

KONE CMD 2014

# Developing our business in China on a broad basis

William B. Johnson, Executive Vice President, Greater China  
September 26, 2014

# Agenda



- Our performance in China
- Major current market trends
- Solid long-term growth drivers
- A growing service opportunity
- Priorities in further developing KONE in China

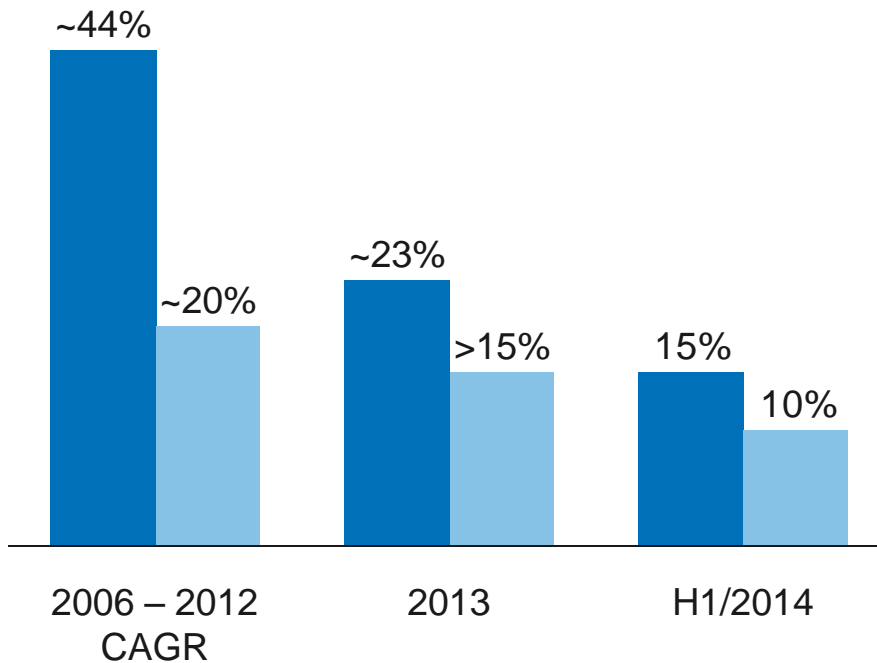


# We have continued faster than market growth in new equipment in China



## New equipment orders received (units) vs. market growth

■ KONE  
■ Market



Note: The KONE figure 2006-2013 includes GiantKONE from December 2011 onwards. Market growth based on KONE's estimate.

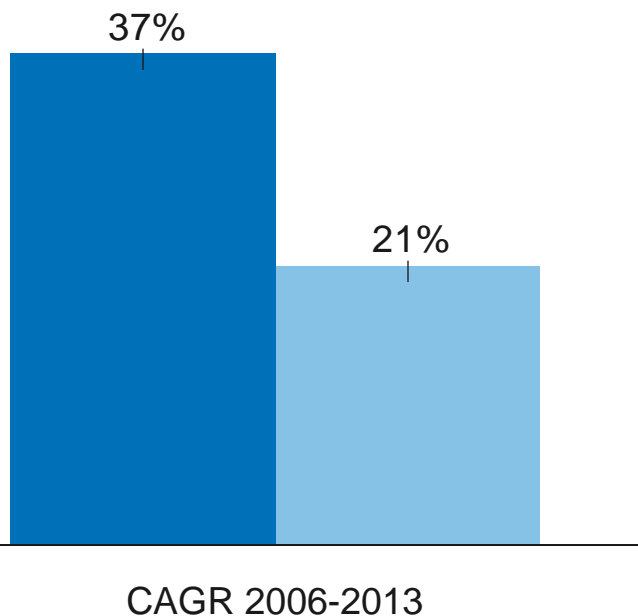
- #1 in new equipment in 2013 with 18% market share (2012: 17%)
- Very competitive product portfolio covering all segments
- Dual brand strategy: KONE and GiantKONE
- New KONE factory in Kunshan fully operational and GiantKONE factory has been expanded to meet future demand

# We have grown faster than the market also in maintenance



## KONE's maintenance base vs. total installed base growth

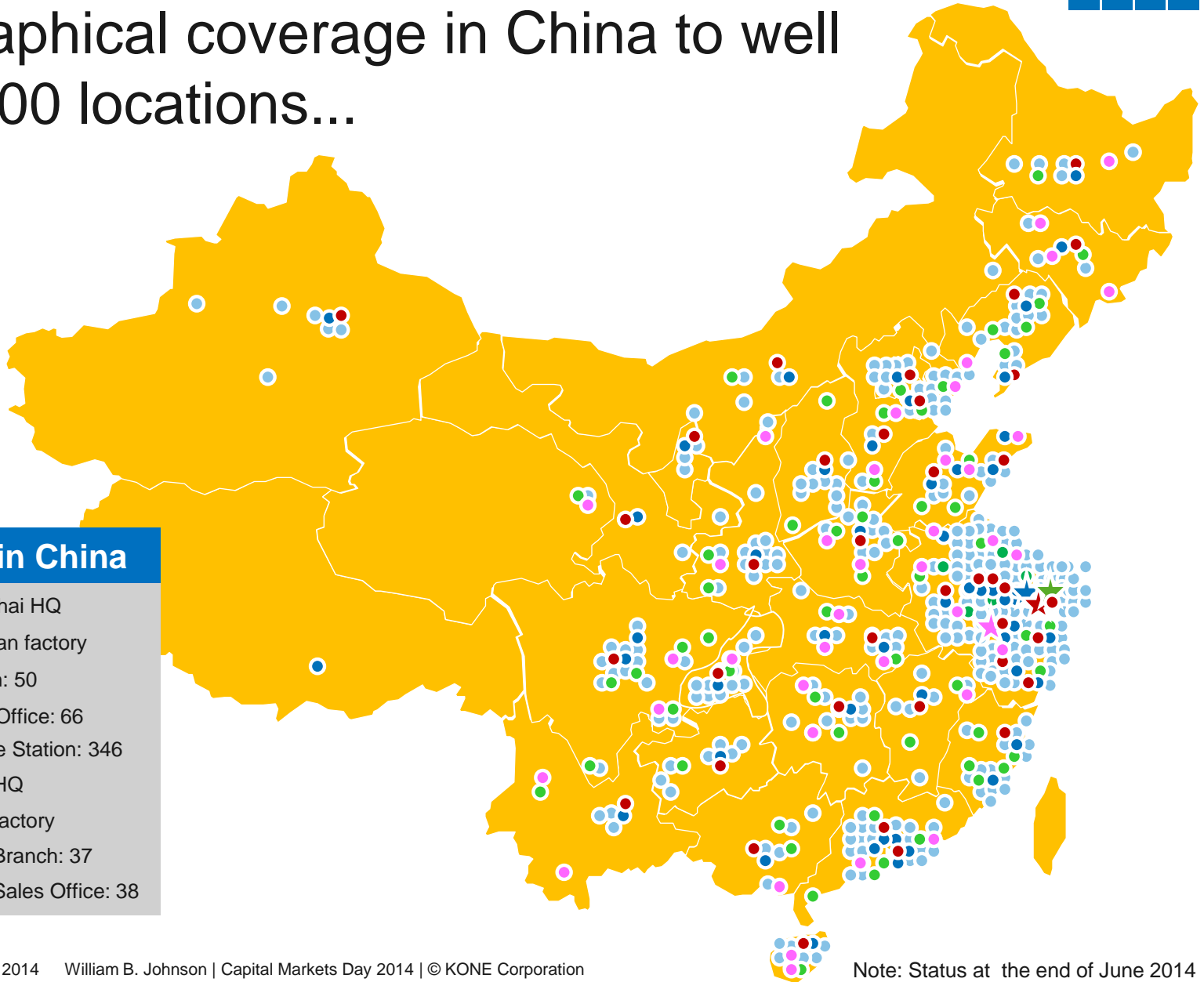
■ KONE  
■ Market



Note: CAGR 2006-2013 including KONE and GiantKONE.

- #1 in units in service
- Maintenance portfolio covering all market segments
- Industry-leading conversion rate
  - Conversion rate ~50% for KONE and GiantKONE; ~60% for KONE brand only
- Network coverage expansion – more than 80 new service stations opened in 2014

# We have continued to expand our geographical coverage in China to well over 500 locations...



**Footprint in China**

- ★ KONE Shanghai HQ
- ★ KONE Kunshan factory
- KONE Branch: 50
- KONE Sales Office: 66
- KONE Service Station: 346
- ★ Giant KONE HQ
- ★ Giant KONE factory
- Giant KONE Branch: 37
- Giant KONE Sales Office: 38

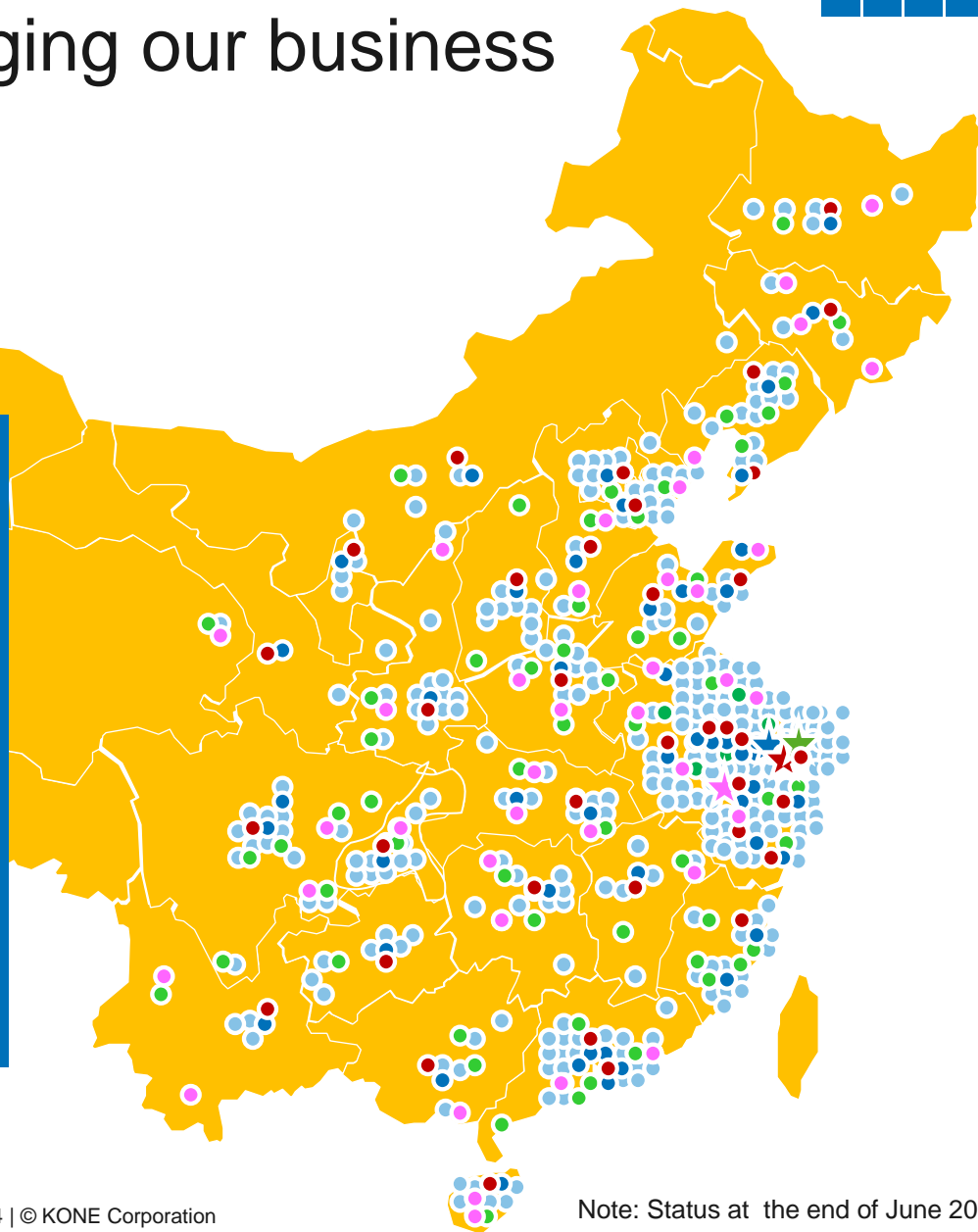
... and this allows us to have great transparency in managing our business at the local level




- Full P&L accountability deployed across ~90 branches

and

- Ability to track market and business performance separately in almost 400 locations

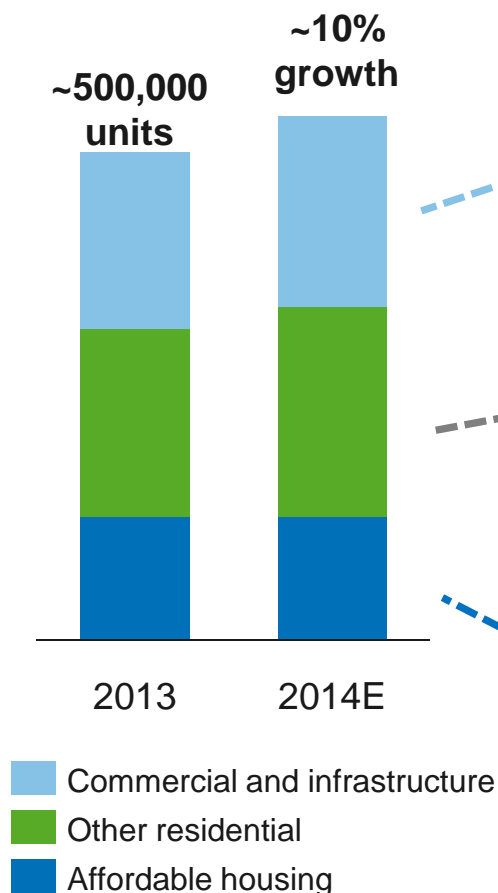


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- The background of the slide is an aerial photograph of a modern city. A prominent feature is a tall, slender skyscraper with a glass facade, which is the One World Trade Center in Shanghai. The city is built on a peninsula or near a large body of water, with various modern buildings, green spaces, and a waterfront area with boats. The sky is a clear, light blue.
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# Chinese new equipment market expected to grow by ~10% in 2014



## E&E indicative market growth, 2014e



## Segment-specific development

Commercial segment seeing solid growth, especially office buildings, infrastructure segment relatively stable

Residential segment (other than affordable housing) picking up, slightly renewed focus on tier 2 cities

- Reported 6.6 million starts in 2013
- Reported starts 1-8/2014: 6.5 million
- Relative share of segment gradually decreasing
- Focus on urban renewal and shanty town reconstruction



# China's current market environment is characterized by three key development trends

1

**Real estate sector seeing a mixed investment environment across regions and locations**

2

**Larger developers in a more favorable situation on the market**

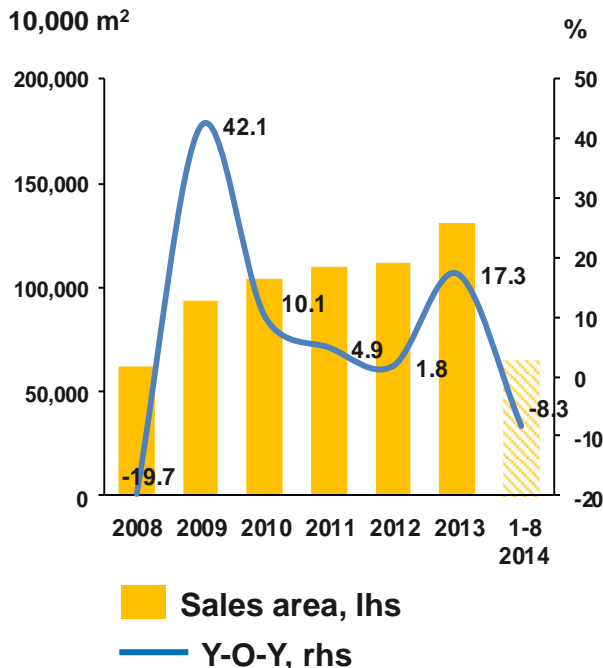
3

**Increasing emphasis on quality, safety and energy-efficiency**

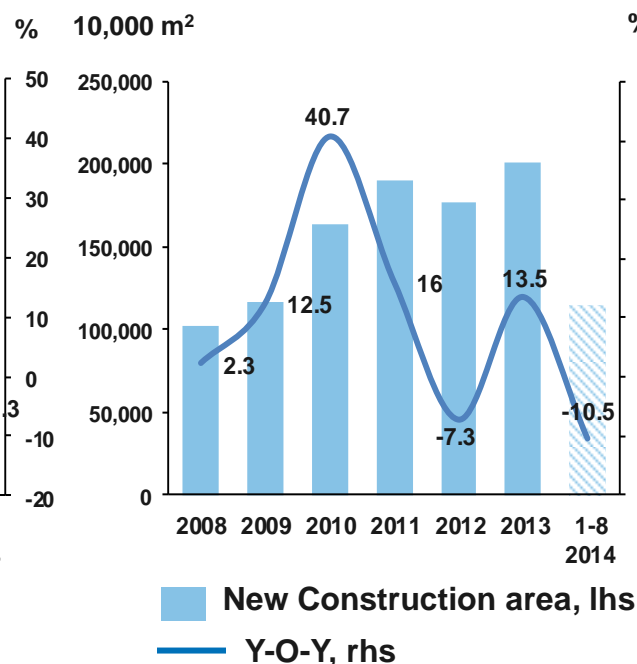
# Real estate market: following a strong end to 2013, consolidated sales and new construction area have shown weaker development in Jan-Aug/2014



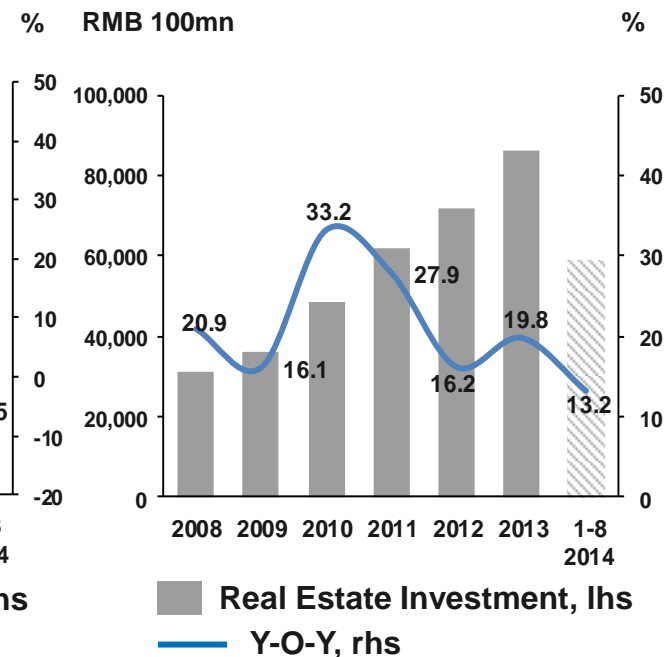
## Total area of property sold 2008 – Aug/2014



## New construction area 2008 – Aug/2014



## Real estate investment 2008 – Aug/2014

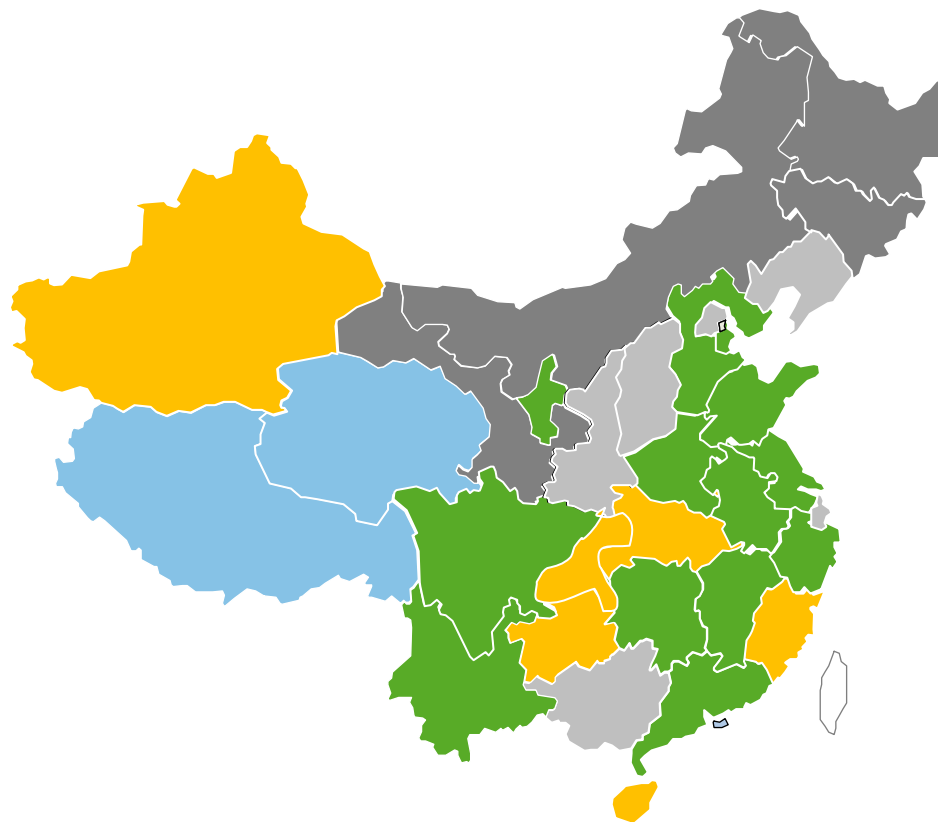


**New construction area back to y-o-y growth in July-August**

1

However, the market development is very diversified, both at provincial level and within provinces

## Real estate investment growth rate % (y-on-y), H1/2014



14.1%

Investment growth rate %  
(y-on-y)

↑ : >40%

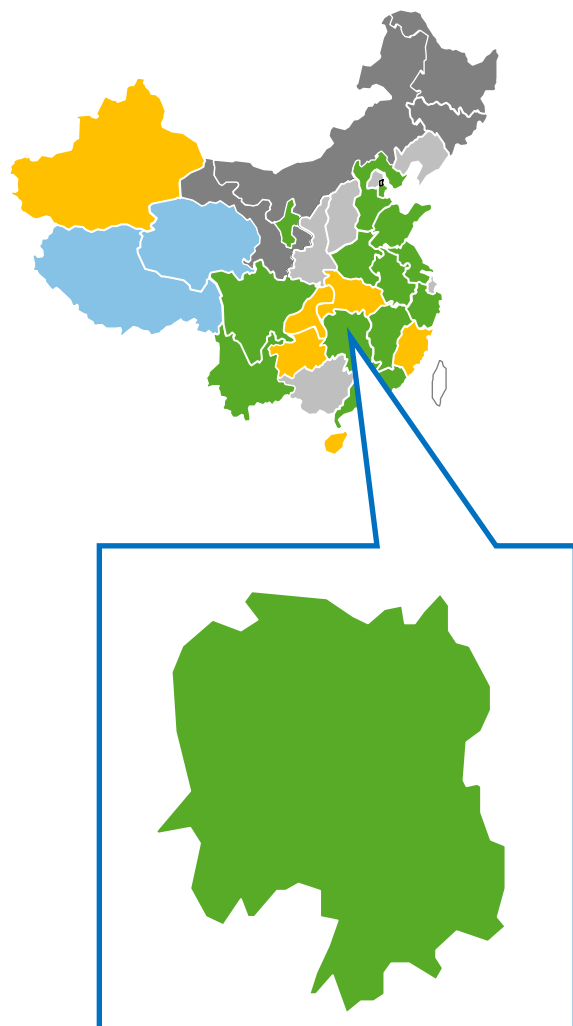
■ : 20%~30%

■ : 10%~20%

■ : 0~10%

■ : <0

# Example of local market diversification: the Hunan province



Hunan province	
Population	66.9 million, 5% of China
Urbanization rate	2013: 48% 2020 target: 55%
GDP	RMB 1,197.5 bn, 4.4% of China, growing 9.3% y/y in H1/2014
Real estate investment	H1/2014: up 10.8% y/y
New E&E orders	2014: E&E orders expected to account for >3.5% of total China
E&E in operation	Over 80,000 at the end of 2013

# Example of local market diversification: the Hunan province

## Hunan's regions and cities undergoing very different stages of development

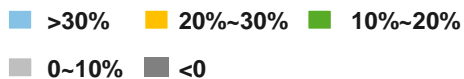
- **Changsha, capital city, tier 2:** urbanization rate up to 71% from 61% within the past 5 years
- Investment in residential and infrastructure continuing at good level

- **Zhuzhou, tier 3/4 city:** Strong investment in the past years, temporarily exceeding demand
- H1/2014: real estate investment grew by 5.2% y/y, real estate sales area declined by 23%
- Urbanization continues, but housing inventories need to be absorbed before investment picks up

- **Shaoyang, tier 3/4 city:** Urbanization at an early phase, with urbanization rate of 38% in 2013
- Very high investment ongoing with y/y growth rate 41%, sales area in H1/2014 climbed 46% y/y.



H1 2014 Real estate investment growth (y/y)



Source: 2014 H1 investment growth from local bureau of statistics.

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**Increasing emphasis on quality, safety and energy-efficiency**

# Financing situation continues to be tighter for smaller developers



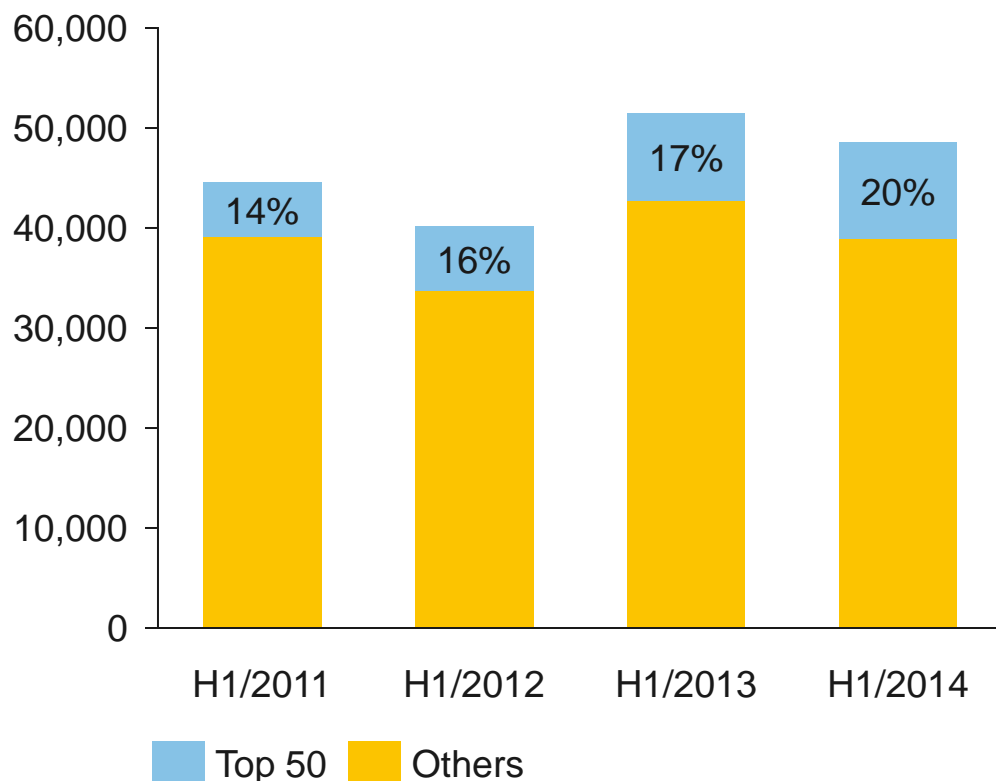
- Bank lending continues at good level
  - China banking regulatory commission eased the definition on banks' loan to deposit ratio, increasing banks' capacity to lend
  - Reserve requirement ratios lowered for smaller banks
  - Recent 500bn RMB liquidity injection from the central bank
- "Non-bank" lending undergoing deleveraging, this having a negative impact on total financing availability
- Large developers are in a better position with continued access to bank and bond financing. Smaller developers have been more dependent on non-bank lending.

Some consolidation is clearly seen among developers, with the larger developers gaining market share



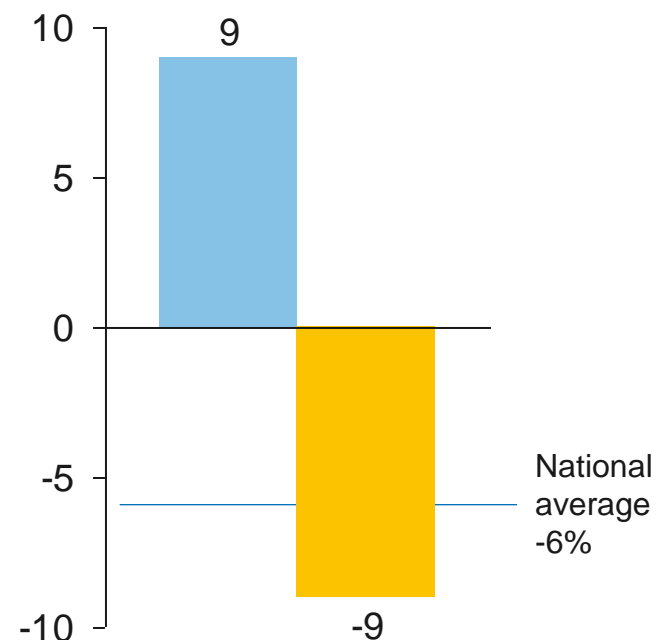
## Developers' share of total floor space sold

Sales area, 10,000 m<sup>2</sup>



## Growth rate, H1/14 vs H1/13

%



Source: CRIC, China Real Estate Appraisal Center, National Bureau of Statistics



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# Increased focus on safety and better service levels in buildings is a continued important trend on the market



- Special equipment safety law enforcement to ensure high-quality installation and operation
  - Role of the OEMs increased in the installation process of new equipment
  - Implementation ongoing
- The Chinese code for new elevators and escalators is adopting further points from European code, with focus on safety
- Support for energy-efficient technology
- Existing maintenance regulation is strict

# KONE is in a strong position to capitalize on current market trends and growth opportunities



## KONE's strengths in the current market situation

### Wide geographical and customer coverage

- Ability to serve customers in different city tiers and customer segments across the country
- Wide coverage enables granular approach to utilizing market opportunities

### Two brands with high-quality delivery


- High quality solutions across all market segments and price ranges
- Reliable technology and on-time delivery

### Great team

- Key to capturing market opportunities and execution
- High employee engagement
- Customer loyalty at strong level

### Fast-growing maintenance business

- Strong capability to serve customers full-chain from new equipment to service
- Solid value proposition to customers

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- The background of the slide is an aerial photograph of a modern city. In the center, a tall, slender skyscraper with a glass facade stands out. To its left, there is a large, curved building with a distinctive roof. The city is built on a hillside, with various residential and commercial buildings. In the foreground, there are several modern buildings with balconies. In the background, a large body of water is visible, with many small boats and a larger ship. The sky is a clear, light blue.
- Our performance in China
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# Drivers for E&E market demand in China



- Key drivers for floor space growth:

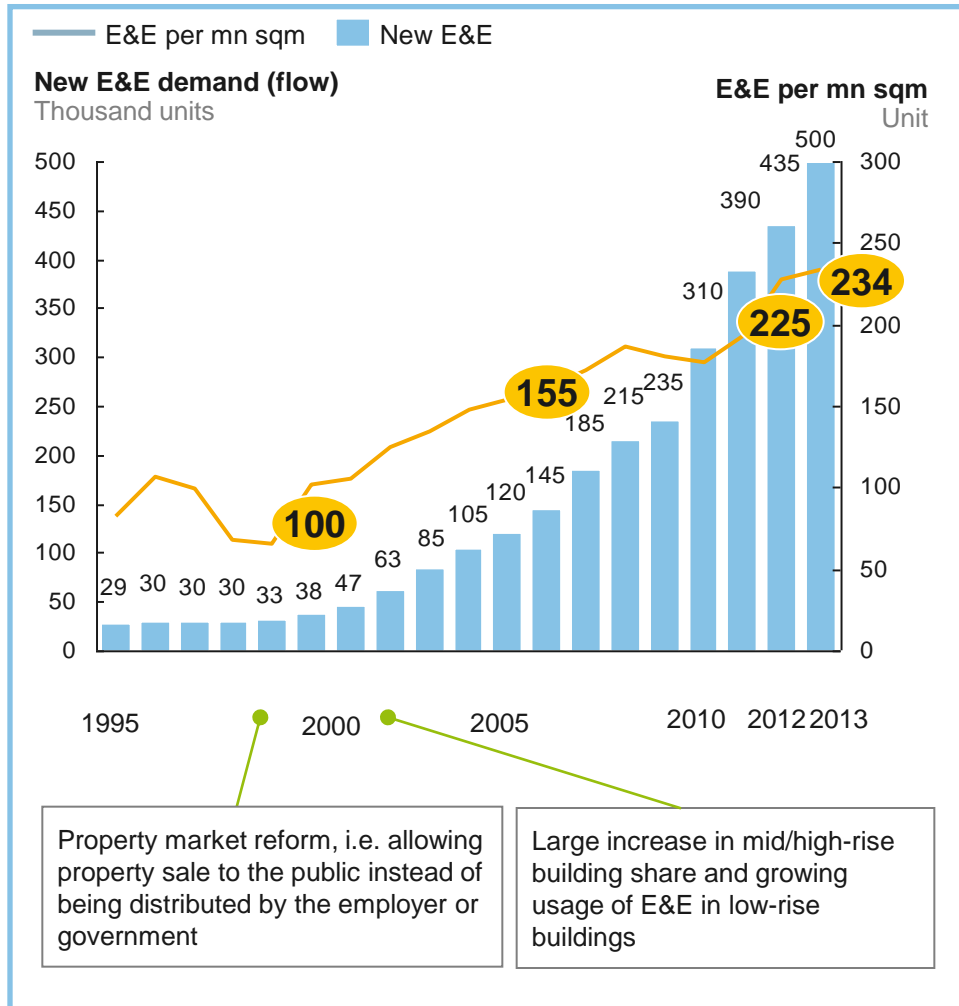
- Increasing number of urban people
- Increasing sqm/capita
- Demolition and replacement building

- Further drivers for E&E intensity growth:

- Change in building type mix from low-rise to mid-rise
- E&E intensity growing in all building types (especially low- and mid-rise)



Since 2000, E&E intensity has doubled from ~100 to ~234 units/mn sqm driven by growing share of mid- and high rise buildings and E&E usage in low/mid-rise



- E&E intensity increased ~100% in the past 10 years
- Changes in building mix and E&E usage per building are the key drivers:
  - City evolution drives more mid-rise buildings to be built with more than one elevator used in a single building
  - Increasing comfort and living quality requirements drive elevator intensity in low-rise buildings

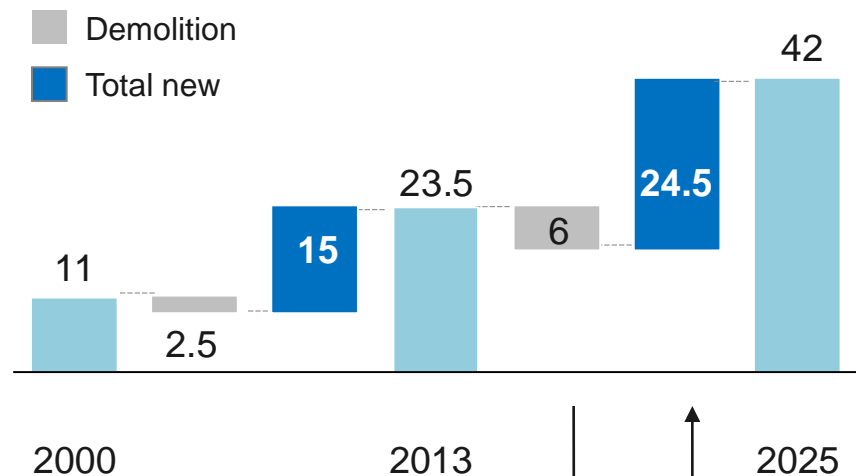
Source: KONE data

# Rebuilding will represent >20% of total new construction and have multiple times higher E&E intensity compared to the demolished buildings



## Demolition and total new construction vs. net stock addition

Billion sqm



E&E intensity in flow, units/ million sqm

30

>234 today, expected to increase

- **Demolition will boost construction by >20% vs. net stock addition driven by**
  - Upgrade of old city centers from low-rise to high-rise buildings due to increasing land cost
  - Short life of buildings built from 1980s and early 1990s
  - Changing function of local area (e.g. from residential to commercial center)
- **New building floor space flow replacing demolished floor space has almost 8 times higher E&E intensity (comparison to 2013 new flow)**
- **E&E intensity per sqm of new floor space is expected to increase further**

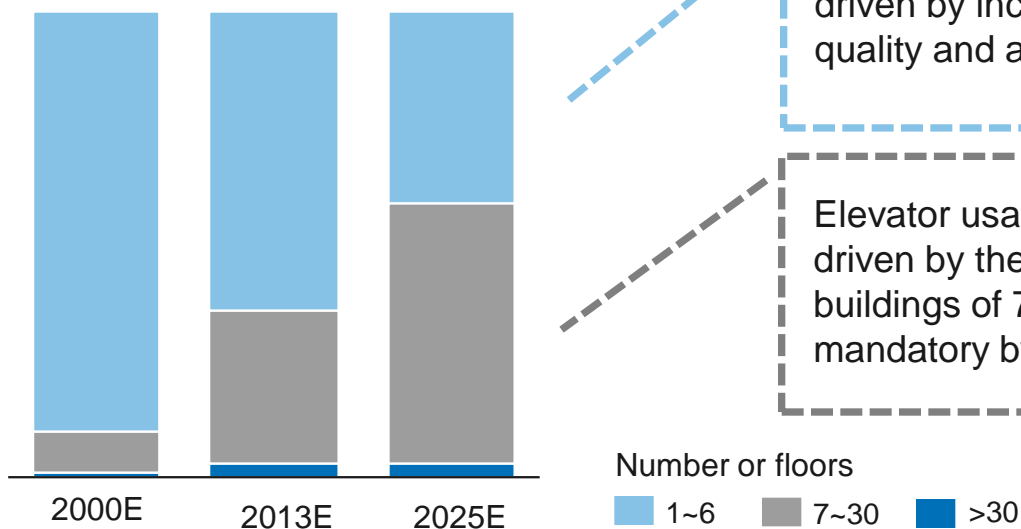


# Going forward, E&E intensity is expected to continuously increase as mid/high-rise share of buildings and E&E usage continue to grow

## Evolution of residential building mix by number of floors, indicative

### % of buildings built

Percent




## Elevator intensity to increase further

Elevator usage for low-rise building to increase further driven by increasing demand of comfort level, living quality and accessibility

Elevator usage for mid-rise buildings to increase largely driven by the increasing intensity of elevators in buildings of 7-11 stories, where 2 elevators are not mandatory by regulation (increasing comfort level)

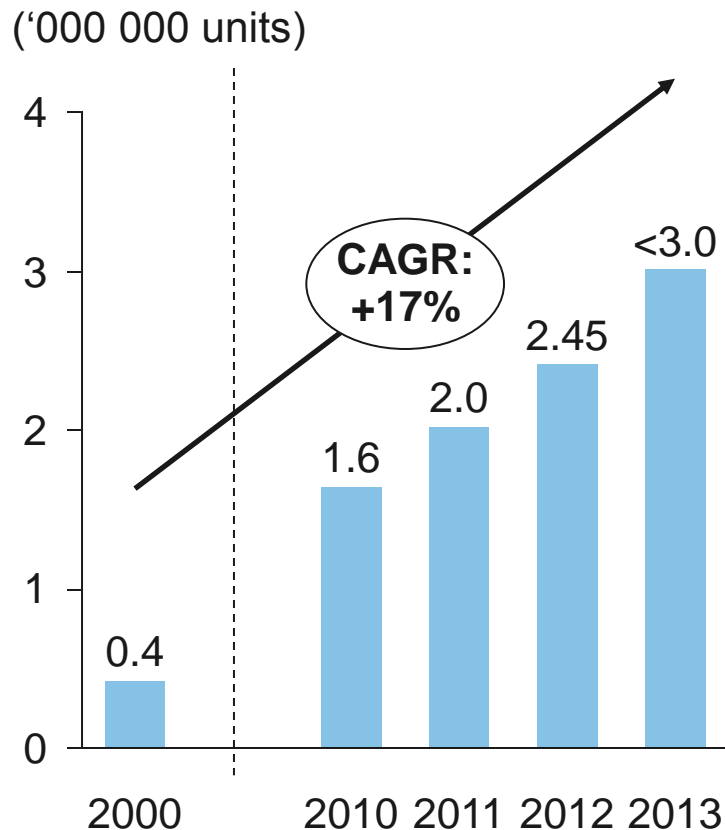
Moving forward, **all tier cities are expected to see an increase in mid-high rise building share** as more people continue to urbanize, living standards from growing middle class increase and land continues to be scarce in urban areas.

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- The background of the slide is an aerial photograph of a modern city. A prominent feature is a tall, slender skyscraper with a glass facade, which is semi-transparent and serves as a backdrop for the text. To the left of the skyscraper, there is a large, circular, multi-level structure with a curved roof. The city is surrounded by a body of water, with several boats visible. In the foreground, there are several modern buildings with balconies and greenery. The sky is a clear, light blue.
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# China's installed base has been growing rapidly, making maintenance a significant opportunity



## China elevator and escalator base



## Maintenance market in China

- Competitive landscape is fragmented
  - OEMs' share is around 25%
  - Small local players (including self-maintenance) cover over 70%
- Authorities are increasingly interested in maintenance and are tightening regulations
  - For example national minimum standards for frequency of maintenance visits

Source: China National Special Equipment Safety Supervision Bureau and KONE estimate

# Already today, KONE has an extensive maintenance coverage in China

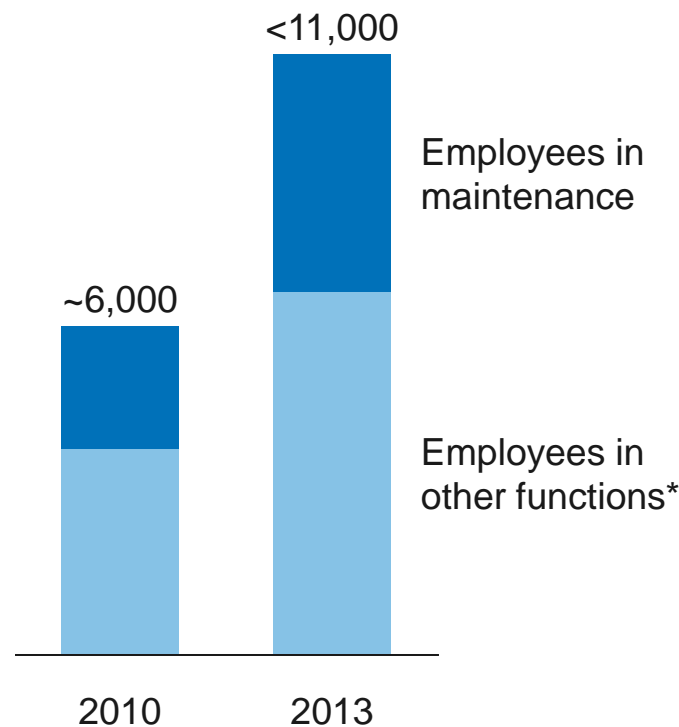


## Where we are today

- Widest geographical coverage across locations
- Our focus is on servicing our own units and growing our maintenance base organically
- Strong presence in segments and cities where customers value high-quality service
- High in-take of young, new field personnel

## KONE China employees

The number of our maintenance employees has doubled between 2010-2013



\* Other functions include sales, administration, manufacturing and installation

As we are extending our presence in maintenance, we are systematically developing our resources



- Developing the competences of our maintenance field and sales personnel
  - Regional training centers
  - Systematic capability development for technicians
- Rolling out new tools to boost productivity
- Developing modernization capabilities to capture opportunities on the way and to capture long-term modernization potential

Total training hours logged for maintenance technicians in 2013:

**>300,000**



# Going forward, we want to significantly grow our China maintenance business in a profitable way



## What we want to be

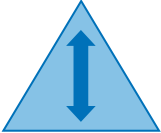


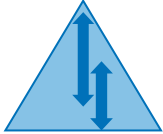

- An even more highly differentiated maintenance provider with superior customer service and customer communication
- A company effectively leveraging productivity-enhancing technologies, e.g. field mobility tools



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- The background of the slide is an aerial photograph of a modern city. A prominent feature is a tall, slender skyscraper with a glass facade, which is partially obscured by the text boxes. To the left of the skyscraper, there is a large, curved building with a distinctive architectural design. In the foreground, there are several other modern buildings, some with green roofs. The city is situated on a waterfront, with a large body of water and a harbor area visible. In the distance, there are mountains under a clear blue sky.
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# Our key focus areas in developing our business in China are intact



Focus areas	2005	2014	Future objectives
<b>Expanding product portfolio</b> 	KONE focused on higher mid-end segment	Broadly competitive offering for all segments	Continued close co-operation between local team and global R&D to further develop competitiveness
<b>Expanding geographical coverage</b> 	Geographical coverage concentrated in larger cities	Approx. >500 locations	Ensure presence in all attractive growth regions and ensure alignment of resourcing with local market situation
<b>Active talent management</b> 	Target to attract the best talent and retain key people	Improved retention rate and employee satisfaction	Develop and promote internal talent; Attract external talent to support fast growth
<b>Two-brand strategy</b> 	GiantKONE JV established	Clearly differentiated role for each brand; two brands a clear competitive asset	Dual brand strategy to strengthen competitiveness further
<b>Building a leading maintenance business</b> 	Small maintenance base; target to achieve fast growth	2006-2013 maintenance base CAGR over 35%	Further expand the maintenance network, focus on conversions





Going forward, we will continue to:

- Capitalize on the fundamental market opportunities in both new equipment and maintenance
- Target faster than market growth
- Increase customer loyalty



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