) [Service business] (00:01:27); and Bill Johnson, Head of Greater China, will be joining virtually. So, he'll join us a bit later in the morning.

And then, for the other EXB members, executive board members, here today: Karla Lindahl, relatively recently still appointed to head the South Europe and Mediterranean business; and then we have Tricia Weener, here in the front, our Chief Marketing Officer; Maciej Kranz, our Chief Technology Officer; and Johannes Frände at the back, Johannes Frände, our General Counsel.

Couple more people who are good for you to know, for those of you sitting here in the audience, Heidi who you met at the registration; and then we have Liisi sitting there at the back, both in the IR team. So, if you have any questions on practicalities, please turn to one of us.

In the spirit of sustainability, we have not printed out the handouts. They're all available online. You have the KONE website and the Wi-Fi information for the venue in front of you on the papers. So, that's good for you to know. One last-minute change, unfortunately, to the agenda Ken Schmid, the Head of our Americas business, was not able to attend. So, we're all very sad about that. Hopefully, we'll get him speaking to you at another event soon.

And then maybe finally, on practicalities, we have reserved quite a bit of time for Q&A today. So, those of you in the audience, raise your hand, the mic will be brought to you. And those of you online, there's a question box, please send in your questions and we will make sure that we get to those as well in the Q&A sessions.

I think that's all for me here in the beginning. So, I would like to welcome Henrik to the stage.

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

Thank you, Natalia. And also, my behalf, great to see all of you here, a fully packed room that makes me very, very happy. And welcome, everyone online, great to have you as well. And as Natalia said, we've had exciting and eventful few years behind us. So, I'll give, today, little bit of a context to how we see the world; how KONE has performed; and in particular, how we are developing KONE according to our strategy; and really, what we think it's going to take to win in the current era that we're going through. My colleagues will then dive much deeper into how we are executing on this strategy.

For the past two, three years have been exciting, to say the least. We all know that 2020 started off, we thought, this is going to be a great year. Then, of course, we had COVID. Actually, 2020 wasn't a bad year if you look at the second half for us. Then, we had 2021 with supply chains being disrupted and I think the consensus in the world was that we're going to see an improvement this year. But then, of course, things actually got just worse from a supply chain perspective globally, with the very tragic war in Ukraine, of course, and all the COVID lockdowns in China, which now seems to be opening.

So, there's been enough movements, there's been enough things to do in this environment, and hopefully becomes clear that – how we've been thinking about it and how we think going forward. But one thing which hasn't changed has been that we are in a good space. We are an industry with fundamentally good growth drivers. Urbanization has continued. There was a lot of question when COVID hit that, is urbanization are going to continue? And actually, yes, very much so.

So, 70 million people continue to move into the cities every year. That creates a lot of opportunity. And on top of that, which has been an even increasing trend, has been the growth in single adult households, which means that people who live by themselves usually want to live close to the services, close to the city centers, which means that that [ph] use of land (00:05:47) is expensive and you need to build upwards. And it may be a little secret that we like when people build upwards. So, that continues to be a fundamental trend that hasn't changed anywhere.

Then, we know sustainability, the biggest challenge of our time; and that creates a lot of opportunities because buildings are a huge emitter of greenhouse gases. So, to build greener buildings, to modernize buildings, we can see that this trend is very, very strong. And we can see that over 40% of developers are expecting actually that majority of buildings that will be developed just in a couple years' time will be green-certified buildings. So, companies with strengths here will find great opportunities; not only the right thing to do but a great opportunity. And then, technology, a phenomenal enabler for driving change. But also, providing better experiences which are expected by users and customers at the moment. So, many good things that are driving the long-term growth in our industry.

Now, also, we can see when we look at our industry, the good thing is that – we had the pandemic, many industries hard hit, there was a lot of questions around property, but we can see that the whole construction industry has rebounded. And what I think is even more interesting, if you look at the data to the right, that is number of elevator starts in various segments; and starting from 100%, which was beginning of 2019. What I think is fascinating is that we can see that in all segments, except for offices, we are at 100% or above. So, people are moving out and about.

And we can see also offices have rebounded, not quite to the level where they were but I think what is even more interesting is that we can see that retail is actually above where it was in 2019. So, we can see that our customers are needing services. There is a fundamental need for people to move and to help them move in a better place. So, we seem to be pretty much back to normal from that perspective, even though there are many things that are not as they were before. But at least people are moving, getting out and about, which is a great, great thing.

Now, this environment, which I will talk more about how it's changing, is, of course, driving changes in our customer expectations. Changes in customer expectations always creates great opportunities to differentiate. And that is always a good thing to remember that, while changes can cause difficulties, they are principal – principally an ability to differentiate. In this environment where everyone is suffering from costs, the fundamental need of productivity in the construction trade is just going up. We know the margins are not very high there, so very much needing productivity. You'll hear much more about from my colleagues about that.

Then, it's all about smart buildings. We all talk about what is a smart building but, for us, it's really how do we improve the user experience and how do we create adaptability for our customers, which has been a fundamental need in this changing environment. And then, we have sustainability, which, as I mentioned already, we started to see is becoming a key design principle. And, of course, here, smart building is critical to that. So, I would say, it's a lot about productivity and how we bring intelligence to improve the experience of our customers and their users, and bring sustainability into their buildings.

In this environment, how have we done? If you look at since 2018, if you look at short term and longer term, we have continued to outgrow the market. In new equipment, there's been only slight growth in the market overall in the past few years, but we have compounded about 4% in new orders. In the services business, we have – we are close to our long-term growth rate in the past two years. The COVID year did cause a bit of a dip but we almost recovered past that. And we could see, last year, we grew 7.5% our maintenance business; and first quarter this year, 8.7%. So, whether we look at shorter term, longer term, we continue to have clearly the industry-leading growth in maintenance; and that is something you will hear a lot about today, how we differentiate and how critical this business is in the current environment to us.

When we look at our longer term profitability development, we know that the 2017, 2018, those were the difficult years in China, then we started to recover but then we were hit by COVID and, of course, now, supply chain disruptions. So, it's clear that we are not happy with the trajectory we have on margins right now. That you will hear also a lot about today what we're doing to further speed up how we implement more dynamic pricing strategies, also how we are working more on being able to get the product costs down in environments where costs are up significantly.

Productivity, an absolutely fundamental driver, even more important than the past; and also, how we are implementing more dynamic contract models. Because it's clear that our industry, like many, where we have the long order book, that the order book moves slower than the input costs, how can we get more similarity to the two developments here. So, you will hear more about both – all of these topics, how we are driving an improvement in our margin, because it's clear that it's fundamental to us to improve our margin and start to get closer to our longer term targets.

So, how we're doing it? Well, it's clear that that's about our Sustainable Success with Customers strategy. What you will hear is that, while this strategy was already crafted a bit over two years ago, it is still very much relevant. And I will talk about now what is happening in the environment and what it's really going to take to win and how we are executing our strategy to win in this environment.

So, it goes without saying that the world around us has changed and continues to change. There are few good things here as well. The good thing is that markets have recovered and the demand for particularly our service and solutions is strong. That is great. We can see also that customers' demand for value-adding solutions is continue to increase. Very important. And we can also see that the need for sustainable solutions as urban areas want to be part of the solution in sustainability, those are all fundamentally positive things and, I think, areas where we have some fundamental strengths.

But then, clearly, there are some challenges as well. It's clear that we are seeing a weaker economic outlook right now as a result of surging inflation everywhere, the war in Ukraine, COVID lockdowns in China; all of those are having a short-term impact on demand in certain areas. We also know that the era of zero interest rates and abundant liquidity seems to be over, as central banks are trying to adjust to this situation. It is clear that for many of our customers this is a fundamental thing. And what can be called a shortage economy seems to be a fundamental theme continuing. As many companies are near-shoring, that is actually just going to cause even further strain on supply chains in many parts of the world. That is not a thing just for our industry, that is a general phenomenon we can see everywhere.

So, there are many good things and there are challenges. So, how do we navigate this? So, what do we think it's going to take to win in this era? In this era, we think, to win will take to drive growth even more through value rather than only volume. If you think about the winners in the previous era, which we can say was the China mass urbanization was the era of globalization, and it was very much a volume game. Now, on top of that, you need to have also growth in value with your customers. So, differentiation will clearly be the winner. You'll hear a lot more about that today. It's clear that productivity and agility for our customers and also for us has become a fundamental driver.

Supply chain resilience, goes without saying how important that is. Sustainable offerings and solutions, great demand for those, many cases even a right to play but has a great opportunity when you get that right. And then, in this environment, how are you an employer of choice? A huge, huge thing today. You will hear more about all of these topics today, and the good thing is that we feel that we have some really good assets and positioning to capture opportunities and win in this environment what we think – how we see that one needs to win right now.

And how we're going to do it? Well, it's clearly about executing on our Sustainable Success with Customers strategy. I talked about already the megatrends, what's driving growth in our industry; it talks about our purpose and where we want to get to. And in our strategy, we have what we call our Where to Win's. I'll talk more about those. That is where we expect to find the best opportunities for growth and differentiation in the coming years. And we have our Ways to Win, which is how we're developing KONE to improve the business continuously.

If I take a few examples, they're empowered people, incredibly important today. How do we continuously make KONE a better place to work? We have an objective to be a great place to work, also humble that that can always be improved. So, it's a lot about how we're driving further empowerment of our employees; how we are really, in this environment, doubling down on upskilling our people and making sure that we are employer of choice. Marketing and sales renewal, a fundamental thing when we see customers, the way they want to be served is changing. How can we make sure that we are serving them really the way they want to be served in much more efficient and better ways. And then, Lean KONE is really about fundamentally how we improve quality and productivity; and everything embedded on the KONE culture.

But if you look at the four areas where our strategy is really built on areas where we can find the best growth and differentiation opportunities. We talk about our core products and services, that's really the core where we are. We want to really lead with connected and adaptable products and services that are cost and carbon optimized. So, that is really a fundamental basis [ph] wherein we (00:17:42) want to have a core product competitiveness. Then, it's about new solutions for customer value. That is really how we help our customers succeed in this environment with the various People Flow Solutions, that you'll also hear more about today. The third one is about the service business in China, which is the biggest growth opportunity in our industry in the coming years. No one has a position there like we do. This is where much of the growth will come in a fast-growing albeit fragmented market. So, you'll hear more about that from Bill Johnson today as well. And then, about smart and sustainable cities, how can we be the preferred partner for our customers in smart and sustainable solutions?

So, if I look at some examples here, we want to definitely lead our industry with our connected solutions. We have two fundamental platforms upon which we build our services and solutions. It's our DX Class products, which are now rolled out across the world. Starting in late 2019 in Europe, Middle East, and Africa; then we started rolling out in Asia; and now, also North America. So, it's available everywhere. Then, the other one is our 24/7 Connected Services. In our subjective opinion, we think that it is the leading connected service in the market. Why do we say that? Well, it's clear that it is the one that the customers are paying the highest premium for right now, that is an objective thing. And we can see that it's resonating for customers across segments. We are very often asked that, are people in residential are willing to pay for this? Absolutely, they're seeing some benefits or actually a lot of benefits here but also in all segments, and it continues to increase the penetration and you'll hear more about that.

So, fundamental things that are key for our development going forward. And when I say that these are platforms that we build upon, they are not static. So, if you remember, we launched 24/7 Connected Services first time in 2017, that's a while ago already. Although, we have constantly then brought new services like our 24/7 Planner right now for construction time use or our DX Class elevators which is a fundamental platform, and you can then bring in further services seamlessly on top of them. So that is how we think about it, and these are ever-evolving services and solutions. So, you can constantly see smaller or bigger things coming on on top of them; and also providing our customers with opportunity to bring their own services as well.

And then, I mentioned the biggest growth opportunity in this industry in the coming years in China services business. We can see that the China market is definitely transitioning actually quite fast from having been very much a new equipment-driven market to be a market much more balanced between new equipment and services. We only go a few years forward, we can see that half of the world market, [ph] and that measured in (00:21:01) number of units, will be in China. And how do you win in that market? Well, clearly, you need to have a big service base. If you look at both units that we have in service, the dark blue bar, or units under first service period, we have already over 0.5 million units in China. That is clearly higher than anyone else. We have installed in the China market about 1.2 million elevators and escalators. No one comes close to that. Okay, so it is the opportunity to really capture that growth we have like, I would say, no one else. We know it's a fragmented market, it will continue to be, but the growth opportunity is definitely there both in maintenance and in modernization. And as I said, you will hear more about that later today.

And then, finally, mentioned that sustainable solutions are critical. That's a key design principle for a large amount of our customers. So, we can see that there's a huge demand for them. And how are we thinking about providing sustainability? It's through connectivity to provide accessibility with connected solutions. It's about further predictability all the time to improve the lifetime because that is, of course, from a sustainability perspective, the most important thing that – how do we extend the lifetime of our products? And we know that when we modernize or we put in new solutions, we can improve the energy efficiency significantly. And here, we continue to be the leader in energy efficiency in our markets.

We also are focusing a lot on how we can improve circularity of our products. And then, last year, we again broke new ground by being the first in our industry to launch first carbon neutral maintenance options for our customers. And now, we also have a carbon neutral product that we can sell to our customers, again, breaking new ground. And this is, of course, comes as a result of us having the most ambitious pledge in our industry. We have pledges both on Scope 1 and 2, which are direct emissions from our operations, which a lot of companies have. There, we're making great progress. We want to be carbon neutral by 2030, so we need to reduce by 50% our emissions and then compensate the rest. But really, actually, the big thing here is the 40% reduction that we are aiming for in Scope 3. If you look at that chart, you can see that 98%, 99% of all life cycle emissions are in Scope 3, so that is the big thing.

And the biggest impact, of course, the life cycle energy consumption. There, we have a commitment to reduce this by 40% by product sold by 2030. This is incredibly ambitious. How are we going to get there? Well, it's through focusing on what products we sell, it's about fundamental R&D, and it's working with our suppliers to have lower impact on the materials we put in. So, stay tuned on this. Do we have all the answers how to get to 40%? No, but I would say the momentum is there and a lot of focus in our organization to get there. So, that's how we think about it and think that this is a fundamental competitive advantage in the coming – or now and the coming years.

And nothing like this is going to happen without engaged employees, and that is absolutely central to KONE. We don't have this year's results yet, we're going to have them soon, but we can see that constantly our employee engagement have been above so-called high performing norms. So, it's about creating a great experience and journey for our customers, of course, always based on culture and leadership. We focus a lot on building the basic values, how we want to work with one another every day, which is a fundamental to our culture. And we work a lot on diversity, equity and inclusion nowadays; and a fundamental thing for everyone is how do we make sure that all of our employees have the skills that are required for the coming years. So, a big focus on our upskilling program – programs. And then, of course, flexibility and wellbeing, fundamental things today. So, absolutely critical to be able to be the employer of choice to attract the best people because that's going to be a fundamental competitive advantage going forward.

So, to summarize, we are taking actions both to counter the near-term headwinds that we are seeing. It's about dynamic pricing strategies and contract models, absolutely fundamental to us. We are making good progress there but it's clear that the [ph] mark (00:26:15) is moving, although we can see that our speed here is actually quite good right now. It's about also, of course, in a environment where all costs are going up, how can we fundamentally also lower the cost of our product and improve our productivity. And then, of course, right now, what has been a big focus is that how do we recover quickly from the COVID lockdowns in China. It's clear that the area where we have a lot of – we had our – have our biggest factory and a lot of our suppliers have been some of the areas with the toughest lockdowns. So there's, of course, a lot of focus on how to recover from those lockdowns now rapidly.

But at the same time, we are investing in our future to drive differentiation through adaptability, productivity, and sustainability. You'll hear much more about them. And then, very much where I think that more of the growth in the coming years will come through opportunities in maintenance and modernization. Here, we have continued to grow faster than our core competitors, and that is what we intend to do in the future as well. So, that's something we're investing heavily in to drive even more growth through services in the coming years. So, we're seeing good progress in our strategy execution here.

So, in summary, market outlook long-term is good, in particular in services. There are many changes in the external environment. The way we think about it is that changes creates opportunities. If everything just would be stable and the same, it would be – we all would look the same after a while, but this creates a lot of opportunities; and we believe that we have some great assets that we're very well-positioned to capture opportunities and differentiate with value-added solutions in what our customers are going to look for.

So, that is little bit of context for today. You will hear much more about all the things I talked about from my colleagues. So, little bit going deeper to each of these. But to start with, I now first hand over to Ilkka, who will talk a little bit more about the financial performance and how we are navigating from a margin perspective this environment. So, Ilkka, please.

Ilkka Hara

Chief Financial Officer & Member-Executive Board, Kone Oyj

Thank you, Henrik, and also, warm welcome on my behalf to this Capital Markets Day. It's great to see so many of you here physically. It's been too long that we've been able to see each other. But also, I know there's many people online as well today. So, today, what I will cover is a – our view and path towards our financial targets. I'll talk a bit about what have we done but also where do we see opportunities going forward, complementing what Henrik already said but also summarizing many of the topics that you will hear more about from Hugues, from Tomio, as well as Bill from perspective of China.

But let's start with our financial targets. We have three targets. We want to grow faster than market; we want to continue to improve profitability towards our long-term target of 16% EBIT margin; as well as continue to improve our working capital rotation in order to continue to have good cash flow generation for the business. I'll talk a bit more about all of these topics today. Clearly, from a growth perspective, we already heard from Henrik that we are making good progress there and continue to see opportunities going forward.

On profitability, short term, clearly the cost inflation has been something that creates a headwind short term, but we're continue to be focused on improving towards our long-term target of 16% EBIT margin, as well as continue to grow our EBIT on an absolute basis, so balancing between those two. And then, I'll summarize also our progress on cash flow at the end, which has been quite good and especially in the recent years, I would say, exceptionally good.

But before I get to this, I'll talk a bit about the drivers we see that we can leverage in our business to continue to grow profitably. First, we have a very strong position in the key markets, particularly in the markets where we see opportunities to grow our services business. We are the number one in China, and we have a very strong position also in rest of Asia-Pacific where we see opportunities to grow the maintenance business going forward. We have a solid track record for innovation. You'll hear a lot about DX elevators today and 24/7 Connected Service (sic) [24/7 Connected Services] (00:31:28) as a platform that enables us to continue to grow faster going forward but also improve profitability.

We've been on a journey of sustainability for a long time. We've had targets to improve our energy efficiency for our products, and we have a product portfolio which is very strong from that perspective. Now, lately, what I'm very proud of is actually our KONE Care DX maintenance offering. So, if you choose a KONE DX elevator with a KONE Care DX maintenance, you get the most sustainable offering in the industry by far. It is a carbon-neutral way of maintaining your elevators.

And then lastly, it is clear that without the right engaged motivated teams, we cannot make this happen. We cannot have the most loyal customers. But I believe we're making good progress there as well. And it is a key lever for us to continue to grow our business profitably.

So, let's look at a bit more in detail what has happened in terms of growth and also our actions to improve profitability. Henrik already talked about how, over a long period, over the last 10 years, we've been able to consistently grow faster than the industry and also compared to our peers. The source of growth has been our new equipment business, which has grown close to 9% in the last 10 years. Also, we've seen good progress in growing our services business, so maintenance growing at 5.9%, as well as modernization contributing at 4.9%.

That's about the past. We then look forward. We see that the best opportunities to continue to grow are in the side of the services, both on the maintenance, as well as in the modernization. Whereas in new equipment business, we do see opportunities to have growth, but it's more a stable, low-growth environment driven by the megatrends of urbanization, as well as urban renewal. At the same time, in maintenance, we see opportunities to continue to accelerate the growth.

We see opportunities to grow mid to high single-digit the business going forward. We have a steady increase from the maintenance base, but also the digital offering enables us to accelerate that growth. And as Henrik talked about already, we have actually seen a more rapid growth in last year and the beginning of this year. Also in modernization, we continue to see good opportunities to grow. We see that we can accelerate the growth there as well to a high single-digit growth driven by installed base, which is aging, as well as the opportunities we see for modernization going forward in China. And you'll hear more about that in Bill's presentation. But that's the base growth that we see in the business.

But we also see that we can boost the growth rate for our business. First, in the new equipment business, we are seeing that our equipment with connectivity can contribute more value to our customers. We can also contribute with our productivity-enhancing solutions, more value to our customers, increase the size of the pie and size of the wallet that we're able to address with our customers. So, accelerating the growth from the fundamental growth we see in the industry. Tomio will talk more about that.

Then second, 24/7 Connected Services platform that enables us to grow our per unit value in our maintenance base. That is something that is already happening today, and we see good opportunities to continue to do so going forward.

And in the modernization, I talked about aging installed base as an opportunity. But we see increasingly our customers also modernizing younger equipment as they want to be having a buildings that are more adaptable to the current needs of their tenants, the needs of their users, as well as the need for more sustainability. With more modern solutions, we can actually increase that as well. So, here, Hugues will talk more about it. But clearly, these are opportunities for us to continue to accelerate the growth for the business.

From growth perspective, we progressed well. At the same time now, we've seen a rapid inflation in the last years. We've seen significant cost increase since 2020. For us, it is more towards the second half starting in 2021. Material prices have increased. We've seen, especially on the semiconductors side, rapid increase and also shortage economy being in place. So, we've been able to supplement our supply from our suppliers with spot purchases that have increased a lot the prices there.

Also, logistics costs have increased, and that's a phenomenal that has happened everywhere with particularly logistics flows from China to Europe, China to North America, but also within the other regions as well. All of that has meant that our costs increased last year – our input costs increased last year about €200 million, and we continue to foresee that this year that increase is a further €150 million to €200 million. And that's clearly impacting our profitability.

When we look at our EBIT development, we are expecting our EBIT to be positively impacted by the growth opportunities we see. At the same time, this headwind from cost inflation is impacting negatively. We are seeing also labor cost impacting both our field, but also subcontracted work impacting our profitability negatively. I'll talk a bit more about how do we mitigate that. But then both productivity and the growth of our maintenance business that has a mixed positive impact to profitability then counters some of these headwinds. But all in all, we are seeing an impact to our EBIT in the two cost categories that represent the biggest cost items in our P&L, both labor and subcontracting cost, as well as materials.

But what are we doing about it? So, we're taking strong actions, and we've talked about actions already previously. First, we're driving pricing actions across all regions and businesses. We are working to lower the cost through sourcing and offering R&D actions that we're taking the products. There, we see also good progress in the actions we've taken already.

And then lastly, it's about continuing to drive productivity in both in our installation, as well as in our maintenance field operations. And, again, there, not only is the Lean KONE access that we're taking that Henrik talked about in our strategy, but also overall continuous improvement that we're making is contributing positively.

Well, I'll start with each of the items, and I'll start with the pricing and product cost progress. And now looking at where we are in taking the actions to counter the headwinds, and this is now representing our first quarter orders. First, on the pricing actions. If I look at our equipment businesses, so new equipment as well as modernization, we've seen the best ability to counter the headwinds in Americas. There, the pricing opportunities have been the best. Also in Europe, Middle East, Africa, we've being able to drive good progress with our pricing. Followed by Asia-Pacific. And where the pricing has been most fierce has been in China, where we have had roughly stable pricing in our orders. All in all, pricing is one side of the coin.

In the maintenance side – so this is about the equipment business. In the maintenance side, we would be able to see mostly green full bar – full circles. The actions that we've taken so far to counter the inflation actually have been very good, and we continue to see good opportunities there. But then when we look at the product cost actions that are the other way of countering the headwinds, we are seeing that in China, we've been able to drive the best progress with those actions, but also continue to see that they contribute positively into other regions. So, this is about pricing and product cost actions to counter the headwinds.

Then about field productivity. So, if you think about our industry, it is very distributed, highly local industry. It's about maintenance technicians maintaining elevators. It's about installation technicians installing elevators in the shafts. It is also about manufacturing equipment in a central location. But it is equally as much about all of our suppliers contributing to that material flow. So, in order for us to drive productivity, we have to work together with a full ecosystem of partners that at the end see the productivity in the installation side, in the maintenance work that we do.

First, what do we do in the installation side? One of the actions that we've taken is that we drive our manufacturing sites, as well as our suppliers, to manufacture equipment that is easy to install. It is defect-free, and it is something where we can see consistent installation methods being used, how to make it easy to get productivity. We actually have seen good progress. Over the years, we worked with our suppliers, and we've been able to drive 90% down the defects from the components that come from the suppliers. That's immediate quality improvement that drives productivity. Overall quality contributes to productivity positively.

Second, we were here in virtual setting two years ago. At that point, we talked about how in North America we see good opportunities with our new MonoSpace product to drive productivity in the installation side. In North America, the labor cost is the big – highest. So, how to drive productivity with the installation hours is the most meaningful measure. And I'm happy to come now back and say that we've achieved it. We have more than 25% reduction in installation hours with those products. So, this is about how to drive productivity with the installation side.

We are also working to drive productivity and field operations in the maintenance side. There, it is about every day improving a bit, and I'll let Hugues dig deeper on these data points in his presentation. But first, we have been able to drive more than 5% increase – or reduction in fixed cost per maintenance unit, and Hugues will talk about concrete examples how to make that happen.

Similarly, connectivity is about value-add. It's about offering something which our customers are willing to pay for, but it is also helping us to be more productive. And with the 24/7 Connected units, we are seeing that the call out rates, the time customer needs to contact us, we need to go to an elevator are reduced by 30%. So, not only is the elevator more available to the customer, but also that improves our efficiency of operations.

So, that's good. So, these are the type of actions we're taking short term to counter the headwinds that we see from the cost inflation. But what are we doing in long term, and how do we work towards our long term profitability target? So, clearly, maintaining this faster-than-market growth rate is important. We are seeing that we're able to leverage our fixed cost over a larger business that drives economies of scale. So, growth from that perspective is important. Secondly, we talk a lot about today on differentiation. With differentiation, we can add more value to our customer and also have more pricing power. So, clearly, that is something that helps us to drive profitability up in all of our businesses.

We are seeing that growth opportunities in the industry are best in the services side, and we want to accelerate this with our value-added solutions. And also, that contributes to our long-term profitability target, being able to work towards that. And clearly, overall connectivity is something that drives value to our customers and also contributes to our ability to both have more value to our customers as an offer, but also working more efficiently, as I talked about. So, all of these help us to work towards our long-term profitability target of 16%.

Then few words about how our financial position actually helps us to support our strategy execution. I guess I wouldn't be a CFO if I wouldn't be also a bit proud of how we can contribute for the company to continue to be focused on making good progress developing KONE going forward.

So, first, from a cash flow perspective, we have a good cash generative business model. We continue to see working capital are contributing positively, and I would say that the last years actually have been exceptionally good from that perspective.

We have a strong balance sheet that enables us to look forward, to focus on the opportunities we see, and that's also something that, in the turbulent times that we've seen the last years, I haven't had to worry about how to finance our operations. We've been able to focus on how to deliver value to our customers, how to make sure that we operate in the best possible way going forward. So, we have a strong negative net debt position of close to €2.2 billion. And also, our equity continues to be very strong, despite the strong dividend that we paid over the years.

But the cash flow is due to our good business model. We continued to invest to our research and development. We scale up the investments in 2015, 2016 to this 1.8% of net sales level, and therefore – thereafter had more stable investment from a percentage of sales perspective. But with the growing sales, we've been able to continue to grow our R&D efforts to continue to differentiate great value to customers and have leading-edge products and solutions to our customers.

Second, in the maintenance business, we've also contributed positively with M&A with bolt-on acquisitions further increasing our service maintenance portfolio. We continue to be focused on those. There, our appetite continues to be there. The limiting factor has been more the availability of our targets to be acquired. Seems to be an industry where many people want to continue to be there, but we continue to see how can we maintain this acquisition speed to consolidate the market.

So, we continued to invest to develop in the business on the R&D side, as well as then on this bolt-on acquisition. And with that, we've still been able to continue this strong growth of our dividend, close to 10% dividend growth over the last 10 years with last 2 years with an exceptional cash flow that we've had also extraordinary dividends being paid on top of that. It is something that we continue to be proud of and see the steady development on dividend as a one way to contribute back value to our shareholders.

So, if I summarize my message today, we are focused on delivering shareholder value. We're well-positioned to capture the growth opportunities we see in the market, as well as, with our differentiated offering, see further opportunities on top of the underlying growth. We have clear actions to restore the margins and secure progress towards the long-term targets. And we are committed to developing our business and ensuring steady increasing in shareholder returns going forward.

With that, I'll stop my presentation, ask Henrik to join me and Natalia on the stage, and I think we're ready for Q&A.

QUESTION AND ANSWER SECTION

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Yes. Exactly. We have time for Q&A. I see Daniela eager there in the front. Before we go to that, just as a reminder. To everyone on the webcast, do be active, send in your questions via the platform.

But with that, Daniela, please go ahead.

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you. Good morning. Daniela from Goldman Sachs. If I may ask two things. One, I wanted to ask regarding DX and how that has contributed to margins lately, I guess. Is it still that it was a period of investment and so it's maybe been dilutive through the launch? And how do you see that evolving, sort of contributing to your long-term margin target, how relevant it is?

And then the second question, sorry, just a very short term focused one, but on the margin in 1Q, just to understand, tying up a couple of your comments, I guess service, your margins have not gone down, I assume, given your pricing commentary. I think you've also said before that China margin was still slightly above [ph] group (00:50:59). So, is it that new equipment at the moment is loss-making in some regions? And, yeah, sort of what's the path from there? Because it sounds like more of the headwinds are in China, but maybe perhaps is the rest that is on weaker profitability.

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

A

So, if start with the DX question, so I guess you're referring to DX Class elevators. So, there, I guess it's been couple years now that we've rolled out the offerings starting from Europe then to Asia-Pacific, China, and then North America lately. And to be honest, the rollout has been the fastest we've seen so far. And from that perspective, initially we had still a comparison point to old products, and we are seeing a premium on the DX offering. Now we can see that it is generating demand. It's a way for us to differentiate against the competition, and then a bit more pricing power. So, I see that contributing positively. The investment there is more about R&D investment. So, that's mostly been done. And then we have the 24/7 Connected platform, for example, that we can just switch on on DX. So, that is – in my mind, contributes positively to our margins.

Then second question was about Q1 and the margin development there. So clearly the biggest change in our margins in year-on-year, so last year in Q1, we did not yet see much of the cost headwind in our P&L. We're able to, with a sourcing agreement, postpone the impact to our P&L. And that is a headwind, which was then fully impacting this year's Q1, approximately €80 million of impact on the quarter. Most of that's coming from raw material driven increases in the component cost. Yes, maintenance continues to be developing positively from a profitability perspective, but clearly that's one part of it.

Then the second part was that if you compare the development in China, so – especially in the new equipment side, so we did not see there a normal growth due to the lightness of the developer liquidity. So, that's impacting then also negatively on the mix on the new equipment side.

Natalia Valtasaari A
Head-Investor Relations, Kone Oyj

I think there was another question here in the front row.

Miguel Borrega Q
Analyst, Exane BNP Paribas

Hi. Good morning. It's Miguel from BNP Paribas Exane. Two questions from your new equipment. You talk about more dynamic pricing contracts. Can you just help us understand a bit better how these are different? What do they include exactly? And any differences between China, everywhere else?

Then my second question. On the 40% reduction in emissions per product by changing the materials and packaging, any views on how this will impact product cost long term?

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

So, let me actually start with the second one. So, the 40% reduction, it's not only materials and packaging. It's – the most fundamental is energy consumption over the life cycle and actually going to reduce cost for our customers. Depends on what materials we go to. They may be a higher cost for them, but then we need to make sure we can get the premium for them. So, that's many of – if you look at steels that are greener, yes, they come with a premium. So, we have to see what our customers are ready to pay for, but the most fundamental thing we can do is on the energy consumption, which is a good thing.

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

And also, many of the actions that we're taking us actually are more redesigns, how we use material, how the products work. So, it's not only about doing the same thing, but thinking about doing differently. And there, it can be something that comes with a cost or can actually be also more cost-efficient.

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

[ph] Anyone (00:55:13)...

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

A

So, what was the second question?

Miguel Borrega
Analyst, Exane BNP Paribas

Q

The pricing contract models.

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

A

Oh, yeah.

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

A

Do you want me to take – I can take it. So, the pricing contract models. What it means, as I mentioned, is that historically not a very big part of our contracts have had indexation clauses because usually what happens is that you have a developer who is committed to develop – to deliver a building to some tenants at a fixed rent in a few years' time. And they want to get a fixed price contract with a general contractor, and then a general contractor wants to get fixed price contracts with us.

This, we're starting to see, is changing. We definitely see clear changes here. That means that you sell today something, if [ph] you want to deliver (00:56:00) in two years' time, you're going to have adjustments to the price over time so that therefore it becomes more dynamic. It's clear that not all customers want to have that, or actually not many want to have it. But as they are also getting, we see changes here, and, of course, that's something we're driving, that you can get more indexation into your contracts.

As I said, it's only a small part now, but we see that that's starting to increase clearly now. That's a object – I wouldn't expect that to be turned around like this, but the trend is definitely right one there.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Good. I think we had one more here, and then I promise I'll get to the other side of the room as well.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Hi. It's Andy Wilson from JPMorgan. I've got two. I just wanted to start on – you made a question here, like, at the start – sorry, a comment rather at the start on talking about this kind of value and volume contributing to top line growth. And I just wanted to kind of understand whether that was – is that a change in terms of policy with regards to sort of how you're trying to drive the growth and just being more mindful that chasing volume at any price, if that's been what's happening, is definitely changing because it doesn't look on the sides that followed that there's any short of ambition in terms of the overall growth rate. So, just wanted to sort of understand if that's a shift in terms of your thinking from a kind of top down basis, given what we've seen maybe over the last 12 months or so.

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

A

It is a slight shift because if you think about the environment, particularly when China was – when we had the mass migration phase in China and volumes are going like this, then really the key strategy was, how do you get more volumes? Because you knew that with the increase in volumes, you could get a lot of productivity in your supply chain.

When there's less growth in the future, what do you need to make sure is that your growth, it's not going to be smart just to drive it through volume. That way, you want to get more is through value. And if you look at our maintenance business today, and you'll hear more about that from Hugues, actually, why are we growing faster than our competition? Not the only one, but one of the key reasons to that is we are focusing on the value aspect as well. And I think this is something that is critical. If you want to grow with good profitability, you need to focus more on the value-added aspect, and we can also see that there is demand from customers for that.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

And then the second question just around price development, and thank you for the kind of the regional commentary, it's obviously very helpful. Just interested if you can kind of comment on whether you think that's indicative of what the industry is seeing or whether there are certain areas of where you're either under or overachieving, whether that'd be, I guess by regions, obviously helpful as well.

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

A

Well, I guess it's hard for me to comment what the competitors are doing. I think overall, if you think about KONE's strategy, it's about value-add. So, we clearly are a company that continues to work on how to contribute more value. And normally, that means that we are well-placed to drive pricing forward. I would say that we've been working on this for now a number of quarters and continue to drive that forward. So, I think overall, we're doing quite okay compared to the industry.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Let's actually take one from the line just because it was around the same topic about pricing and productivity. So, a question on China maybe for either of you to address. And the question goes, there's been little impact on price in China so far, but it has been the best region looking at productivity. With kind of pricing declining on new orders, how much can you improve productivity in China?

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

A

Well, the chart that Ilkka showed, that was on fundamental impact on product costs. So, clearly, first, product cost has going up because all materials have gone up a lot. And then what have we been able to do from fundamental R&D perspectives, of course, to work that down a fair bit. And the progress in that area has been the best so far in China, which is important, because they have, of course, materially higher proportion of labor compared to other parts of the world.

So, I would say this is something that needs to continue. But at the same time, I think it's clear also that everyone in China is having a challenge with this, with the cost increases. And therefore, I do believe that prices will have to start moving there as well. There have been so many disruptions now recently to the market that I think focus has to be more on, how do you keep on going? How do you keep on delivering with this very tough lockdowns? And how do you recover out of that? And then we come next stage, how do you start also drive pricing?

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Excellent. Thank you. Now back to the audience, and we have one here in the middle.

Philip Gottschalk
Analyst, Trium Capital.
Q

Yeah. Good morning. Philip Gottschalk from Trium. So, you've talked a lot about pricing, about value-add. Can you maybe develop a little bit more on what your actual pricing power is in the field today? How much can you be a leader in driving price versus being obliged to follow what the competition is doing? And in terms of differentiation, you mentioned sustainability, digital connectedness. But when you look at the competitors, they are also following on these trends. So, how much incremental pricing can you drive, not compared to a traditional elevator, but compared to the best model of your competitors? Thank you.

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

So, I think it varies quite a lot which business we were in, and pricing in a services business compared to new equipment business are very different. In services, there, you have an established long-term relationship with your customer and you can have that discussion. And there, we've seen that we've been able to improve pricing. And there, I would believe that we are ahead of the pack because of differentiation. So, we can see a clear premium that we are getting in many cases of that because of differentiation that we have.

New equipment, those – when you sell those, yes, you have many long-term frame contracts on that, but you also have – a very large proportion will always be based on a tender. So, there will be certain specifications that you will have and people will tender against those specifications. What is important to do is to early influence to make sure that customers will want to choose solutions that have the value-added aspect. That's why it takes a bit longer and why it's not as quick as pricing in services business.

And I think if you look at our industry, we have very tough competitors. They have differentiating elements, and we have differentiating the elements. It's that, how can we make sure that ours are the ones that are most relevant for customers' needs just here and now? And only time will tell how well we can do. We think we have some good assets. As I said, competition is tough, and therefore we are – really want to focus on what are the biggest needs for our customers right now and here today.

Philip Gottschalk
Analyst, Trium Capital.
Q

Okay. Thank you. Any number to share maybe on the premium you mentioned in maintenance?

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

Ilkka, maybe talk about it more. When we are able to sell our Connected Services, the premium [ph] rate (01:03:52) is quite significant, and we see that we have a different strategy there. I think it talks a lot about the quality of our Connected Services.

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

A

Yeah. Maybe one way to think about it is when it comes to 24/7 Connected Service, so when we sell that on top of a normal maintenance contract, the good thing has been that throughout the rollout, we've been increasing the penetration. But what we've seen is that the pricing has been quite stable. So, normally when you go through more volume, you'll start to see the early adopters becoming more the volume customers and then it impacts your pricing. But actually it hasn't for us. And one reason for that has been that we've continuously developed offering to had more value-added included to that. But we are seeing it's a significant increase to normal maintenance contracts when we add the diesel offering on top of its 20% to 30% increase in price depending on the market. So, it is, in my mind, a great opportunity to differentiate in the eyes of the customers.

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

A

And you will hear more about from both Tomio and Hugues and you can [indiscernible] (01:04:59) them on the same topics.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

It's nice that you're building expectations here. I think we had one more here in the middle and then we'll move over to the end over there.

Panu Laitinmäki
Analyst, Danske Bank A/S (Finland)

Q

Thank you. It's Panu Laitinmäki from Danske Bank. I have two questions. Firstly, on the 16% EBIT margin target, can you talk about your own assumptions behind that in terms of what kind of sales mix does that require in terms of new equipment versus services and that's what kind of margin levels for China and elsewhere and for new equipment and services? Even if you cannot go into numbers, can you kind of directionally comment where do you need to improve the most to get there?

And then secondly, on the services margin, obviously you don't report what it is, but if I look at your competition who does report it, I think they had more than 22% last year. And the question is, do you see that as achievable for you with the current set-up with the kind of [ph] country mix (01:05:53) and the scale that you have in the service units under management? Or is that something that you could [indiscernible] (01:06:02)? Thanks.

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

A

I'll start with the long-term margin target. First, what I would say that it's not the target where we put an excel together and drove the target from that perspective. It's an ambitious target for us. And clearly, if you look at the last few years, we have been working away from that, so it is a more ambitious target right now. But then that being said, clearly the fact that we see the opportunities and services for growth contributes positively there. And like you said, so our maintenance business has a higher margin than, for example, the new equipment business. So, that clearly contributes positively to it. And at the same time, as I always said, we need to balance a bit how do we work between absolute and relative profitability. Just getting relative profitability would mean probably making wrong decisions for the long-term growth of the business. So, you need to balance between both, but I would say that this margin target is especially internally, very, very good. It gives you an ambition of where we want to get to and everybody needs to work towards that and clearly we are committed to it. But I wouldn't say that it needs to be within certain business mix or [ph] country mix (01:07:25), but I think it's where we need to see everybody improving on their profitability towards that target. Ilkka?

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

A

And then, we had about – so, your second question was about services. As I said, we don't disclose profitability in services. And it's clear that the ones who disclosed have slightly different mix. But I would say that our development has been positive and when we compare ourselves, yeah, looks pretty okay.

Panu Laitinmäki
Analyst, Danske Bank A/S (Finland)

Q

All right. Thanks.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

And we have Tom there.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)

Q

Yes. Good morning. This is Tom Skogman from Carnegie. I have a couple of questions. First of all, I mean, the market really wants to get some confidence that this margin trend is going to turn around. You have showed a lot of initiatives. But I also wonder, isn't it kind of – shouldn't you do some kind of a larger cost-cutting program to really have – to restore confidence that the margin trend is turning around next year.

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

A

I'd say the most important thing for margins right now is clearly pricing and productivity, and that's where we want to keep very focused on those aspects. At the same time, you want to drive efficiency in all parts of your organization, and you can do that in various ways. And I think we have – we are pulling many levers that we can right now. But I think pricing is the most important on productivity. Those are the areas where we think that would be the levers you want to pull right now to improve your margin.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)

Q

Another thing you could do to kind of restore confidence in the longer-term margin trend will be – to be – to show the service and equipment margins separately or regional margins like some of your competitors do, like [indiscernible] (01:09:15) the Head of the Divestment and Otis [indiscernible] (01:09:18) service margin separately. I mean, that would give tools for investors and analysts to really kind of estimate what can happen long term if there is no growth anymore, for instance, in China. Have you considered this? I think it would add a lot of value to us.

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

A

I think we'll take the feedback on disclosure. And from our perspective, we looked at this as a business where all of the three parts of the business contribute to the long-term value creation of the business and that's how we report it. But what naturally, it is something that we need to consider as feedback.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)

Q

About consolidation, you obviously have a very strong balance sheet. And in China, we see that the growth period starts to be over. But it's kind of easy to understand that it's probably too early to start to spend money on consolidating the China market. So, my question is, would you rather – if you could choose, would you rather spend your money on the Americas region or in Asia at the moment? If you could choose, where would it make more sense to strengthen the position basically now?

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

A

I would say wherever you can find good targets. So, the problem is if that there's – if then at any targets, then it's difficult to choose.

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

A

And also, I would still go back that if you look at the China, I think we have a huge opportunity in the services side, but I'll let Bill talk about that as well as with Hugues.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. Thanks.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Okay. Thank you. Just behind Tom, we had our first...

Q

Hi, [indiscernible] (01:10:50). I have to – after Tom's questions, I have to ask the one that I always do. When is it time to start buying services as you have done so successfully in the rest of the world?

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

A

In China, you mean?

Q

Yes, in China.

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

A

That's, of course, the question we need to look at, as we said, so far, organic growth has been excellent there. And we, however, want to keep our focus fully on the organic growth, and now there are a lot of KONE equipment out in the markets, so how do we recapture them. But it's probably going to become a relevant question in the coming year. So, let's see how and where and what the model will be. So, stay tuned on that.

Q

Okay. Thank you.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I know there are a few hands here. I want to turn to this side as well, because I feel like I'm facing this way and it's maybe not fair, but we're good, okay.

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

A

[indiscernible] (01:11:40).

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Yes, we have a couple on the lines as well. But let's go to Tomi here and then [indiscernible] (01:11:46).

Tomi Railo
Analyst, DNB Bank ASA (United Kingdom)

Q

Hi, Tomi Railo, DNB. Still a follow-up on the profitability, not only for the first quarter, but do you think that you are making money or are you losing money or are you breakeven on the new equipment, the modernization business outside of China this year?

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

A

Well, that is, again, come back to that segment reporting question that we're not giving exact segment profitability, but clearly with this headwinds, it is impacted negatively. Overall new equipment business, as you've seen from a modernization side, we've talked about how there actually we've seen very good opportunities to also work with pricing to counter the headwinds. So, that's progressed well. But then, the size of the new equipment business, then overall does impact to the headwind. But we are expecting to make a profit there.

Tomi Railo
Analyst, DNB Bank ASA (United Kingdom)

Q

And maybe before Bill talks about it. But what is the latest – what do you hear from China in terms of lockdowns, reopening, et cetera impact on the second quarter?

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

A

So, reopening, as I said, the lockdowns, particularly in Shanghai area where a lot of the elevator supply chain is based have been very drastic. Also in Kunshan, where we have our biggest factory, there were several weeks where lockdowns were very, very tight. And of course, then we've been running so-called closed loop production for the past weeks where it means that people cannot leave the closed loop. So, that has had an impact. And the biggest issue is still logistics. So, from today, restrictions are being lifted actually with quite some speed. So, definitely things are going in the right direction. And it's been, of course, very tough environment in the past weeks, and we have to see that how quickly does logistics normalize. That is really the big thing. And how quickly can certain suppliers ramp up that have been within Shanghai, that's – those are the bottlenecks right now. But I would just say that the good thing is that as of today restrictions are being eased, actually quite some speed.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

[indiscernible] (01:14:13).

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

A

[indiscernible] (01:14:14).

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Yes.

Q

Hi, this is [ph] Nitya from Deccan (01:14:17). I have a couple of questions on a chart that you put up about the 90% reduction in defects in America. What were you doing wrong to have such a high defect rate in the first place?

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

A

I don't think we were – this is actually a 10-year...

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

A

It's a 10-year journey. So, it's a long-term journey. And it's not actually Americas. It's global number.

Q

Oh, got it. Yeah. The second question on the same graph, you mentioned about third-party contractors on the installation side. Can you give us a sense of what percentage of installation is done by third party?

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

A

It really varies a lot between markets. So, we have some markets where we are doing all the installation ourselves, and then markets like in most of European markets where it's a mix. And then, for example, in China, installation is done by third parties. We just supervise the work. So, it's a mix between the different countries.

Q

So, just staying on the same graph, you mentioned 5% reduction in the fixed cost base. Can you give us a sense on the service side what is fixed cost, variable cost for you?

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

Maybe, Hugues, you can comment a bit on that in your presentation.

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

Let's leave it to that because you will hear so much more about it.

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

Yeah, it's exactly actually the details behind that is there.

Q

Last question from my side is you said that the overall maintenance growth for the business from – on a value perspective is going to be better than the last decade that we have seen. But at the same time, you also mentioned that the mix of portfolio is going to be driven more by China. And given the pricing premium difference on a revenue per unit basis, it would seem that the mix would be working against you rather than for you. Then, how do you grow faster than the 5.9% that you've had over the last decade?

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

What's your question? Hold that on and then you ask it from Hugues. Okay. Can we can we do that? I think you will get the better answer from him than from us.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Yes. So, let's try to do one final one from the lines before we go onto a break. There are quite a few topics coming in that I can cover in later presentations as well. So, be patient. Those of you online, I haven't forgotten you.

Let's do one on 24x7 Connected Services and on the productivity benefits you mentioned, Ilkka, in your presentation. So, do you think that this is something that will eventually be passed on to customers through reduced price or are you actually seeking to improve margins?

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

Well, I think first if you think about our 24/7 Connected offering, we've continued to develop that with a value-add first strategy. So, how do we actually use the technology to deliver something that the customer sees the value? Then as a result, the callouts are coming down, but it does mean that also customers are actually they don't have to worry about that, equipment availability is better than the past. So, it actually is something that is value adding and visible to them as well. Yes, we do get some efficiency as a result, we can time when we visit the equipment, how we built the – and plan for it. But at the end, for us, it's really a value-added strategy. But again, I will – Hugues has more on that one. So, I don't want to spoil his presentation.

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

A

Perfect. Thank you, Ilkka. All right, I think now we've reached the end of this Q&A session. We have plenty of time after the other presentations and at the end of the day, so we can have more discussions then. But now, time for a short break, about – well, just under 15 minutes. So, if we can start again at 10 o'clock. There is coffee and refreshments just outside. So, enjoy.

[Break] (01:18:03)

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

All right. Welcome back from the break. I think people are still gradually making their way in here to the room. Hope you had a chance to grab a coffee, speak a bit, talk with – mingle. I'm very pleased that we'll be continuing our morning sessions now with the Head of our Greater China business, Bill Johnson. Bill is joining us virtually. So, let me just – I see him here. Let me check that he hears us well and he sees us well. Does that sound good and clear, Bill?

William B. Johnson

Executive Vice President-Greater China Region, Kone Oyj

It sounds very clear. How about myself?

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

Yes. Perfect. Excellent. Then, I will let you take over.

William B. Johnson

Executive Vice President-Greater China Region, Kone Oyj

Thank you very much, Natalia. And thank you, everyone. Thank you for coming. I'm looking forward to talking to you a little bit about the China portion of our KONE Capital Markets Day and talk to you why we see us continuing our leadership position in new equipment and services in China.

But before we get into the present situation, let me recap some key data points that happened at the end of 2021. At the end of 2021, we were number one in the China market in terms of deliveries and units on your service. We were – we had more than 23,000 employees. We serve more than 30,000 customers. We have 90 branches and more than 600 service locations across the China geography. And this includes both our brands, the GiantKONE and the KONE brand.

Since the beginning of our operation, we have shipped more than 1.3 million units from our factories in Kunshan and in Nanxun. And as mentioned, we maintain more than a 0.5 million units under service in the China market, the largest portfolio by far. And as you can see when you look in the right-hand side, the services business only really at this point represents 15% of our sales, but it's clearly the one with the greatest growth potential going forward.

Now, it's clear in recent years, there has been a shift in the market mix. The new equipment market has definitely peaked, but we see that and we believe that it will remain at a very high-level. We have to remember that the

China NEB market is by far the world's largest NEB market. And we believe that will remain the biggest for years to come.

In addition, we're seeing the maintenance and modernization markets continue to grow at a very high rate. It's really beginning to hit its stride and we're very optimistic about what we see for the future in this part of the market. And when I look at how we're positioned, I say that we're in a great position to continue to outperform the market in all of these three key business sectors, new equipment. We're going to maintain our leading brand in this market. In our maintenance, we have a solid foundation. And we're going to continue to gain share through our digital solutions and productivity tools. And the all-important modernization market is coming up and this is where we're also building our brand to capture more opportunities here.

When you look at the right side of the page here, you see the chart in terms of this mix, clearly, services are going to be the fastest-growing part of the market. And we believe that by 2025 or so, it's going to be approaching near 50% of the overall market in terms of monetary value.

Now, one big topic that needs to be addressed and I've already heard some questions on this already is the COVID issue and its near-term impact. There is no question that it has had an impact, with more than 50 of the 100 largest cities with some degree of lockdown, when you see all the restrictions that have taken place, particularly when it's aimed at logistics, that's certainly going to have an impact on our situation. The good news is, though, that the ports seem to be back to operating situation and easing policies are beginning to be issued by the government, in fact, almost on a daily basis.

And today, I have good news that the opening of Shanghai has begun. All the lockdowns have been lifted. It will take some time. We have to ramp up slowly, but I think this ramp up is going to be measured more in weeks than in months. And right now, what we're trying to do is really get our operations and get the city and get everyone back to work and back to normality. Now, during this period of time, this lockdown, KONE operations had been very consistent. We had good demand for our products that continues, it's still very solid. Construction sites have been closed, but we've been now gradually reopening them and getting deliveries to them. The good news also is that our service business has really helped to soften the blow when it comes to these sorts of – sort of impediments and while our factories were closed for about three weeks in April and a couple of days in May, they're now pretty much back to full capacity. Our big issue is helping our suppliers get back themselves to business, get themselves back to full capacity, and then make sure that we can continue to resolve any lingering logistics issues that are making it more difficult to deliver product or deliver material to our factories.

In the short term, there is no question that the property sector has taken a hit. And there's – with multi-week lockdowns, it has certainly had a negative impact, not just on the China economy as a whole, but specifically on our real estate market. And unfortunately, these lockdowns have added additional headwind that have exacerbated the credit squeeze that began in the second half of last year. As you can see from these charts, if you look at from Q3 of 2021, it began coming down both in terms of property sales and new construction. They both came down. And then, of course, in Q1, they continue to come down and then of course, April certainly down.

But as I mentioned, almost on a daily basis, we're seeing the government issue many, many new proposals and policies to support not just the overall macro economy, but specifically the real estate industry. And on the real estate industry, they're supporting not just on the supplier side, namely the big developers, but also on the consumer side, making it easier for people to get mortgages, lower downpayment ratios. Many things that will make it easier for people in these cities to buy apartments.

Oftentimes when we're in these situations, we want to make sure that we're looking at the overall trends, the overall situation in the market. So, the key underlying trends continue to be there and support this optimism that we have. And I believe it's very much so. When we look at the trend of urbanization, that's continuing. There's no question about that. And I'll go into detail in a minute, but we still have about 10 million to 15 million people a year moving into cities.

Another key underlying trend that's taking place are the city cluster formations and this is the way the central government is trying to target investment and make rational decisions about how to improve transportation, medical, education, all sorts of these important services that help make the economy run smoothly.

Another key trend, of course, is developer consolidation, that is a big thing that has happened particularly as the government has moved to squeeze down credit on those companies that are overleveraged, that is also forcing a lot of consolidation. That's going to have an impact on our business going forward.

The other final real big fundamental trend that's taking place would be the digitalization and connectivity that our customers are asking more and more for. And interestingly, that become a prerequisite by many provincial governments before anyone can do condition-based maintenance. And that's going to have a very material impact on the competitive landscape going forward. Let's take a little bit deeper dive when we look at the urbanization rate, you can see here on the left-hand side, 2020 we're about 64% urbanized. But I believe that we're going to continue to see that steadily climb up for the next 10 years to about 70%. In addition to actually just the volume of people coming into the cities, we're really seeing the government focus on the living conditions. Through urban renewal, they want to improve living conditions because they're trying to support the policy of larger families. That means you need larger apartments. And when you're improving their urban landscape, when you're making things more livable, that actually improves elevator density in these cities. And again, we believe that we're very well positioned to maintain our leadership position in each of these market segments of residential, commercial and infrastructure.

Another major trend or driver is the city cluster formation. Now, this is a policy by the central government, as I mentioned, to focus investment. And you can see the first wave of investment and focus are on the top five clusters seen here in blue, blue circles. And these first five cities represent about almost 60% of China's GDP in 2020. And you can see where they're well positioned along the coast and actually in the center there. This would be a very large population centers in the middle of China.

And as you look at those dots, those are where we're located with our branches, our service depots, factories, logistic centers. These are all where we are. And you can see we're very well represented in these top clusters. And then, in the future, we're seeing five secondary clusters being developed and nine emerging clusters as well. And we're very well positioned in each one of those going forward. And that's how where – when we look at these city clusters, this is also where we're making our decisions in the future about where to open offices, where to set up more service depots to support our customers.

Another trend I spoke about earlier was developer consolidation, and this will definitely continue for the foreseeable future. Why is that? Well, the market is maturing for sure, and that's beginning to squeeze out weaker players. Another big trend that's happening is that the government and financial institutions want to actively support the larger players. And as you can see here from 2015 to 2021, they went from about 25% total share in the market to approaching close to 50% by the end of last year. So, we think that's going to be a very important trend. Now, what's important for us is that these top developers are – many of them are key accounts. And we want to grow with them and we want to make sure that we're supplying them with the best kinds of products and services that we can, to continue to be their key partners as well.

But I also want to emphasize that while we really focus a lot of energies on these top developers, we have a very broad base of customer mix in all city tiers and in all market segments. When you look at the right-hand side, you can see that this formula has been, I think, very positive for us.

In 2010, we were about 10% market share. But by the end of last year, we were approximately 20% market share. Now, as I mentioned, the new equipment market will decline. And we're expecting this year, because of a lot of the lockdowns and a lot of the credit restrictions and certain other policies, there will be a general decline of about 10% to 15% this year in new equipment.

That said, though, if you look down at the bottom left here, you see that each year we have been able to outperform the growth in the market, and I believe we will continue to outperform the market as we go forward. I'm often asked how do we do that, what are the key things that give us confidence that we can continue to outgrow the market. The first one is our dual brand strategy. I think this has been a very powerful combination for us to hit all geographic segments, all customer segments, high, mid value segments. It gives us great reach into selling to different kinds of markets in tier 3, 4, 5 cities. And then, of course, in tier 1 and 2 cities.

Another key component of our competitive strategy is having the best products and innovative offerings in the market. And I believe that we're very much the leading player when it comes to product quality and innovation. Innovation, though, is not just on products. Oftentimes it's how we work with customers. And our customers keep repeatedly saying, hey, KONE, you're the easiest people to work with in your industry. When we work with you, we're very confident you're going to be able to keep up with us, and in fact, lead us and help us with our projects.

Installation productivity is one very key area where we continually focus on, and I've seen some efforts in this area recently which give me very big confidence that we're going to have additional productivity opportunity, improvement opportunities here in installation, which is very important for our customers. And of course, reliability on the service side, that is both a benefit for our customers and for us. It makes us more effective suppliers and improves our customer satisfaction, but it improves our cost system – our cost situation, so we don't have to repeatedly take care of problem units.

A third tier or our third pillar of this strategy is our extensive channel partners. I believe this is a real force multiplier for us when we go out to market with our more than 2,000 loyal partners. They help us see all the opportunities in the market. Each year we're tendering hundreds of thousands of project – of elevators in the market. And by having partners who can help us understand where the opportunities are, this really helps us to be much smarter and much more effective when it comes to selling, when it comes to delivering our services. And also, they're located with us in many of these city clusters.

Moving on to the all-important and really exciting growth opportunity in the maintenance market. Maintenance is becoming really an increasingly key driver for our growth here in China. There's no question about that. And if you look at the left-hand side, you see by the end of 2022, we're going to be approaching 10 million installed units here in China. But when you look on the left-hand side, you see, although we're number one in terms of service units in China, we're still only 6% of this market. This is a fantastic opportunity runway for us to really capture more. And I believe one of the key drivers in this is going to be technology because many of these small service providers will not be able to keep up with that. Hugues, I know, will talk a little bit more in his presentation about that.

But how will we get to this growth opportunity? Well, as you see each year, we have outgrown the market when it comes to adding to our service business. Our maintenance growth has been every year better than the market, and how do we do that? Well, we do that again through our great service network coverage. We invest in our sales network to improve conversions and retention, these are two key metrics that I measure all our service teams in all the branches, because this is a key winning – as it should be done very – it should be top of mind with our teams at all times, because this conversion retention is the easiest way to grow our business. Also, more innovations such as 24/7 remote monitoring. This is a great product that our customers pay us for and they love what it brings to them and also is becoming more and more of a requirement by provincial governments before any company can do condition-based maintenance. And finally, we've invested over many years to upgrade our field productivity and service quality.

Modernization is the next very exciting piece of this aftermarket service business. Why is that? Well, if I had a – we've always dreamed of, hey, if I had a crystal ball and could see the future, that would really be great. Well, I can tell you, we have a crystal ball right here and we can see the future. In 2004 to 2020, we had a supercycle of new equipment sales. Well, you look forward 15 years, that supercycle is going to simply repeat itself, but now for modernization. So this is a very exciting opportunity for us. But we haven't waited. We have already really invested in this side of the business. And you can see each year, we have outperformed the market by a wide margin.

Why have we been able to outperform so well? Well, because we're not just looking at our own portfolio, which is very young. We've only grown so fast in a very short period of time. But we go after non-KONE equipment. We really have a great brand that customers, not just for our brand, but other brands, look and say, hey, KONE has got the solution that we want. So we're able to really have a great product. We have a great product offering so that our customers want it, and we continue to have a great sales channel to support our growth. And the icing on the cake is that by 2025, 500,000 units of KONE equipment will be more than 10 years old. And that's our opportunity to continue – to go after our own service base.

In summary, the elevator market in China, the mix is shifting. No question about that. It's shifting toward services. This is where great opportunities are. However, I want to emphasize that it's not so easy to build a service business. It takes years. In fact, I will say it even takes a generation to put in place the infrastructure, the training, the organization, the thinking, the mindset to build a service business. It doesn't come overnight. It takes a lot of time. I believe we are super well-positioned both in terms of products, services, organization, leadership to really capture these opportunities, and not just in services, but also continue to hold our position in the new equipment business as well. We got a strong foundation. I'm looking forward to the next few years here in China. Thank you.

QUESTION AND ANSWER SECTION

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Thank you, Bill. And let's head into a bit of Q&A now. I wanted to take one from the lines before we go into the audience. There has been a couple of questions around the market mix and how it's changing. So maybe if we can provide a little bit of clarity on there. So first of all, if we look at the business mix in China, new equipment services or new equipment maintenance and modernization, do you expect the change towards service to be driven by the decline in new equipment? Or do you expect the services growth will actually accelerate from the current levels that we're seeing?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

I think it's really going to be from the installed base that we've been putting in year after year after year. Think about this. We've been putting in 600,000, 700,000 units as an industry into this market. And people are waking up to the importance of a good service aftermarket. People's expectations – customers' expectations are rising. I don't think this is at the expense of new equipment. It's very much its own business. It's very much organic. And it's – and I think we're all going to begin looking at the independent service providers as our opportunity to really grab even more share from them. And recapture. As you've seen, we've already installed more than 1 million units in China. I'm only maintaining at this point about 530,000. I want to recapture those KONE equipment that is out there. That's a huge opportunity. That's just low hanging fruit right there.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Excellent. Thank you. Let's then come to the lines, and I think I saw the first hand over here, or sorry, into the room.

Antti Kansanen
Analyst, Skandinaviska Enskilda Banken AB (Finland)

Q

Yeah. Thank you. Antti Kansanen, SEB. Just a question on China new equipment, and you demonstrated that you have been outgrowing the market in terms of units ordered. Today, we've been heard a little bit about a focus shift towards more value over volume. So could you comment a little bit about what this means in China new equipment context? And kind of reflecting the fact that perhaps the market is not growing anymore going into the next couple of years, does it mean that you're going to be more selective in terms of markets where you can leverage your brand [ph] there or your (01:42:03) position and perhaps achieve a bit better pricing and profitability? Thank you.

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

Yes, absolutely. We have had a lot of internal discussions about how to approach the next several quarters in the market. Clearly, the rise in raw material costs and some labor costs as well have really focused us on making sure that we get our cost structure well, increase our productivity. But we've also come to the conclusion that we can't delay much longer. We have to begin to now ask our customers for higher prices. This is – and they're facing the same issues that we are. So we're beginning to already open these discussions with many of our customers. I've already been talking to my teams through – across China and this topic is now front and center in all our discussions with our customers and our hope is that we can get – at this point, we already have a price premium, but now we need to push it a little bit harder.

Antti Kansanen
Analyst, Skandinaviska Enskilda Banken AB (Finland)

Q

But I guess looking at longer term, how do you kind of balance between – I mean the service opportunity is obvious in China and kind of driving installed base is adding to that one. How do you balance between defending your market share independent on pricing or kind of improving the margins, not only by productivity gains, but also by improving pricing?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

Right. We don't want to get volume at any cost. We want to make sure that we're smart about how we've done this. And I think over the years, we've been actually very successful at getting the right kind of profitable growth that we've always wanted. Now, under this circumstance, if our market share takes a slight hit, but that means that we're giving up more marginal – marginally priced contracts that don't make sense for us, then unfortunately, that may be something that we have to consider.

When it looks – when it's coming to the maintenance market, we are continuing to provide additional services to our customers. One thing that we've been looking at or one thing that we're about to launch is a 10-year warranty on key components to customers of ours who take our service. But we're going to ask for a slight premium for that. And we're also going to insist that if we're going to give you this guarantee of components going forward for 10 years, that you need to be loyal customers for us for that entire 10-year period.

Antti Kansanen
Analyst, Skandinaviska Enskilda Banken AB (Finland)

Q

Okay. And last one for me would be on kind of the market mix shift. If there's more emphasis on the state-owned developers and also maybe perhaps a bit higher growth on the social housing side, how does that impact your business regarding your dual brand mix or your service capture rates?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

Well, we – both of the brands have strategic accounts. On the KONE brand, the strategic accounts tend to pay us a premium and they give us volume, of course. I would say that on the GK brand, they have been able to work with a different mix. They have a lower mix of strategic customers and more mix of independent developers. And so they – and also, they use more distributors who, from a cash flow standpoint of view and payment terms, is much, much stronger. So it's – they're – both brands operate independently. Both brands have product portfolios to touch almost all segments. I would say the lowest end, the KONE brand does not have, the highest end, the GK brand doesn't have. But there's enough of a portfolio for each of these brands to compete well in the marketplace and to find the right customers.

Antti Kansanen
Analyst, Skandinaviska Enskilda Banken AB (Finland)

Q

Okay. Thanks so much.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Let's take one in the corner over there. [indiscernible] (01:46:12).

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Hi there. It's Joel Spungin from Berenberg. I've just got a couple of questions. I think you mentioned condition-based monitoring. I was wondering if you could talk a little bit more about that and where we are in the process of regulatory change. I've heard some speculation the rules could be changed as soon as next year. I was just wondering what you're hearing with regards to regulation in China and the shift to more condition-based monitoring. And then my second question is, what do you think that means from a financial perspective for KONE Services business if you're able to increase the amount of remote monitoring that you're doing on the installed base?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

Yes. We were watching very carefully. There have been about 13 cities that have piloted the CBM. And again, one of the key prerequisites for any company to be able to participate in that pilot is you have to have remote monitoring. So we have participated in almost all of those cities. Unfortunately, this lockdown recently has probably set the timetable back a little bit. But it seems that the pilot program has concluded. The feedback has been quite positive. And our expectation is that, as you just said, sometime next year, they'll roll this out nationwide. And again, I can anticipate at that time that unless you're really prepared for that from a technology standpoint of view, or an organizations standpoint of view, it will be maybe a bit of a challenge for the smaller operators, particularly on the technology side.

We have geared up for this. Since we participated in the pilots, we know what it's going to take. We're also looking at what this means for pricing. Again, I think when we go to customers and we offer more technology, but perhaps fewer scheduled visits, when we offer greater reliability, anticipate problems, there's a value there for them that they'll want to continue to maintain pricing and perhaps even offer us a premium. And then, as I mentioned, other services like 10-year warranty on key components, we know that our customers find that very attractive already. [indiscernible] (01:48:30).

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

So, just to clarify, your thinking is that this will help in terms of improving attachment rates and better pricing as you sort of move to a condition-based monitoring model over the next few years?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

I think pricing may stay flat, but because it's condition-based maintenance, it'll have a better productivity impact for us going forward. There's no question about that. And again, because we have to add the 24-hour remote sensing and we're getting constant data, we're going to be able to do more proactive maintenance and repairs. We've seen this. It's quite an amazing result when you put this on a large number of units. You immediately see – it takes a lot of time for the team to understand how to read the data. But once they do, the call out rate really takes a precipitous drop. So this has helped with our productivity of those branches that are using large numbers of remote monitoring units. So I think in net, it's going to be a very positive on our overall margin.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you very much.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I think we had one here at the front.

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you. It's Daniela from Goldman Sachs. Just one follow-up, I think, on your comments regarding both for maintenance and modernization. When you do your own equipment, the KONE or Giant equipment versus doing others, is there a margin differential? So as you grow more of the share of your own, is that a positive margin event over the longer run?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

Just to clarify, we don't do – we do very few foreign equipment maintenance, but we do modernization. Is that what you referring to, actual modernization?

Daniela Costa
Analyst, Goldman Sachs International

Q

Yes. I thought I understood it that, in both cases, you are doing some other brands, not just for foreign-owned, but I'll take it just for modernization, if that's the case.

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

Sure, let me clarify. We, we do very few foreign brands. And when we do it, usually when we take over a larger portfolio from, let's say, a strategic customer, a big developer, and they want one service provider, so we do that. But generally, we – there are so many of our units out there and we don't want to add too much complexity to the mix in terms of maintaining foreign brands. It's complicated and there's certainly safety issues, training issues and things like that. But when it comes to modernizing of foreign equipment, we typically go for either a half modernization in which we completely change the machine and the controller out and may retain, for example, the cab and things like that or we do a complete modernization, which we take everything out, perhaps except for the rails.

Daniela Costa
Analyst, Goldman Sachs International

Q

But in general, I think you do modernize a lot of stuff that is not KONE. So is that local brands?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

It's everything. Everything.

Daniela Costa
Analyst, Goldman Sachs International
Q

And can I ask also on the maintenance side, when you had – you mentioned 15% of your current sales is maintenance, but for the market is much more. I think in the chart, it was 25% or 30%, in the chart that had the whole market. So it's local brands that are maintaining your elevators at the moment? Is that where the capture comes from?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj
A

Yes. At the moment, it's mostly – yes, mostly independent service providers, yes.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Let's take one from the lines again and then we'll move to the room if I think we have time for a couple still. One question on kind of the maintenance markets. As they mature in China, how do you expect this to impact the profitability of the KONE China business or the KONE China maintenance business?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj
A

I believe this will have a very positive impact as – because our maintenance margin is very solid. It's higher than our new equipment margin. So I think this is going to have a very positive impact overall as we add more maintenance to our mix.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Excellent. Thank you, Bill. And I think we have time for one more in the audience. And here, we had a very patient person. Let's see. There's a mic coming from you around the back.

Guillaume Dalibot
Analyst, Katko Capital
Q

Thank you. Guillaume Dalibot from Katko Capital. Just a follow-up on the previous question. Actually, the implication on the new equipment margin as the overall market is going to shift towards more maintenance, which is a higher – structurally higher margin business, do you expect some players to actually use the profitability from the new equipment market and reduce it in order to capture some new business?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj
A

Basically, are you asking, is there going to be more price competition in the market?

Guillaume Dalibot
Analyst, Katko Capital
Q

Yes. In new equipment. Yes. And decline in margin?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj
A

In new equipment. It's always been a very competitive market here in terms of pricing. We watched carefully because there's so many rounds of tenders. We're looking at pricing all the time. As I said, we've made a commitment to try to raise our prices within the market. So we're going to watch it carefully what's the impact, are some people going to go for volume at this point, what's the impact on our business. As I mentioned so far, we've been able to actually get a premium from our customers compared to market. My hope is that we can continue with that, but we have to be smart about it. We just don't want to go for volume at any cost, but we certainly do want to defend our market position as best we can in a smart way.

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

That's a great way to end the Q&A session. So thank you so much, Bill, for joining us virtually. Happy that everything works out well here. Our next speaker is the head of our new equipment business, Tomio Pihkala, who will be talking about how we're driving differentiation and resilience in his area of responsibility.

Tomio Pihkala

Executive Vice President-New Equipment Business, Kone Oyj

Thank you, Natalia. All right. Is it visible? Yes. Well, really excited to be on the stage in more face to face settings this time after some time. So my name is Tomio Pihkala. A few words about myself. I have been working more than 21 years in KONE. Now, in my current role since 2019, and you can imagine that it has been quite eventful the past few years in this role, including supply chain and sourcing, but very exciting also at the same time.

It's clear that the construction industry has been facing some turbulent times and – but I'm so proud how KONE teams have been navigating through this period. And it's clear that our very high loyalty among our customers, strong market position overall, in markets like China and everywhere, and, of course, strong innovative offering has been playing a hugely important role during this period. And most importantly, supply chain has been showing resilience during the turbulent times.

So in my presentation, I will focus quite a lot about the future. But of course, also, some important learnings from today. And I would like to talk about what are the key enablers for us to really improve competitiveness in new [indiscernible] (01:56:32) business and how do we ensure that our supply chain will be futureproof in a way. I would say some of the key words will be agility, resilience and speed. Those are the winning factors going forward.

Henrik and others already talk about overall market development in elevator industry. If I look at new construction market, we have seen a broad-based recovery. It's very much residential-driven, but also, actually, that all the segments are now recovering. We know that our retail segment and hotel segments actually were mostly impacted by COVID, but they are coming back. Geographically, Bill already talked about China. Clearly, lockdowns and liquidity challenges have caused some challenges there in the short-term.

If you look at rest of Asia-Pacific, very strong rebound from the COVID. North America, actually, we think that is very optimistic near – short-term outlook. And then Europe, Middle East, Africa, slight growth expected despite the uncertainty caused by Ukraine war. But although demand environment is [ph] you see (01:57:59) developing in quite positive way, it's clear that global supply chain constraints have caused some challenges. There's been significant raw material cost increases. Logistic network has been in a very difficult situation. Component shortages, especially semiconductors, have been causing some headaches, and then, of course, various lockdowns in different stages of the supply chain.

These are impacting our customers. Customers are slowing down some of the decision making. They are also experiencing some delays in construction sites. Finally, of course, they are facing also commodity pressure like we are facing. And these are also impacting us. And we are not immune against these disruptions. However, there are a lot of things we are doing to mitigate these challenges. Ilkka and Henrik already talked about it quite a lot, but we are increasing prices. We are increasing our productivity. And also, we are reducing product cost to mitigate raw material headwinds.

When it comes to logistics, we are looking alternative routes to optimize our logistic flow. And also, in some cases, we have moved also elevator production or elevator component production to the other supply units to make sure that we can serve our customers in all situations. Semiconductors has been a huge topic also in our industry. Elevators has actually quite a lot of semiconductors. I would say thousands of semiconductors used in single elevator. So it's clear that this has been also a challenge. We have been working very hard to make sure that we can supply. We have done a lot of redesign work of our printed circuit boards. We have searched alternative suppliers for hundreds of chips so far and especially, we have been keeping very constant dialogue with our key suppliers in ensuring that we are – all the time they have the right information, right forecast. And we have been operating in more this kind of crisis [ph] mode (02:00:10) to ensure that everybody is in same page all the time.

Then we have had, of course, these lockdowns. And of course, this Shanghai lockdown has been the very recent case. But there has been lockdowns actually in the different stages of supply chain globally all the time in past two years. I mean, I don't remember how many lockdowns we have had so far. And they are impacting in sometimes very unpredictable way. And that's why it has been very important to have a proactive risk management. It's about having basically early warning system where you immediately know if something is happening [ph] in somewhere (02:00:45) part of the world, and able to react in quick manner. And essentially, we have had – we have been in a crisis team. I personally have been also joining weekly and daily to those crisis meetings where we basically want to make sure that we communicate very efficiently. We make decisions very quickly and we make sure that we have a constant dialogue with the key suppliers to ensure that we can react to the situations without any delays. So, that has been pretty much operating model in the past two or three years. So, definitely that's been quite eventful. All in all, I mean, there has been a lot going on. And for sure, we are not yet over with all these challenges.

But then going forward, of course, we need to make sure that our supply chain can adapt to whatever environment we are living in, and I would say to the certain new normal where disruptions are more like a norm. And you still need to able to run your business, you still need to able to deliver your elevators to the customers. So to do that, we are focusing on four key areas to develop our supply chain. I already talk about proactive risk management. This is something where we need to continue to work very actively. It means that we need to have very systematic way of mapping out over our supply chain, including all the sub-suppliers, making sure that we know exactly where are the potential weak points and what are the risks we may face and proactively address those and have a 24/7 risk alert system so that you get immediately notification whatever happens during the supply chain.

The second area is the multi sourcing. It basically means that you need to make sure that you have an alternative supplier, not just in an elevator [ph] module (02:02:45) level, but also in components and parts level, and this is not only applying for us, but also for our suppliers and sub-suppliers. They need to make sure that they always have backups and alternatives available. And this is something, of course, we have continued to do. We have had a multi sourcing activities in a past few years and we have been able to reduce the single source portion of our supply chain.

The third area is sustainable operation. Already, different country requirements and regulations are increasing higher standards and higher bar in this area. Our job is to make sure that we anticipate new regulations, able to, of course, comply them, but also we want to make sure that we actually have a competitive advantage in this area. So this is one good example about advantage. So we have set a target to reach carbon neutral supply chain already by end of 2024, so very soon. And this is one of the way how we want to make sure that we are really forerunner in sustainability.

Then about flexible supply footprint is actually quite a big word, including a lot of things. One actually angle for this area is that we want to diversify our Asian supply chain to make sure that we are able to operate in all kind of environments. I would actually elaborate that little bit in more detail. What does it mean that we have more flexible supply footprint? To simplify, it means that you are able to produce same products or same components in either supply unit A, B or C, depending on the situation. Now, this is easier said than done, because you need to make sure that you have the harmonized product platforms, you need to have harmonized supply chain processes and also related IT systems like ERPs and also product lifecycle management systems.

We actually have a good starting point at KONE because our supply chain are actually continental as a nature. We have supply chain for North America, Europe and Asia. But then the whole idea is that how do we make sure that this continental supply chain is actually more interchangeable so we can actually mix component production and make sure that we can then operate in a flexible way? And there, of course, things like product harmonization is very important. Actually, was it two years ago in Capital Markets Day, I introduced product harmonization program. Huge amount of our efforts and this is now starting to really pay off. It is creating flexibility for us to supply elevators in the future.

And then, of course, in parallel, you need to also invest in your manufacturing. And here, we have put a lot of focus on diversifying our footprint in Asia. And I will actually give you some example. What does it mean in practice? This is actually a bit of simplified illustration. There are actually much more arrows going here and there between supply units. But to visualize what the supply diversification means, we'll continue to have actually quite major supply chain from China. We are exporting also from China, but then we will make sure that we also have alternative supply units such as India to serve our customers. And this is how we diversify volumes. And what we are going to – why we'd want to do that? Because we want to have this increased interchangeability of the component production. And secondly, we want to optimize our logistic flow, essentially optimize logistic cost. And then lower country dependency, a secure material availability and maximize product competitiveness. So it's a – and this is going to be much more dynamic because you may have more capacity available in one moment in the factory B and you want to sort of orchestrate your order volumes to the different factory depending on the different situation, so that's what we are trying to do.

All right. I talked quite a lot about supply chain already. Let me talk about my favorite topic, product offering. Product offering continue to be instrumental part of our competitiveness. Ilkka, Bill, Henrik already talked about some of the great things we have been bringing to the market. KONE is known for innovations; we are proud about those. New innovations are born when we understand customer pain points and hidden needs better than before. That's when the innovations were born. So, that's why it's very important to hear what our customers are saying. What we are hearing from our customers, what are their key pain points today? I will pick up three important pain points. Number one, builders, they are suffering due to the significant productivity challenge. Actually, the whole industry has not been improving productivity too much in the past decades. Even 70% of the working hours are wasted at the construction site due to the inefficient working practices. At the same time, of course, you have seen the raw material headwind also impacting our customers and increasing pressure.

Number two, buildings are a reason for 40% of world greenhouse emissions, 40%. It's fair to say that the future of this planet depends on how well we're able to reduce the emissions in the buildings during its lifetime but also construction time. So, there's no question that sustainability is becoming important priority for our customers. Finally, about the third point, pandemic has permanently changed the way how we work. There's no really return [indiscernible] (02:09:31). Even if we have – we are having now some face-to-face meetings here. Flexibility is going to be the key word, flexible working, flexible workspaces. And that will be solved by technology, by smarter buildings. That's a third area where customers are very much focusing on.

So, how we are responding to these pain points? Two years ago in Capital Market Day, we told how KONE introduced first truly digital elevator in the industry, KONE DX Class elevators; you have heard already quite a lot about DX Class elevators. That elevator has building connectivity; it's a future-proof solution. And around that elevator, we build entire ecosystem of digital solutions which we can offer for our customers to customize the people flow experience depending on a customer's individual needs. KONE DX Class elevators have essentially three value propositions. Number one, create value with the connected people flow solutions. Number two, differentiate with the redefined user experience. Number three, partner for smart and sustainable buildings. And now, I'm very excited to introduce fourth value proposition, accelerate construction with improved productivity; I'll come to the details very soon.

But before that, you may wonder how we have been progressing with DX Class elevators. Well, actually, Henrik already [indiscernible] (02:11:09). But actually, it has been pretty exciting journey. It has been really hitting well in the market, exceeding at least my personal expectations when we were first launching it. We have sold over 75,000 elevators. We are now covering all the regions, including North America; and not just regions, but also different segments. And then, this ecosystem of digital solutions are expanding. We have more and more third party solutions, KONE solutions coming. Recently, we launched solution called KONE Office Flow, and this is really the flagship solution for most demanding customer applications. Very encouraging feedback, super exciting offering. It's fair to say that this is going to be de facto solution for smart buildings in future.

Then, health and wellbeing offering is also something we have developed a lot during the pandemic due to the known reasons. Finally, Henrik already mentioned about it, but we have made some really exciting launches in the area of sustainability. We want to be really first runner in this area. That's why we want to be first with the fully compensated, CO_2 compensated elevator and also maintenance offering. And recently, we have also built capability to install elevators to the wooden buildings. And wooden building is not just a minor thing anymore; it's actually picking up quite quickly especially in Europe where we have hundreds of installations already. So, that's pretty exciting.

Now, back to fourth value proposition, accelerate construction with improved productivity. Now, this is almost like a new business, I would say service business for builders, and we have built completely new offering in this area. The flagship solution in this offering is called KONE JumpLift. The idea of JumpLift is that we can help our customers to reduce construction lead time by weeks or even months and offering significant monetary savings for our customers, hundreds of thousands of euros all the way to the millions of euros depending on the complexity of the project. And of course, customer can also start enjoying the revenue when the pre-building is completed also earlier.

So, what is the idea of JumpLift? JumpLift enables movement of the materials, construction materials and construction workers and people while building has not yet reached full height. It's still under construction, it's not ready, but we're able to put elevators into use to serve as construction lifts. And this way, we're able to reduce waste, we're able to also reduce time for the waiting and, obviously, we all know time is money. JumpLift offering is something we have had already for high-rise elevators or pretty extreme cases in the past, but now we actually industrialize it. We actually brought it to the old type of buildings as a standard solution and as a modular solution. And it's not just that; we actually, as a first company, launched machine room-less JumpLift elevator which is really nicely fit to the low and mid-rise buildings, so that's going to be a significant opportunity now for our customers to improve productivity.

JumpLift, of course, can also offer some other benefits. It's actually improved work safety quite a lot, which our customers appreciate. It's also much more immune against weather condition because now, the elevators – actually, construction elevators are in the middle of the building unlike traditional Alimaks and traditional construction lifts which are used by our customers. So, this is really something which customer have been waiting for long time.

Builders are also talking a lot about situational awareness. This is a big, big topic. Why? Because construction project has a lot of surprises. It's actually quite chaotic if you go to a site. You see a lot of surprises, issues, and probably now during these times even more. And one of the headache of project manager is to know if something is not going well and how to ensure that you actually learn about those much earlier. So, that's why they are talking about situational awareness and to use digital means to actually create that. So, for this purpose, we have developed KONE 24/7 Connected Services for construction time use elevators. This offers 100% transparency how construction lifts are working and actually also predict maintenance capabilities to make sure that the equipment are running. So, now you have situational awareness of how the material flow and people flow are working; where are the bottlenecks, how to make sure that your site is not slowing down because of the flow.

So, I could talk more about these great offerings, but there's one thing I want to still say before I conclude my presentation. While we are very excited about opportunities what this new offering will create, we have also realized that pandemic has changed the way how we need to interact with our customers. Customers are increasingly preferring digital touch points, and this is very visible in early phase of construction process. But there are actually customers who prefer to have self-service from the beginning to the end, and this is actually happening quite quickly. And this is why we have been introducing self-service customer tools like elevator planners, beam tools, car designers. And we actually need to continue to develop a seamless multi-channel experience for our customers, something we are going to hear more in future. But if you look at just what we have already offer, we have seen clearly a shift in the lead times. Customer response time have been moving from weeks to hours, so there's much more things going on [ph] at much faster pace (02:18:00). And also, overall volumes of digital interactions are picking up very quickly. And this is very essential when we are bringing the new offering to the market; how do we make sure that we can do this in a digital way?

So, time to wrap-up. I was basically talking about two things, supply chain and product offering. Number one, as you can see, we are very optimistic about the opportunities what the offering can offer for us financially and business-wise. What do we want? We want to continue to be recognized as innovation leader, and the customer pain points are really calling for new innovation more than ever. Number two, we have a very realistic view about challenges, what supply chains are facing today and tomorrow, and we want to make sure that we build a future-proof supply chain which is the most robust and most resilient in the industry. So with that, well, thank you and I guess there's some time for questions.

QUESTION AND ANSWER SECTION

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Yes, indeed. We do have some time. Did we have anything? Let's start here in the room this time around. There, one in the back.

Q

Yeah. Hello, I'm [indiscernible] (02:19:24). Many thanks for your presentation. So, you showed us how you accommodate future trends, but I would like to better understand your portfolio as a whole. I mean, when I look at competitors generally in the industry, on the one hand one wants to have a seamless offering; on the other hand, a seamless offering kind of increases complexity. And then looking to you as a leading player, you are exposed to residential, commercial, public; and within that, tons of sub-segments, tons of sub-specifications. And I would like to know in your product development how you address that. So, what sort of number of units you need to be able to sell that you say okay, it's worth going for it or we leave it because it doesn't bring anything? Second question is what percentage of your portfolio is really a global portfolio?

And the third question I have is when you look at the portfolio as a whole, I mean, you have always been talking just about the margins being a function just of mix between service and new equipment, etcetera. But as far as I understand, new equipment is also – the margins there is also a function of where you stand at the learning curve. So, at the beginning, you have higher costs, [ph] introduction (02:20:58) costs, etcetera, and over time you kind of milk the product also. Where do you stand there in the product cycle across your portfolio? When we would need to see a full rejuvenation of it? Thank you.

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah. Very good questions. I'll start with the first one. So, indeed, I mean, if you want to sort of satisfy all the customer needs in all segments, that will lead to the complexity. That's why you need to be smart about it. So, that's why we have had also product harmonization program. We're actually reducing the complexity of our offering because basically, in a technical platform level we're going to have much less components, much less component modules used. And then basically, you're going for the mass customization by digital means, so you have digital layer. DX Class elevator is actually enabler for the mass customization that is very efficient way to actually customize, and you don't actually create complexity because you do a lot with the software and you do a lot with the APIs and you're using the digital platform behind that. So, that's maybe number one question. Number two question was?

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Related to where we are in the product lifecycle, I think.

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah. So, maybe it would be good to...

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I'm sorry.

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

I think it was a different question.

Q

So, what percentage of your portfolio you're offering...

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah, yeah.

Q

...is really truly global products that you would sell?

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah.

Q

Take, for instance, residential that you can sell across the globe.

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah, yeah. It's actually not that easy question to answer. But if you go for a technology or component level, for example, we have motor technologies we use in all continents; same motors, same technology, and same applies for our controllers. So, actually, our offering is very global. But then, when you configure elevators in continent level, you need to consider different code requirements and so on; then, there is some customization to the local market needs. But essentially, we have a global offering.

And then, I think your third question about because there's typically some learning curve and cost curve when you launch a new product is actually a very good question. We really want to avoid that cost curve in the beginning, and that's why we have – we are investing a lot on product harmonization program. So, if you look at KONE DX Class elevator, actually it is very cost-efficient from the beginning because it's not that we sort of we change everything in elevator technology; we actually use a lot of what we already have and improve. And that's going to be the philosophy because we want to differentiate at scale. We don't want to sort of create beautiful one-off solution which is not scalable and also expensive in the beginning, so that's something we really want to avoid. So, I'm very proud to see that DX Class elevators which really are mainstream is actually very competitive cost-wise also.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I think we had Joel over there.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Hi. I just wanted to ask about the comments you made about supply chain which I thought were quite interesting. Maybe just sort of a big-picture question. How far through this process of sort of making these adaptations to the supply chain that you highlighted are you? Is this stuff that's just started in the last 12 months? And realistically, how long is it going to take you to do all the things that you would like to do?

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah. It's a good question. Maybe it will never sort of complete. But – and frankly, I mean, many of these things, what I mentioned, we have been doing before even COVID or pandemic started because they just make sense, right, due to a lot of reasons. So, we were working on harmonization of our products and also supply chain processes already before the recent events happened. But I would say when you talk about product harmonization, it takes years and it's typically component-by-component. You want to do that in a very careful manner so that you don't create any issues. Then, if you talk about ERP systems, it takes some time to harmonize. So again, you need to do component factory-by-component factory carefully because you don't want to create any disturbance. So, yeah, but it's a multi-year roadmap where we are progressing really well, and I would say recent events have been even motivating us to even accelerate.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

And then one here.

Q

Hi. I just wanted to ask on the sort of various initiatives that you talked about in innovations in terms of I just wanted to try and get a sense of is that just purely about trying to win market share and obviously then the very high attach rates that you get in terms of maintenance. Or is there a pricing and margin angle to this and it's not really a criticism in the sense of the second aspect, if there isn't, but it's just I guess to help us understand kind of what the ambition or maybe kind of how you're trying to pitch that is.

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah. I would say it's a lot about second part. If you think about DX Class elevators and the fact that we try to sell value-added services on top of the elevator, that's a lot about high-margin service business actually. If you think about JumpLift offering which I was mentioning in the construction area which is kind of new area now where we can explore opportunities, that's a service business. Service businesses in nature is high-margin business so yes, we're looking very much value and differentiation. But of course, we need to make sure that our basic elevators are competitive so that we can get also scale, what we need.

Q

And maybe sort of, I guess, linked to that and possibly linked to an earlier question as well is how global are these initiatives? I mean, is this when you look across – and sorry, this is on the sales process throughout...

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah.

Q

...and the supply chain. But when we sort of go through the various aspects you've talked about, how global are those offerings intended to be? I mean, is that going to be addressing...

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah.

Q

...entire market because it strike me that some of these may be things that might be paid for in some markets and not others? So, I guess interested to get a sense on that.

Tomio Pihkala
Executive Vice President-New Equipment Business, Kone Oyj

A

Yeah, good question. I would say the basic product platforms and basic elevators like DX Class elevators, they are very globalized. As I mentioned already, it's covering all the continents. Now, if you go then for the individual digital servicing solution, there can be actually some local variability. I mean, we may have some local Singaporean robot company who want to sort of connect to our DX Class elevator, and that's only for Singapore. But it's done in such a way that we don't create complexity; it's more about adaptability to customer requirements. If you look at – if you think about JumpLift, it's very much global. We made a global launch. Actually, our idea is to always try to make it as a global launch at the same time, and that's definitely – but even in JumpLift offering, you need to consider some of the local regulations and local, let's say, market practices. But essentially, we're always aiming for global.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

Thank you. I think that was all the time we had for questions for Tomio. We can come back to them again in the final Q&A. Now, we have time for a short break, 15 minutes. Before you all head off, just a quick request from me or rather as a heads up I guess at this point in time. We are of course aiming for continuous improvement in the IR function, and we would love to hear your comments on the event. So, you all have feedback forms in front of you on the other side of the agenda paper, so if you could fill those out and hand those into the team before you leave today. But with that, approximately a 15-minute break. We'll start again at 11:25 Finnish time.

All right. Welcome back. Time to start our last session of the day before we start to wrap-up. You've heard a lot today or Henrik and Ilkka speaking a lot about the importance of the service business and the growth opportunities that we see. So, I'm very pleased that our last speaker for the day is Hugues Delval, the Head of our Services Business who will be going into a lot more detail about some of these trends that you've already heard about. So, please welcome Hugues.

Hugues Delval

Executive Vice President-Service Business, Kone Oyj

Thank you, Natalia. Good morning, and welcome back from the break. So, indeed, we're going to look together through how we at KONE are planning to continue to lead in our service business, and this presentation or this sharing session is three parts. The first one is a quick look at the market and how we see them evolving in the next coming years. The second one is about our performance and basically the strong competitiveness we have entering in the next period. And then last but not least, sorry, about how we are planning or what we are doing in order to develop further our competitiveness and our differentiation.

So, I guess that on the service market side, we can start with one very positive element, is that all our markets on the service side of the industry are growing across all geographies and both in maintenance and modernization, so it's actually, of course, a very positive environment to be in. When we look at the maintenance business, what we see is that there are slightly less than 20 million units in operation in the world – and when I'm saying units, it's both elevators and escalators – and it has been growing with 5% growth rate annually for the last years. And indeed, this growth, it has been mentioned earlier, this growth has been mainly happening in Asia-Pacific and in China. And indeed, the average monetary value of a contract in China is lower than the global average. So indeed, it has a negative mix effect and that's why the monetary value growth of the industry has been growing by around 3% over the last years. When we look at the future, we believe that the growth in units, of course driven by the slowdown in the construction industry, will potentially slow down to roughly 4%. But we actually believe also that the monetary value will accelerate slightly due or thanks to inflation, okay? So, that's how we see the market development for maintenance business.

Then, we can look at the attractive modernization business, a very promising one as Bill has also emphasized. So, what we see is that the modernization market will grow, or at least our best understanding today is that they will grow high single digits going forward. And what we see happening on the modernization side of the market is that of course, the usual drivers behind modernization will continue to be there. So far, we have been very much modernizing for obsolescence, aging of the equipment. And this number of units will continue to grow and, again, China will play a very essential part of the growth of the older units on the market. But what we also see is that many customers are actually looking very much about how do they improve the competitiveness of their buildings, including the younger ones. And we see modernization opportunities expanding into how we can make the elevator or escalator more sustainable, how can we help our customers to improve the user or tenant experience, so how do we help them to make their buildings more competitive on the market. And that's clearly a new trend on the market where we see also good potential for the modernization business going forward, and I will explain a bit more later about how we are addressing these customer needs. And again, you just saw the number of buildings or equipment or units, sorry, elevators and escalators in these younger buildings are about 12 million units today.

So, what about our position? What about our performance in the market? And again, Ilkka has been mentioning already earlier that we have been growing faster than the market on the service side of the business. What's, of course, very relevant now is that this growth has been accelerating over the last couple of years. Of course, Q1 is strong in the maintenance business with 8.7% growth. Actually, 2021 was also at 7.8% growth, so also clearly stronger than the historical trend. And we also see modernization double-digit to start the year, and last year in our volume business modernization was also double-digit, so we see a good trend for the service business again going forward.

But I guess it's probably worth to re-emphasize the importance in our service business about the growth in the portfolio of the units we are maintaining, so the portfolio of the elevators and escalators we have under maintenance contracts. And as you see on the left side, we have 1.7 million units in service today. We have been used to communicate on the 1.5 million units which is the number of units we have under maintenance contracts. But of course, we are also servicing units which we call lifts in first service contract, which means that this is the contract we have with our customers during the warranty period after the construction. And this is of course, giving you an indication about the amount of units we can convert going forward, and we see that this potential has actually increased over the last years thanks to the strong performance in the new construction business, okay? And thanks to this, we have been growing actually slightly faster than the market.

But again, for us, it's not only about growing our portfolio in units which is important, right, because the units are actually the base for a very resilient and profitable business; it's also a strong core where we are then able to sell additional services, value-added services, repairs, modernization. So, it's a very important core for the service business development. What we have been able to do over the last years is actually to grow our monetary value faster than the unit. And actually, we have three levers we are using for that. The first one is the maintenance contract revenue, so basically the pricing and the content of the contracts we are signing with our customers; I will come back again in a few minutes about that. We have value-added solutions, and of course the flagship value-added solutions in 24/7 Connected Services. And we have the amount of repairs we are selling per unit on average that, again, is developing positively for us.

And to give an example, for example, if we take the entire Europe and Mediterranean countries, last year we have been developing about 3 percentage points above the unit growth, and one-third of it is coming from 24/7 Connected Services. So 24/7 Connected Services is adding 1 percentage point of growth to our business globally which then enables us to counter what you were mentioning earlier about indeed, there is an headwind from the mix. But we have been able, through these different actions, to more than compensate these headwinds and develop our monetary value actually faster than our unit. Then, again, we all understand that we are entering or we are in a more inflationary environment. This is, of course, very much true for the material part of our business. But the material cost is not the majority of our cost in maintenance, right? It's labor for almost 80% of our costs, which again we expect inflation in the next coming quarters. But, again, these capabilities of pricing, of selling value added solutions and of increasing the repairs per unit are making us very confident that actually we can treat the inflation as an opportunity in the maintenance business, and that's actually what we've been demonstrated over the last couple of quarters and years actually.

Well, talking about service before talking about China would not be right and, again, Bill has been mentioning that in his presentation. Some of you have heard actually because I've been asked that I've actually relocated to China for the last 15 months. I'm living in China and having spent most of my time over there for this period. What I can share with you is probably a few insights or main points that Bill has mentioned. So, the Chinese markets will be the major parts of the service gross going forward. About 40% of the gross in maintenance and modernization will happen in China over the next coming years.

We have a very strong starting position. We have a strong construction business. We have very strong teams, good service networks, good customer relationships, good supply units, which is of course very important in modernization. We also understand that there are some dynamics in the Chinese market which are different and that we need to tackle differently. Regulations is one of them, definitely the difference, the diversity of China between the Tier 1 and 2 cities and the Tier 4 and 5 and plus cities. But also the technology offers new opportunities in China, certainly because there are some very advanced technologies but also the communication platforms like WeChat and IDP are clearly very different than for the rest of the world. So, this ability to offer China for China will also play a very big role in our ability to continue to develop faster than the market in China.

So when we look at the present and the future, again, we want to continue to lead by – through differentiation into – our ambition is clearly to continue to grow faster than the market and, of course, profitably. How are we planning to do that? Well differentiate – when you – when we say that we want to differentiate, it of course starts with understanding how we are providing more value to our customers. And you have heard some of the items which are on the slides. But I guess that when I'm listening or when we are listening very specifically to the building owners and the property management companies, we hear three kind of outcomes they are expecting from us.

The first one is about how do we help them to improve the efficiency, the transparency, and the sustainability of both their buildings but also the operations. It's probably top of mind for a vast majority of them. They need to both – and, again, mainly in the office and commercial segment, it's about how do we help them to improve the user and tenant experience. They understand that they need to attract people back to the buildings. And then last but not least, it's of course they continue to value a lot the expertise of the professionals which are helping them and also a lot about the convenience to deal with, how can they actually also be more efficient on their side so that they can, of course, be more cost effective and address their own customer needs better. So, this is actually critical because this is a very strong foundations to all what we are developing in terms of solutions and offerings. And you will find them – find these three elements back across the next couple of slides.

So on the offering side, quick look at the back mirror. When we look at – in 2016, we have launched KONE Care. I will not give too much details. It's, I guess, known by most of you. KONE Care is actually an offering. In the past, the entire industry and still today for most of them is offering basically two contracts, standard one, comprehensive and the customers choose. In 2016, we have introduced a concept where the customer can completely customize their contract, the services they are selecting, the service options and the service levels. And of course, we must customize meaning that we are industrialized on the delivery side of it. Very strong success. Still today, this is very foundational in all the offerings we are building further on top of it.

Then 24/7 Connected – Connect, I will come back in a minute. It has been already talked about, but I will give you a bit more detail. 24/7 Planner launched end of 2020, which actually is giving the customers and the property management companies an asset management plan which is not only built on our people expertise but also on the actual condition and else of the equipment. Very – again, very strong success, early success with our customers on this.

Then, you have heard about the KONE DX Class elevators which are the most eco-efficient and actually the smartest equipment in the industry today. Based on this, we have launched late last year the KONE Care DX maintenance contract, which is actually giving the customer a new service promise, which is the most advanced maintenance for these DX elevators. It includes always 24/7 Connected Services. It also gives the – or provides the customer with the opportunity to select other digital services. And as also Ilkka mentioned, that's the first maintenance contract which offers carbon neutral maintenance to our customers. And there, we help the customer to measure, we help the customer to reduce the impact of the maintenance operations, and then we compensate for the rest.

And I don't want to disclose too much, but of course we again see very much of continuous value that we can deliver with that and all customers, so they are expecting even more value even more from us in terms of sustainability, in terms of how do we help them to improve the People Flow performance in their buildings.

24/7 Connected Services, so we are forecasting to reach about 15% penetration in our portfolio by the end of this year, which is clearly more than 200,000 units connected. And we speak about really the real-time connectivity with the cloud, with the analytics. We don't speak about the legacy connectivity or remote monitoring solutions that we also have on the side. And these 24/7 Connected Services units are actually providing very clear value for both our customers and KONE. Actually, when you look at 24/7 Connected Services, it provides a lot of what we call service needs to our field teams. Basically based on the condition of the equipment and the intelligence we have built, it spots potential issues before they are happening. 65% of these service needs are about predictive, so basically they spot something before the problem occurs and impacts the customer. And that leads to, first, very strong safety value, 40% of the entrapment are actually not happening anymore. So, we are reducing the number of entrapment by 40%. And we are also decreasing the number of call-outs, so basically disruptions for both our customers who are managing the buildings but also for the tenants and the users by 30%.

So, a lot clearly – a clear improvement in the uptime, in the availability of the equipment for the tenants and the users. And of course this translates into value for us, not only financially, which Ilkka has mentioned already earlier, but also actually from a customer satisfaction. So we know – as you know, we measure the customer satisfaction every year and we have a 7 percentage point better satisfaction for the customers with 24/7 Connected Services. We have better retention rates. And thanks to the price premium we are actually asking with this, we have better profitability as well. So, very positive momentum with 24/7 Connected Services and, again, we continue to develop, to scale but also to ensure that we continue to add value to our 24/7 Connected suite of services so that we keep the customers, I would say, building on it.

A very important probably comment is also that for these digital services, it's important for any industry and for us as well to show the value, to demonstrate the value to our customers so that they keep using it and repeat the buy. Well, it's an example of a customer. I will let you read the testimonials, but it's a – it's Mapletree Industrial Trust, which is located in Singapore. We are maintaining about 25% of their premises, of their assets, which is about 150 – it's actually not about it, 157 elevators in Singapore. We have actually created last year about 800 service needs. And we have – they have enjoyed a reduction of 50% of call-outs, so disruptions for them. So, it's a significant impact for their operation and, of course, for the tenants.

Another way to look at what we are doing and very much building on what Tomio has explained on the DX elevator is that we are looking at this through how do we create value to our customers across the entire lifecycle of the building. All right. It starts from the new equipment, then it goes into maintenance, repairs and what they can do, then it goes in modernization and hopefully it starts again. We want to be in this infinite circle. And, I guess, that what you can take there is the fact that we – thanks to DX and to other digital developments, we are able to fulfill customer needs or expectations at different steps in this life cycle. And you see solutions to help the customer to improve the productivity, to help the customers to improve the transparency, to help them to improve the user experience.

And, again, we expect this to improve the stickiness or the retention of our customer – with our customers. That's what we show – we already see with 24/7 Connected Services. We expect that to enable us to recapture some of the units we have lost. We expect that to improve the conversion rates and of course also something very important is that, as we said, the contribution for the construction – from the construction business will stay very high for our service business but will probably – I would say not fuel the growth as much as it was in the past. That's where we are expecting the modernization business to take over and actually to contribute more to the growth of our portfolio in the next coming years. And this is actually, of course very important, right, because we continue to monetize or to create to generate value and revenues for us.

So, we have spoken a lot about the offering side and how we are leveraging digital technologies in order to create more value to our customers. Actually, we are also leveraging technology to improve our efficiency but also our service quality. Let me give you two very concrete examples on the field side to start with. Again, I have explained what 24/7 Connected Services brings to our customers. But actually when you are a field technician of KONE and you'll receive first – thanks to 24/7 Connected Services, you have 30% less disruption in your planning because you avoid call-outs. Then whenever you need to intervene on a call-out, you are actually equipped with the insight about what are the root causes of these call-outs and what could be the ways to solve it.

Then, technology can also help us to help the field technician to understand what is next best job. What – from a travel time reduction point of view, where should you go next? And of course, there when – technology can also help us to identify if they need a spare part and to ensure that they have the spare parts with them. So, we see the technology, of course, 24/7 but also much beyond 24/7 will continue to help us to drive not only customer – not only service quality because, again, all these are leading to a responsiveness – better responsiveness, but also it helps us to drive efficiency. And we all understand that in the maintenance of business, when we reduce travel time, when we reduce, sorry, the number of corrective interventions, we actually are also improving sustainability. So, this is very virtuous circle for us.

Then again, on the SG&A side, on the fixed cost side, we have moved a couple of years ago to a centralized or a centrally managed organization for handling all the customer queries. And I don't speak about the call-outs or the technical calls for the moment. I really speak about the customer calling us for tendering, for an invoicing, for changing data, for a question about the contract and so on. Last year we have actually received 1.3 million of these calls, of these customer queries. And thanks to the technology, again, we can know not only measure of service performance and hence improve the customer service, but now we can clearly quantify why are the customers calling, which means that now we can actually go to self-service capabilities or go to proactive information to our customers so that actually we can avoid them. We can help them to get the information before they need to call, which again, is convenience for them and it's actually efficiency for us. And we continue to develop that hence the discussion on the minus 5% on the fixed cost per unit development, which we see a clear potential ahead of us to continue on this direction.

So, as a summary from the service business side, again, we see service markets growing, maintenance and modernization across all geographies. So, very positive momentum. This inflationary environment is actually creating opportunities for us, both on the maintenance and the modernization through pricing, through value-added services and solutions, and through productivity or efficiency gains. The importance for us to continue to grow the maintenance portfolio in both units and monetary value, very essential to the future growth of this business and, again, the resilience of our service business and the profitability. Modernization growth will accelerate both as such it will be a growth driver for KONE – profitable growth driver for KONE, but it will also – or it needs also to provide more growth to the portfolio. And then last but not least and I think that we have showed a few examples that differentiation is the way to grow for us although it continue to grow for us. But that's actually what – the way we've been driving this business already for a few years in order to continue to grow faster than the market.

Thank you.

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

Thank you, Hugues. And now we have time for questions. We'll start in the audience again this time. Lots of hands going up. I see you all. Let's start with them.

QUESTION AND ANSWER SECTION

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)
Q

Yes. Hi. This is Tom Skogman from Carnegie. OTIS, your key competitor published their service profitability. It's like 23%. And if I'm not totally wrong about your equipment margin, I mean you're quite far behind that to my understanding. And then I realized they have a larger installed base, 2.1 million elevators. Then you have 1.5 million in your service base. So, is – how crucial is really density to close that margin gap? And given your density has, of course, also improved a lot, has there been a positive trend long-term in the service profitability?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

So, I guess that Henrik and Ilkka have already partially answered that, right? But – so indeed, we don't disclose profitability per business or geography, number one. Number two is that when – I think Henrik mentioned that when we see or when we look at what's outside, we say, yeah, in terms of profitability, that's something we are comfortable with and that we have been actually developing our profitability on the service side of the house already over the last years.

Indeed, density is contributing positively. It's a tailwind in terms of margin development. Then, of course, you have mix impact, right, in the level of China, for example. China service business overall is positive at group level, but of course the pricing is lower than the rest of the world. So, it also partially explain the mix impact on the service business.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)
Q

So, just to understand it that the margin is kind of improving over the years in the Western world and your density is improving. But then, China growth being faster than other regions. That is kind of a drag for the margin development basically?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

No. Margins are improving everywhere. But, again, the mix place – the mix is giving an headwind to the total picture of the – at KONE level.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)
Q

Okay. Thanks.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

You understand the size of China, including, of course, the growth is also coming very much from the construction business, right? 65% of the construction business is in China, which you then...

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

[indiscernible] (02:57:27)

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

...get into the service business or the maintenance business. Thanks.

Tom Skogman
Analyst, Carnegie Investment Bank AB (Finland)

Q

Thanks.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I think we had something here.

Q

Yeah. Thanks. Question on the modernization market and the dynamics, I mean, you mentioned that it will play a bigger role on capturing maintenance base if we compare modernization of new equipment market. So – and I assume that that means that you are targeting to take market share by modernizing also non-KONE equipment. So, is there a fear that that modernization market becomes a bit kind of a price driven in a sense that everybody is seeking these benefits? And, overall, how does the tendering activity and the pricing discussions with clients differ from the traditional new equipment market so?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Yes. So indeed, it means that we're going to grow outside of the units we have in our portfolio, clearly. Let's remember that it's both KONE units and competitors' units, right, because we have a number of unit which are outside of our portfolio. Bill, for example, mentioned in China that we have delivered already 1.2 million units and we have a bit over 500,000 units in our portfolio. So, it creates also potential for us.

I think the modernization markets are already pretty competitive. Then of course the dynamics are slightly different than in the new equipment business because, of course, for most of the time we are discussing the – first the modernization business is [indiscernible] (02:58:55) for the moment much more, I would say, complex from a technology point of view. And I would say that it's more discussions individually with the customers, very – very often the building owners directly or the property management companies. We don't have – or we have very little, for example, involvement of general contractors in the buying process on the modernization. It can happen, but it's actually a limited part of the business.

Q

Okay. And then the second one, perhaps more kind of a short-term focused. I mean, there was a bit of a talk about need for more dynamic price contracts and I guess that was a comment on the new equipment side. But are you happy with the kind of the structure of the pricing contracts that you have on maintenance? I mean, if we now see a bit of an acceleration on the labor cost inflation, also – I mean fuel prices are in a higher level. Are these things that mechanically are correct data on your prices automatically? Is there a significant time lags between these? Or is there any need to kind of look back at the contract structure?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

So I would say that we are probably in a favorable position there on many aspects. The first one is that, in many geographies we have actually escalation clause or index clause in our contracts. And the time lag is usually less than one year or one year. Again, thanks to the KONE Care structure where we have flexibility in the content and the pricing of the contract, we can actually also introduce added value services to our customers to also back up price increases and value increases, so it helps us quite a bit. So, we expect to be able to continue to, I would say, again see or have the inflation as an opportunity rather than a risk or challenge on the maintenance side of the business definitely.

Q

Yeah. That makes sense. But like if we just compare apples-to-apples there might be a bit of a time lag this year before the clauses kick in going into 2023.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Sure. But we already have inflation in some places, right, because again inflation has been there in many geographies already, Asia-Pacific, China, India. So, of course, we see it more moving on the Western side. But, as I said, we have other weapons which – in our hands in order to play with that.

Q

Okay. Fair enough. Thank you.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

And we had Erkki here.

Erkki Vesola
Analyst, Inderes Oyj (Research Firm)

Q

Hi. It's Erkki Vesola from Inderes. Connectivity, obviously being a major competitive factor. Could you briefly describe what are the major competitive advantages of your 24/7 Connected Services vis-à-vis Schindler Ahead or Otis ONE?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Well, as you know, we don't really compare or talk about competition, right? But I guess that the approach we have has been, since the beginning, to focus on the value we are providing to our customers. And that makes a very big difference, right? We have defined since the start three values or we have understood three values from the customers. It's about safety, it's about transparency or – yeah, transparency, sorry, and it's about intelligence, meaning predictability in this case.

And we are really focused on understanding how 24/7 can address or answer to these three values or can support these values, and then demonstrate the benefits to the customers. And I guess that a lot of it is in the intelligence we are creating, so analytics, algorithm and so on, and the data we are collecting, of course, and then the ability of the systems to be used by our field technicians. And, again, where we have this back loop into the systems where our service technicians are constantly telling us about the quality of the service needs they have received. And that's the core, I would say, of the competitiveness.

Then it's from an offering point of view. Then, again, it's not only about product and technology right? It's also about the ability of our people to sell the value and these new offerings to our customers and also on the field to execute on it. So, it's not – it's really – this change is, of course, about technology and offering, but it's also very much about how our people are embracing it and are, I would say, communicating this solution and the benefits from it to the customers. It's relatively complex system.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Let's take a few from the lines. There's been quite a few questions coming in on 24/7. So while we're on the topic, first of all, do you anticipate a wider push into kind of mass connecting your maintenance base? And what percent of your maintenance base do you think needs to be corrected before you have sufficient mass to really make an impact on productivity and/or retention?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

Okay. Well, I guess, again, for the moment, our strategy stays to provide the value to the customers and sell this value – and sell the added value of the 24/7 to generate additional revenues for us. What we see is that we continue to accelerate in scaling and of course, again, what Tomio has mentioned about the penetration of the DX Class elevator is actually helping us, right? Because what does it mean, the DX Class elevator? It means that the equipment is – all the connectivity is there. So, we don't have to add any new hardware or anything. We can just switch on 24/7 remotely through a software download.

So, it's of course creating a significant benefits because of course all the volumes from the new equipment business will feed our 24/7 and will help us to continue to grow. And, of course, when we are modernizing an equipment, which is also the DX controllers, for example, we are bringing also these digital capabilities to the older equipment.

So, for the moment, that's how we are driving this. And again, as we said, our main focus is on the value we are providing to our customers and the monetization of it. But, again, we also see efficiency gains in the future. But today, we continue to see more value in the selling and providing value than on the taking the efficiency.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Perfect. And are you able to connect customers' multi-branded portfolios to 24/7?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

Yes. That's probably one of the advantage of our solution is that indeed we have solutions which are enabling us to connect, I would say, KONE equipment from different types of generations but also non-KONE equipment.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj A

Great. And then one more from the lines before we move into the room again. Could you comment on how digitalization is impacting the competitive landscape in the maintenance business?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj A

Yes.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj A

Brief question, try to take it briefly.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj A

It's pretty early. But what we can see is that, of course, it helps the large OEMs to – or it should help the larger OEMs to improve conversion and retention. And that's what actually we see in the results, right, which means that indeed for the smaller players of this industry, either they will need to find a solution or buy a solution from somewhere, or they will need to offer a different types of values. And what we can say is that the growth of the non-KONE – non-OEM this year has been clearly lower than the OEM. Is it a longer term trend? Let's see.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj A

Great. Then to the room. Here in the front. I think you were actually asked to wait [indiscernible] (03:06:23) your question, so this is your opportunity now.

Q

Luckily most of...

Hugues Delval
Executive Vice President-Service Business, Kone Oyj A

[indiscernible] (03:06:27)

Q

Most of the questions you answered, but I guess the presentation threw up some more questions. So first question is, what's the kind of churn rate you're seeing in your technician base?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj A

Well, it's very, very, very – there is a significant variance per country on this. It can go from 2 to 3 to 10-ish. But it's just a very significant variance. But, again, I think that what's important for us and you are raising a very big point is, of course, that the service business will continue to be a people business, right? So, our ability to continue to engage our teams, to train them, to give them the new the new skills which are needed in this world are very essential, which is also for us opportunities to offer them career path and keep them with us and retain them. But usually most of our technicians are actually long-term tenure with us.

Q

And I know you're seeing inflation in the wages as well, but a slightly different question. If you look at your technician compensation structure, what percentage is variable in that compensation structure?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Again, significant variations per country. We don't have one single standard for that. It varies so much per country. It can be from 0% to 50% and depending on the country.

Q

Oh, it could be as high as 50%?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Yeah, I think in some. But it's actually exceptions, to be honest. It's mostly fixed. But in some places, we have actually a good proportion of the salary which can be variable.

Q

You also talked about industrializing the backend as KONE customers customize their solution at the front end. Can you give us an example of either going to a unit level at a branch level, how it was pre-KONE Care? So, when it was comprehensive in oil and grease contracts and how is it post when the customer customizes it? What's the [ph] route (03:08:28) density difference at the back?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Well it very much – well, we continuously develop the [ph] route density, right? So, there are several factors in the route (03:08:35) density and of course the number of equipment we convert from the constructions enables us to constantly, I would say, look at the density. I would say that from a customer point of view, again, they can select the number of services and the options, etcetera, they have. And how do we make it easy for teams to deal and it is that we have field mobility solutions for all our service technicians around the world. And when they arrive on the equipment, they exactly know what's then included in the contract, what are the response time and so on. So we are actually driving or, I would say, communicating to our service teams about what's the, I would say, contract options before they arrive on-site.

Q

Yeah. But is this – is still a large percentage of your contracts comprehensive [indiscernible] (03:09:24)?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

It again depending very much per geography. So in North America, it's mostly comprehensive. In China, it's mostly stand-out. But again, it's old way to – it's actually the old way to look at this, right? We have significant variations now. And before, we could say, ah, this one is comprehensive, this one is stand-out. Today, it's actually a continuum of different services and options in between, right?

Q

Okay.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

And it's actually not only about the spare parts, it's about responsiveness. It can be about many other things.

Q

Okay. So one last question there.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I was just going to say, let's give someone else a chance as well.

Q

Yeah, one last one. So when – in your presentation, you talked about repairs and spare parts driving growth for you, right? So from a per unit economics perspective, are you better off having a comprehensive contract? Are you better off having repairs and spare parts?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Depending on the customer and depending on the contract. Depending on the price, actually, right? If you have a very good price for comprehensive, then you are better with comprehensive. If the price negotiation is not good, then you prefer to, I would say, go for a bit lower parts coverage. So it's very an individual negotiation. That's where – again, in the KONE Care, the way our tools are built is to actually give these information to our salespeople at the time they are selling this. They know.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

All right. Let's take one more from the room if we have one. I think I saw a hand here first. [ph] Stuart (03:10:55), you haven't asked a question yet. I'm sorry. You've already had one chance and come to you again during the lunch. We're trying to get a lots of variation here in the room.

Q

I'm going to try to sneak in a couple of questions under one topic heading. Just would like to know what's the conversion rate in China today? How's that changed over the last couple of years? How do you think that changes over the next three to five years and why?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Okay. So the conversion rate in China is around 60%. It has been relatively flattish over the last – slight improving, but flattish over the last years. Although I see it improving, I guess that it will very likely or we are working very actively to improve it. I guess that there are a few elements to it. There is, of course, the service density and the customer relationships. There is the technology element. And, of course, the more we bring these services like 24/7 and et cetera, the more we create a positive environment for us to improve the conversion. And I guess that what Bill has mentioned also about the growing importance of the key accounts and the top developers is also fueling better conversion rates.

Q

[indiscernible] (03:12:15)

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Mic?

Q

Do you think you need to make any more fundamental changes in how you go to market in China in order to improve conversion rates?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Yeah, it's a good question. For the moment, we continue to believe that there is clear potential for us to improve with recurrent model. Again, you understand that in the construction side, on the new equipment business side, we sell mainly to agents and distributors. What we have been doing for the moment in the maintenance side is that we have invested heavily in direct sales. So this is KONE salespeople selling the maintenance. And for the moment, we believe that that's the way to go. But that's, of course, a very good question to keep asking.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

I think that's all we have time for now with Hugues.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

Thank you.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

Clearly, I should have allocated a bit more time to this topic. Luckily, we still do have some time still for a Q&A. So, at this point in time, I'd like to ask Henrik back on stage to wrap up the event. Before wrapping up, if you have anything kind of in your mind that you still want to ask about, we have all of our presenters here. I think we still have Bill on the line. So, please feel free to come back to another topic or continue on services. Here we go.

We have one here in – at the end.

Q

Thank you. I just had one – couple on services, actually, if that's okay.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj
A

That's fine.

Q

So I guess the first one is maybe thinking about inflation and obviously higher labor costs. And I think everyone sort of seems to assume that you've just passed it through, it's indexed and it's all fine. But presumably, if I'm a customer who for the last few years have been seeing sort of low-single-digit inflation in my elevator maintenance costs, and now I'm being presented with an increase of 9%, 10%, it's perhaps going to make me think a little bit more about my relationship.

I guess my question is, have you done any work looking at sort of sensitivity to pricing, like in periods of high inflation when we've had these kind of challenges before? Does it affect the retention rates within the service portfolio or has it not really been an issue?

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

Hugues, maybe you start answering that and tell a little bit about this year's experience which is, of course, slightly different than other years.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj
A

Well, I guess, the time we have had very high inflation globally is not very recent, but of course, we have also had high inflation in some parts of the world and we don't really see an impact on the retention performance. I guess that one of the key element in the discussions, in the individual discussions we need to have with our customers is always the question of value versus prices. And in case there is a disbalance or perceived disbalance into it, the discussion can be both on the pricing but also on the value we are providing and, hence, the services we have there, right? So that I think it's very much an individual discussion.

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

A

Now I would say also, if you think about the situation right now, [ph] I've actually reflected (03:15:28) on it recently that what was the outlook last fall? It was – the consensus was we had different scenarios, but I guess the global consensus was that come first half of 2020 that supply chain issues, logistics issues and things like that would start to resolve themselves, and maybe cost would start coming down. And therefore, we could still – last year, there were still on the customer side and generally market, the question is, hey, hey, this situation will end, so you cannot increase prices.

Now, the situation we are in I would claim that irrespective of industry business, the question is no longer that you need to increase prices, the question is how much. So the mindset has changed. And I'm sure, we know with ourselves, you get your electricity bill at home, if you would get the increases a year ago that you're getting today, you would have jumped through the roof and I would just, [obscenity] (03:16:24), this is the environment. I think it does play an impact. So, I think that the environment is more [ph] better for it (03:16:31) now. But of course, we have to see it going forward and, of course, it starts to be a overall challenge for the economy and everywhere, but that's environment we are in.

Q

Thank you.

Anders Idborg
Analyst, ABG Sundal Collier Ltd

Q

Hi. Anders Idborg at ABG. So just on the price cost clauses as you – I mean, just wanted to understand, how big proportion of the orders that you take now for new equipment have these in them? It's very significant and obviously it takes some time to roll through to revenues. And the other part is, do you expect these to be permanent? As you said, customers don't like them. At some point, it might be a competitive edge just to have a fixed price, et cetera. So do you think this is a temporary issue or not?

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

A

Yeah. We've seen so much changes over the past three years that I'm not going to start making very long range of predictions because only thing you know is you're going to be [obscenity] (03:17:37) wrong. But how big of a percentage do have indexation in contracts today, it's quite a small percentage. The point is what we are saying in tendering, now, we are increasing it, that we have built the model. So, we are driving it there. But before it is a high percentage, it's going to take some time. But the point is that's the direction.

We also have to remember if the indices – if costs go down, there's opposite impact. So you also have to be smart about it commercially when you do it and when you don't. And at some point, if you have a strong point of view that costs are going to go down, maybe you want to have indexes in your contracts. But I still think that long term, fundamentally, to get a better match on the duration of your order book and your cost structure, I think is a good thing.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

We have one at the back there.

Q

Thank you. Yeah, my impression is that [indiscernible] (03:18:32) companies typically also are great capital allocators. What is the optimal long-term capital structure of KONE and in which scenarios could share buybacks be part of it? Thank you.

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

A

I would say we haven't defined an optimal capital structure. It's clear that we have a very strong balance sheet. If I reflect on the past 15 years since the financial crisis, I think having a strong balance sheet has been an absolute advantage. We haven't a single time in this period where there's been a lot of fluctuation, had to stop. I said if there's something – is our balance sheet restricting us from what we're doing? Absolutely not. We can't stay 100% focused on the business.

Having said that, clearly, we have a very strong balance sheet, but we still think it makes sense because we are interested in driving consolidation in this industry. We think that one day there will be people who are also willing to sell in this industry, not only buy. And then we have a ability to move quickly. But also, it's given us an opportunity to pay good dividends. So, I'm not giving exact answer to your question, I'm just reflecting of how we've been thinking about it over the past years.

Ilkka, do you have anything more to say on that?

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

A

I guess just complementing the second part of the question was – about share buybacks. So I guess we have mostly used share buybacks to take out the dilution from our incentive programs, but I see that there's particular reason why depends on whether it's a dividend or share buyback way to then return capital to shareholders.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Yes. There in the back, please.

Q

I have a question to Mr. Delval, who made the presentation on services business. So you said that all markets are growing at – I don't know for what time period you would make that statement. So in the case, what I'm missing is a bit sort of regional insights. In the case of China, I can fully understand, it's an installed population, conversion, et cetera. But when I look into North America, so the United States, I think there's something brewing there and I don't really understand exactly the thing.

But I mean, let me share you some observations. Pre-pandemic, we've seen more and more retail space in the big cities being emptied due to the whole shifts in distribution. Then pandemic has accelerated that. And on top of it, now post-pandemic, we have a hybrid model of working. So we have also then the office space. And office, correct me if I'm wrong, is one-third of the market. There, you will see rising vacancy rates. I think quite substantial ones. So I have seen in many cities that I frequently visit actually elevators being put idle. So in a block where you have 8 to 10 elevators [indiscernible] (03:21:49) escalators in malls. And, I mean, the question to me is then, now, looking more down the road, two, three years, five years, do you still see – saw the same situation as positive as you express today when you say all markets growing? Can you elaborate maybe a bit on that.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Sure. Well, I guess, as Henrik just said, right, difficult to predict the future in this period. But again, what we see is that there are clear fundamentals behind this growth. Then, of course, over a certain period of time, we can face adverse development or certainly economy. We know that recession, for example, or economical environment has an impact on [indiscernible] (03:22:35) business historically.

But again, we see clearly, also in the US, growth potential, both from the maintenance, resulting from the strong construction activity. And we know that in the US, we see some cities or some regions developing very strongly. Texas, for example, is one of them. But we also see that building owners will not stay put, right, with their assets in the office buildings, for example, or retail. They will transform them. They will adjust them to add more adaptability to the new use of this, which also will create more investments and monetization potential.

Then again, will it fluctuate over the years? That's a big question that – it's difficult to answer. But longer term, I think that we see growth trajectory for that in the different geographies, not only China.

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

A

It is a – [indiscernible] (03:23:32) what you're asking is a very, of course, interesting fundamental question that what's going to happen to all this real estate. And if you saw the data actually I showed early is that the number of elevator starts in retail establishments is at or above pre-pandemic level. So many of these units have been already redeveloped.

I just have been in the past weeks spending a fair bit of time also in North America and talking to some of the major building owners there. They are thinking – they are very proactive about their asset management. And also, offices, I was almost surprised how positive they were about the demand and people coming back, not every day. But I think what we saw pre-pandemic happening is that the average space per user in an office building had been shrinking all the time. I still remember about 13, 14 years ago, we did a study at KONE and then benchmark was 13 square meters per head in an office building.

Now, I know in, and I'm sure many of you have experienced that if you went to the big cities, it went down to 8, 9 square meters even, and that was too tight. I'm sure many people would agree that we were stuffing a little bit too many people into the same space in offices. So now, we're definitely going to have more people – more square meters per person, but people are not there as much. And also the type of – the way you use the buildings is changing and how do you manage this. So, it's interesting actually how positive many of the developers are on office space in the right places. And as Hugues said, there's a huge difference between different cities.

So we continue to see good demand in many places. And if you look at how our maintenance business, we don't disclose it by region, but I can tell you that in North America, in maintenance, we are growing at really nice rates.

Maybe it's just that we are doing a very good job, I don't know, but we are growing in really nice rates here right now.

Q

Yeah. Hi. I have a few questions. The first one is when you look at the installed base, what proportion of that is KONE Elevators and what is other manufacturers? And is there a big margin differential? The second question is, in the residential segment, do we see that buyers are becoming more savvy, so more professional buyers? Do you see that? And if so, do you think this is a positive or a negative for you?

A third question is on the modernization business. You track sort of the attach rates there. When a corner lift is being modernized, how much of that you capture? And then the last one is...

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

A

Hold on, hold on, let's take – if we get [ph] Hugues (03:26:24) to start going through these questions. Hugues, you want to start? With the service base, how much is KONE versus non-KONE.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

So, again, very big differences across geographies. In Asia Pacific, in China, we're mostly KONE, vast majority. In the rest of the world, we are probably balanced, let's say, 40/60. So, 60% KONE, 40% non-KONE.

Q

Yeah.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

And the question was about the profitability. Of course, we don't disclose this. But of course, we can say that, yes, there is a slightly lower profitability in the non-KONE equipment overall – from an overall perspective, but we continue to work on it in order to absorb this [ph] input (03:27:05) productivity.

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

A

[ph] As I said (03:27:06), KONE MonoSpace is such a fantastic product that we'd love to service it.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

Definitely. In the – yes, we measure the retention rate after [ph] monetization (03:27:15) or the conversion rate after [ph] monetization (03:27:16) as well, for sure. And as a matter of fact, for us, clear strategic direction for our teams across the world is that we modernize and we have the maintenance contracts after that. We don't modernize or very rarely without maintenance contract.

Q

Okay. What about the residential segment?

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

A

Well, professional buyers [indiscernible] (03:27:42), if you think about...

Q

I think...

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

A

Can we take this, mic?

Q

Can I take – yes. I think, overall, the new equipment customers are professional buyers, right, most of them. So I don't think that that has – that as such has changed a lot.

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

A

No.

Q

But I think we have – we see some consolidation obviously that big developers are becoming bigger, so...

Q

And on the maintenance side?

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

That's not a phenomenon we observe, no. I would say that more and more the owners of – the Association of Owners play a bigger role in the buying activity. And of course, people are looking and comparing, et cetera, but does it make it much more professional than in the past, I wouldn't say so. There is no big change in this.

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

A

Okay.

Q

Okay. And the last question on the people flow, right. When I enter a building, like with a badge, right, the elevator comes down, I get to the right floor and so forth. How do you monetize that and do we have specific partnerships?

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

A

We have certain partnerships for the, for example, access control and others, how to do the flow better and certain other services there. So this is something – it's a lot about analytics. It's a lot about how you design the units and how much you monitor and adapt because you can always have – you can have a perfect model that you think how the building is going to work. But the only thing you know is if human beings will work – will behave in a different way than your model. So you need to have constant analytics and update that. And that's what we're doing and then working partly with partners, but much of the flow analysis and all that, that's our own proprietary analysis.

Q

Thank you.

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

A

Thank you.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

A

Let's take a few from the lines. There are quite a few questions coming in on China. So I think these are maybe, Henrik, Bill and Hugues, all for you. So let's take them one by one. First of all, maybe, Henrik, if we look at China, could you provide some comments on how you're seeing installation activity developing now in the second quarter versus the first quarter? And maybe if [indiscernible] (03:30:02) lockdowns.

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

A

Of course, Bill can provide more flavor on this. But it was clear that the lockdowns started really at the end of first quarter. So we really saw a slowdown in deliveries and installation towards the end of March. And then, of course, the really severe lockdowns were then beginning of April, when a lot in the Shanghai area just ground to a halt. And if you think about supply chain for elevators, overall, suppliers, [ph] all that (03:30:31), it's very much around Shanghai.

And now in May, we have started to see a ramp-up of that. But there's still a good way to go. And now, of course, we have markets opening up and, as Bill said in his presentation, that still the big thing to get going is logistics to work seamlessly in the country and all suppliers also being able to ramp up. And of course, what suppliers also are dependent on are probably logistics. So there are quite a lot of chains still there. So, it is something we have to see and follow. And by the end of Q2, we'll know more.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj A

Great. And, Bill, can you hear us? I have one for you.

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj A

Yes. Please go ahead. Great answer, Henrik. Yes, [indiscernible] (03:31:19).

Natalia Valtasaari
Head-Investor Relations, Kone Oyj A

Excellent. And I think this is actually building on the previous question that I asked. So what would you say, Bill, how much time do you think any market needs to normalize after the lockdown and how would you describe the pace of recovery now versus what we saw in 2020?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj A

Well, the interesting about these lockdowns is that even as the city opens up, it's city to city, these borders are the ones that we have to get open, because I may be open here in Shanghai, but for my logistics team to take material to another – or two or three provinces away, they have to go through several health checks and that will certainly take some time to open up. But as I said earlier, I think we're talking more weeks at this time than months. So, I think by – I'm very hopeful by early July, we're pretty much back to full speed.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj A

Excellent. Thank you. And then maybe still on China on the aftermarket side this time. We talked a little bit or there were questions around the changes in regulations in the China impacting the aftermarket business. How meaningful is this in terms of driving market share gains versus the independent service providers? So, this shift from the current kind of regulation to condition-based maintenance. Bill, any thoughts on that?

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj A

Well, actually, this is one of the things that Hugues and I have been looking at very carefully. And our teams are constantly checking on this. Hugues, I think, you probably have more recent data than anybody on this. Please go ahead.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj A

Well, I guess that what we can expect is that the way the condition-based maintenance regulation will be applied in the different places or in the different cities of China will be different. And there will be a common frame, but then the application and the rules might actually differ from place to place.

Does it actually – most likely, what we can see also today is that the larger maintenance companies are better prepared for the moment because also we have these remote monitoring solutions in our hands that are a prerequisite to enter into CBM. Then again, how fast will this implementation go? Because regulation is one thing, but I don't expect or at least we don't expect the regulators to say this is now mandatory. What we probably envision, and, Bill, tell me if I'm wrong on this, but we envision a situation where the regulators locally will open it up for the markets to choose the CBM metallurgy and for the customers to discuss with their own suppliers about what they want to have as a value, as an offering. So, it would be very much, I would say, relatively slow in the rollout or in the deployment of this, at least that's current expectations.

William B. Johnson
Executive Vice President-Greater China Region, Kone Oyj

A

I think you're right, Hugues. I think we're going to probably have to have a hybrid model in which we're going to have to do both activities for a period of time, just to see how both the market adapts to this and our own teams adapt as well to this new service model.

Hugues Delval
Executive Vice President-Service Business, Kone Oyj

A

And the service model is probably, and Bill has said it already at a question which was raised about this is both about the operating model, but it also about the value and the offering we are providing to the customer, right? It's on both sides.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

Great. Thank you, Hugues and Bill, for that insight into China and China service. I think that's all the time we have for questions now in this session. So, do, of course, use the opportunity, the people who are present at lunch to kind of continue the discussions. But that's – I'll let Henrik provide a bit of a wrap-up and final words on the day and his thoughts.

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

Okay. Thank you. And hope you have found it interesting today to hear a little bit more about how we are thinking about navigating the current environment now and how to drive a winning strategy in the current phase. So, of course, we talked a lot about services today, but it's clear that we wouldn't have such a strong and well-growing service business unless we would have grown and build such a great new equipment business over the years. And that's really particularly true for China that, as I said, that is the biggest opportunity in this industry over the coming years. That's where a big part of the growth will come.

And that is not a business – a service business, not something you build up over few years. I must say, this is something that our China team has had a lot of foresight a long time ago. This goes back more than 15 years ago when we started to say that, hey, we're not only delivering new equipment, we're also building a service business. Of course, you need to build out your network. You need to build out your technicians. We're training about 2,000 new service technicians every year.

To put in place all this infrastructure doesn't happen over time. This is really based on a long, long-term development that we are now able to benefit from and now really want to double down on the growth there. But it's clear also that we want to stay competitive in the new equipment. We want to continue to differentiate there, find the right opportunities, because that's really what fuels the services in the future. Although we have talked a lot about services, because just simply, we see that in the coming years, in the environment we are, we believe more of the growth will come from services, perhaps than new equipment. So a little bit shift in the market compared to previously, but that's absolutely okay. We continue to see good opportunities there.

So I talked about in the beginning also what it takes to win in this new era. And I mentioned a few things. To drive growth, we want to focus more on value rather than volume. I hope you heard a lot how we do that both in services and in the new equipment business. Productivity and agility, hugely important. And we are focusing not only our own productivity, we really want to show our customers that we are helping them improve their productivity, whether they are building a new building or have a current building, because that's just such a fundamental importance in this environment.

Supply chain resilience, we have been able to deliver to our customers in a very good way, despite the tough environment, but we want to make that more and more resilient in the future. And resilience doesn't necessarily mean that you're going to nearshore everything. It means that you need to be able to be flexible. And I hope that's what you understood from Tomio's presentation. We want to be flexible and have options where we drive, and that's how you build up your whole system for that. Because you know what, in our industry, China continues to be the most competitive place to supply from, but at the same time, you need to have an alternative. And that's what we want to do just as an example.

Sustainability, key design principle for a lot of our customers and what we think is the right thing to do. And we believe we have a great positioning here. And what everything builds on is to have empowered, motivated employees, hugely important to us and employees who have the skills for the future, how we continue to develop our culture, how we continue to upskill our employees. Those are absolutely fundamental things and what we believe are the ingredients to be a winner in the current era, which is different than what we have seen in the past years. But in the end, we are very happy to be in this industry because there are good opportunities and good things to continue to develop.

So with that, thank you, everyone, online for joining us. Very much appreciate you taking the time here. And thank you, everyone, for coming here in person. And the ones here in person, you have a great opportunity to ask a lot more questions from all of my colleagues who are here, some of them who have presented, others who have not presented, but I'm sure you have lot of questions to them. So enjoy the lunch and hope you gain more insights there as well. So thank you for today.

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

And thank you on my behalf as well. Applause to Henrik, applause to all of the speakers.