KONE H1 2018: HALF-YEAR FINANCIAL REPORT FOR JANUARY-JUNE 2018

JULY 19, 2018

3:45 P.M. EEST

Sanna Kaje: Good afternoon, and welcome to KONE's Q2 Results Presentation. My name is Sanna Kaje, and I'm the Head of Investor Relations. I have here with me today, as usual, our President and CEO, Henrik Ehrnrooth; and CFO, Ilkka Hara. Henrik will first go through the Q2 highlights. Ilkka will then talk a bit in more detail about the financials and Henrik will then conclude with a couple of comments on the outlook. After the presentation, we have plenty of time for your questions. Henrik, please?

Henrik Ehrnrooth: Thanks, Sanna, and also warm welcome on my behalf to our results webcast. Today, I have lot of good news to share with you. Although what we also have seen is that what we can't be fully happy with is our results development. But we also talk about how we are addressing that going forward.

Highlights for the second quarter of this year. Clearly that we had a good growth in our orders received. They grew in all regions in all businesses and with now stable margins. That's good. Also, our service business continued to grow well. Here we can clearly see that the differentiation we've been driving in the business over the past years is bringing results.

However, it's clear that we are not happy with development. Our EBIT margin continues to be burdened by a number of headwinds. We'll address that a bit later more. But also, happy to share some good news on results from annual customer employee surveys. So, let's go straight into the highlights of the numbers for the second quarter.

As I mentioned earlier, the highlight is really the growth in our orders received that were about EUR 2.1 billion and growth of 6.4% in comparable currencies. In a market that is pretty stable in monetary value, particularly new equipment, I think this is quite a good achievement. So, that's what I'm happy about. Our order book continues to be strong at close to EUR 8 billion and our sales now about EUR 2.3 billion, a growth of 3.2%.

Our EBIT EUR 280.5 million, and if you look at our adjusted EBIT, where we exclude the cost from the Accelerate programme, and that was EUR 300.4 million compared to EUR 335.8 million a year ago. So, we can see that our EBIT margin declined from 14.4% to 12.9%. And it's clear that this is the part that I'm not happy about in the result.

So, what's good in the quarter though was our cash conversion and cash flow at EUR 366.2 million. Earnings per share EUR 0.43 compared to EUR 0.52 a year ago. But as we always said, one quarter is a very short period of time and it's always better to look at slightly longer period of time. And then now we have of course half a year behind us. And here I would say the message for six months is very much the same as it was for the second quarter. Good growth in orders received at 6.6% in comparable currencies and in sales 6.5%, which is quite a good growth number in this environment.

EBIT EUR 492 million or adjusted EBIT EUR 519 million compared to EUR 582 million a year before, and margin of 12% in the first six months compared to 13.6% a year ago. And cash flow EUR 545 million. There is still quality cash conversion, however lower than last year due to a slightly lower cash flow in Q1, clearly a good recovery now in Q2. And EUR 0.77 per share EPS compared to EUR 0.92 a year ago.

But I think most of you know, the way we measure our success is through our five strategic targets. And on two of them, we have some good updates and some good news. And those relates to our first two targets, having the most loyal customers and KONE being a great place to work. When I think about these targets, they to me the most important leading indicators of the health of the business, particularly in a very rapidly changing environment and an environment we also we have lot of change at KONE. Very important to have loyal customers and motivated and engaged employees.

If I go to more in detail into this, if I look at our customer loyalty that we measure to a net promoter score, that improved again. We have had a many-year improvement and we can see that the actions we have taken are bringing results here.

What are customers saying about KONE? The most frequently occurring comments in our survey that covers roughly 30,000 customers, it is meaningful, is that KONE, we have great products, high quality products. Also, they talk a lot about KONE's employees, service-minded, and want to do – want to provide good outcome for our customers.

And also, very frequently comes up for these three most frequent ones – the third one is that when KONE promises something, then we deliver. And these are very, very important basic fundamentals that are strong in KONE and very important fundamentals when we're driving positive change in the company. So, that's what I'm happy about.

Also in a period of significant change in the markets, very rapidly changing markets customer needs, it is important to have strong engagement and motivation amongst employees. We just conducted our annual employee engagement survey and it has some very good results. 91% of our more than 55,000 people answered the survey, which shows that it's meaningful and that it matters.

Also, employee engagement is on a strong level. And what I'm particularly happy about are some very important results from questions that relate to our direction, our strategy and our change. And that is very, very important in environment where the things are changing that employees understand where are we going because that is really the fundamental driver behind successfully executing our strategy. So, I think we have many of the fundamental aspects there. So, these two I'm very happy about.

Then our Accelerate programme that we announced last year in September, we have lot of good development. We started or initiated number of organisational changes in many of our functions such as our finance function, marketing and communication in our customer solutions engineering and in our local sourcing organisations; all of which are designed to enable our front lines to spend even more time at the customer interface driving positive change and bringing our vision to our customers. And at the same time, being much more efficient and harmonised in all our back-office functions to speed up the ability to deliver new solutions to our customers in a more efficient way. So, also, we are progressing with this programme as we have planned and that's good.

So, I would at this stage like to again express my thanks to all KONE's employees for their drive engagement and motivation in driving forward positive change at KONE. I'm very thankful for it, and I think we have seen good development here again.

So, that's about highlight numbers and a little bit more broadly on our progress. If I then go to market development and start with the new equipment markets. If I go to new equipment markets, not much has changed relative to what we talked in Q2. North America, Europe, Middle East and Africa growing slightly. The North America growth from a good level. Europe, Middle East and Africa continue recovery in South Europe. And growth in the Middle East despite overall turbulence in the region.

Central North Europe stable at a pretty good level. In Asia Pacific, slight growth and it's really India and a few South Asia markets are driving the growth. China pretty stable now in the quarter.

If I look at the service markets, very much also the same we've seen before maintenance, slight growth in North America, Europe, strong growth in Asia Pacific and exactly same picture in modernisation. So, very much same as we've seen before and yeah, overall growth. And what I'm happy about is Asia Pacific markets continue to grow well given our strong positions in those markets.

But let's go a little bit deeper again into what's happening in China. First I would say when we look at China, demand for housing in particular continues to be high. And that has resulted a situation where housing inventory levels have improved over the past couple of years quite significantly, and we can see that overall are at pretty healthy level. So, why is our market not growing more? Why are then house sales stable in lower tier cities or actually declining in higher tier cities? Well, there are many reasons for that.

First, it's clearly the restrictions that are in place in over 100 cities today on property purchases and it's also the very tight liquidity situation which has a very significant impact on our developer customers in their ability to finance new projects at particularly buying land and very high land costs. And we can also see this in the output. So, if you look at the total construction volumes in China, they have been pretty stable now in the first half for the year. And actually if you look at the number of completed buildings, those have been slightly down.

And then you can ask so why are total real estate investments growing so nicely at 9%. Well, the main driver behind that is increases in land prices and impacting this number. With all this, we have seen a pretty stable market for elevators and escalators and that situation we expect to continue.

So, that's about our markets and our overall development a little bit more in depth on China. And with that, I'll hand over to Ilkka to review our financial performance a bit more.

Ilkka Hara: Thank you, Henrik, and also welcome on my behalf to our second quarter results call. And as normal, I'll go through the financials a bit more in detail and start with orders received. Orders received in second quarter were EUR 2.1 billion, which is 3% growth on a reported basis and 6.4% growth on a comparable basis.

I'm happy to see the development that started in fourth quarter last year now with a strong growth in orders continuing in this quarter. Also, we saw broad-based growth. So, all regions as well as all businesses contributed to this growth. The margins of our orders were stable compared to the comparison period last year. So, in an increasing input material environment, that has meant that we have increased our prices to cover that increase in the input materials.

And if you look at China in more detail, then our orders measured in units grew very slightly. But when measured in monetary value, we saw a clear growth there. Pricing like-for-like basis contributed positively and the mix was stable compared to comparison period a year ago.

Then moving on to sales. So, sales were EUR 2.3 billion in the quarter. On a reported basis, slight decline but on a comparable basis 3.2% growth. And as we said already, in the first quarter, result announcement that we saw exceptionally strong growth in first quarter due to the number of starts and now are seeing a more stable first half with 6.5% growth on a first half basis.

If you look at the key drivers for the growth, then Europe, Middle East and Africa contributing 6.6%, Americas at 6.1% and Asia Pacific having a slight decline at 1.3%. From a business line perspective, maintenance had a strong 6.3% growth. If you look overall the maintenance growth, we always say that if we're able to grow at 6% or better, then we're really happy. And I'm happy to see that we were able to now grow at this rate. Also, modernisation contributed positively 3.2% and as well as new equipment 1.4%.

Then looking at our EBIT development. So, our adjusted EBIT was EUR 300 million in the quarter which is down from last year, and the margin was 12.9%. We are clearly seeing that our profitability is burdened by both higher raw material cost as well as the price pressure that we have seen earlier in our orders especially in China. At the same time, growth contributed positively and currencies had a negative EUR 11 million impact to our result.

While I'm not happy about the result, what I'm happy about is that we are now have been taking action to counter to this development. And, clearly, we're seeing those actions having an impact and having an impact to improve this outcome.

Then finally, cash flow. So, our cash generation was strong in the quarter, landing the cash flow at EUR 366 million. So, the cash conversation clearly improved from where we were in first quarter. And if we look at the first half as a whole, the main driver compared to last year's comparison period is the result. So, the EBITDA contributing negatively to our cash flow. At the same time, you see that the working capital continued to improve and contribute positively to our cash flow. So, good to see that we were now continually positively developing the cash conversion for KONE.

Now, I'm asking Henrik to come back and talk a bit more about the markets and our business outlook for the remaining of the year and the full-year.

Henrik Ehrnrooth: Thank you, Ilkka. So, let me wrap up with our market outlook and our KONE business outlook. First, I would say effectively the same that we had in first quarter. New equipment we expect that the market in China is expected to stable or decline slightly in number of units and the rest of Asia Pacific slight growth particularly driven by India. Europe, Middle East and Africa, slight growth and same in North America.

Also, maintenance markets we expect them to continue to develop very much as we've seen so far. Strongest growth rate in Asia Pacific and slightly in other regions. Modernisation; also, same goes for modernisation, a slight growth in North America and in Europe, and strong growth in Asia Pacific.

Then for our business outlook, here we expect our sales to be between – to grow between 3% to 7% in comparable currencies and we continue to expect our EBIT to be in the range of EUR 1.1 billion to EUR 1.2 billion assuming that the translation exchange rates stay at the level where they were at the end of June. If this is the case, then the headwind from currencies is going to be about EUR 35 million. Because of the actions we have taken, we expected the pressure on the adjusted EBIT margin is expected to start to ease towards the end of 2018, which in practice means Q4, and of course we continue the actions. But we can say that we're making progress on them.

We have a number of things that are driving good performance. Our solid order book, a continuous solid and good growth in our services business and the continued performance improvements that we have had. However, we have still matters that are burning our results and they are unfortunately more significant still at the moment. Price pressures we've already seen in order to see it in China. Raw material cost headwind of about EUR 100 million and then the translation exchange rate of about EUR 35 million.

So, that is about our outlook. But then before we go to questions, to summarise, I'm very happy about the clearly improved growth momentum we have in order to see it. That's actually started already in Q4 last year with pretty good growth then and good growth now in Q1 and Q2. So, that's good. We continue to take actions to improve our margins, that's pricing, that's productivity and cost and we're progressing on all fronts.

We can see that the continuous good growth we have in our services business is as a result of the differentiation. We can see a clear link with the progress of our service transformation programmes and growth in services, so we can see that we are definitely going in the right direction. And also, what is important in an environment like this is to have happy and loyal customers and motivated employees; and as I talked earlier, we can see that we increasingly have that.

With that, I think we have plenty of time to go to questions.

Sanna Kaje: Exactly. So, now we can go to the questions. And as we have no audience here today, we can go straight to the telephone lines. So, operator, please. And please ask one question at a time. Thank you.

Operator: Thank you. And to ask a question, please press star one on your telephone keypad. If you're using a speaker phone, please make sure your mute function is turned off to allow your signal to reach the equipment. Again, that is star one. We'll go first to Andre Kukhnin at Credit Suisse.

Andre Kukhnin: Good afternoon. Thanks so much for taking my question. Can I ask about raw materials? Firstly, is EUR 100 million for this year completely fixed? And if it's not, what the sensitivity is there given that we have seen continued inflation especially in the US?

And secondly just looking at 2019 and from what are you seeing in terms of your component pricing installation or maybe lack of, we're hearing some interesting messages from China on that. Is there any ballpark figure you could provide on what we should – sort of what kind of level we should worry about for 2019?

And maybe just a quick follow-up on digital to previous discussions. Could you update us on how you're getting paid in digital on the investment that you have been putting in? What we should look for in your reporting to see that is this the growth in services, is it profitability? That would be great. Thank you.

Henrik Ehrnrooth: If I give first Ilkka about the raw material and then I'll answer the second question after that.

Ilkka Hara: Very good. Thank you.

Andre Kukhnin: Great.

Ilkka Hara: So, first, raw materials. Your question was to summarise – it has multiple questions there at the same time. So, first on the question that how much flexibility there is still within 2018 on the raw material prices. So, as we said earlier that we look our raw materials, so actually component prices, anything between three to six months forward depending a bit about the component. So, clearly for this second half of 2018, there is still some fluctuation that we expect in the fourth quarter. We haven't looked everything down but we expected the EUR 100 million to be the best estimate for us.

Then you're asking us what is the impact to 2019 where we are with the raw material. So, it's too early to really say. It depends a bit about the product mix and how the remaining of the year goes. But as we see it now, then the best estimate would be that there is a slight headwind from raw materials still expected to 2019 but not that scale we see it here in this year.

Andre Kukhnin: Got it.

Henrik Ehrnrooth: And then your question how we get paid on digital. Well, we have many different parts of digital services, perhaps if we start with a 24/7 connected services. That's clearly a service that we sell. And overtime, as we ramp it up and that's going to be shown in our service sales in the maintenance business. However, we have also things that we're selling KONE with new equipment. So, it's going to be a multitude of revenues coming from different sources in the future.

Andre Kukhnin: And maybe just a quick update on how that's progressed now that when you're in sort of two years of investment in this and you've been rolling out 24/7 across the countries?

Henrik Ehrnrooth: As we've said, it's – what I'm very happy about is the feedback we get from our customers. I think what we hear in the market is that the solution we have, converted solution, is really differentiating us and customers are happy with it and therefore pricing on that is quite good. It's always when you come with something totally new, it's something totally new to our customers and also our organisation what we are spending a lot of time is to speed up how quickly we sell and the volumes that we sell on this.

When we say pricing and feedback is very good, so I'm actually quite happy of where we are. But we have to remember that we are still at very early phase.

Andre Kukhnin: Got it. Thank you very much for your time, guys.

Henrik Ehrnrooth: Thank you.

Operator: We'll go next to Antti Suttelin at Danske Bank.

Antti Suttelin: Yes, hi. On Chinese indicators, it's interesting to see the indicators you follow, but I think aren't you missing one important indicator namely starts? When I look at starts the picture is completely different than the graphs you are showing. It's really – this is the third year of quite sharply improving starts. Don't you think that's a relevant indicator for elevator demand in China?

Henrik Ehrnrooth: I think over the longer term, it's clearly a relevant indicator. How it comes through is one has to see. I mean, still we have to see that the total – if you look at floor area in progress has stayed quite stable. And it's still that we don't come our industry need it when it starts, we come in a bit later in this cycle. So, I think why our sector has been stable is that the total – still if we look at the total amount that is being constructed is pretty stable.

Then over the long term, yes, there is going to be a correlation to starts. You have to remember there was quite a sharp fall in starts for a couple of years and now it's been recovering. You probably see a little bit smoother curve. But I don't have an exact explanation how it's going to flow over to our industry.

Antti Suttelin: But do you see a risk that all of a sudden elevator demand clearly takes off? One night you wake up and it's full speed on elevator demand?

Henrik Ehrnrooth: That will be great.

Antti Suttelin: But do you think that could happen?

Henrik Ehrnrooth: I'm not going to speculate what's going to happen. I think what we see at the moment for this year, we see quite a stable market because we still have to see that, – as I mentioned, one of the important things in the market is it's clear that there is strong focus on the government on the quality of housing and how people live. We can also see very strong restrictions on purchases and also liquidity for developers is tight. So, that's what we see in the market. And I think that's why the expect the market to be stable or slightly down this year.

Antti Suttelin: Yeah, okay. Thank you.

Henrik Ehrnrooth: Thanks.

Operator: We'll move next to Lucie Carrier at Morgan Stanley.

Lucie Carrier: Hi, good afternoon, and thanks for taking my question. The first one I had was actually around tariff that has been so far announced and also the tariff which are being assessed at the moment as well, so additional one between China and the US. I was just wondering if you could give us some colour in terms of how we could potentially impact your procurement into the US and also if you are concerned about some shortages of in terms of you supply – your issue in terms of your supply chain. So, that's question number one and then I'll ask the others.

Henrik Ehrnrooth: I will first say that we have to remember that the majority of our business in the US in particular is maintenance or installation activities. It's clear that there will be some impact on us and there is some impact from tariffs. We don't expect that to be material but some impact. I don't know, Ilkka, if you want to comment on that in more detail?

Ilkka Hara: It's not going to be still that impactful this year. Let's say 10-ish million in my estimate in the impact. And it's included in the EUR 100 million raw material that headwind that we talked about.

Henrik Ehrnrooth: But, of course, we follow the situation very carefully all the time and make sure that we have the suppliers that we need. So, I think it's still a reasonably fluid situation.

Lucie Carrier: Understood. My second question was around the drop-through in the quarter. It seems that the drop-through this quarter was not as strong as what you had in the first quarter. Is there anything, any colour you can give us on that whether this is coming from mix of product or things you couldn't take into account this quarter that maybe reported to the next quarter? But it seems that the drop-through was particularly low.

Henrik Ehrnrooth: I don't think that there was a big difference when I look at – I mean, margin impact was pretty similar Q1 and Q2. We had a stronger growth in Q1. But I don't know, Ilkka, do you have any other comment on that?

Ilkka Hara: On a quarterly basis, there is so many fluctuations both country mix playing a part there and also business mix. So, it's hard to comment on a quarterly basis. We don't see a big change there.

Lucie Carrier: Okay, thank you. And then the last question I would have, I was just hoping you could give us an update on the progress you made on your Accelerate programme and if you could remind us what you're expecting in terms of phasing for your savings, how much in 2018 and then '19 and so on, please?

Henrik Ehrnrooth: Yeah. So, as I mentioned earlier in the presentation, we are progressing with a programme exactly as planned. Quite small, very small impact this year. We're going to start to see the benefits as of next year.

Ilkka Hara: We had the same estimates that we have had for the year. So, we're targeting having EUR 50 million of run rate savings by the end of 2018. At the same time, we don't see a large impact in 2018 yet. It's really we have to execute the actions that we are taking and then we see that impact in 2019. And then the reminder, we still have works to be done to have the details available for '19 and '20. It depends how the programmes are developing in the coming months and quarters.

Lucie Carrier: So, just to be clear, you are expecting in terms of savings to have at least EUR 50 million to benefit your EBIT in 2019; is that correct? Considering you're talking about annualised savings of –

Ilkka Hara: That's correct.

Lucie Carrier: Okay, yeah. So, at least EUR 50 million to benefit your EBIT in '19?

Ilkka Hara: Yes.

Henrik Ehrnrooth: Yeah.

Lucie Carrier: Okay. Thank you very much.

Operator: We'll go next to Glen Liddy at JP Morgan.

Glen Liddy: Good afternoon. In your revenue growth, you were showing particularly strong growth in the maintenance market. Are there any particular issues that are driving such lively growth?

Henrik Ehrnrooth: Look, I mentioned in the presentation, I think we have had very stable growth and this has been varying between 5% and 6%, little bit 6% plus. And as we say, that 5% is – that's a pretty good growth in this business. If we get to 6%, that's a good growth in a stable maintenance business that we have. I think we're just executing very nicely on our business here and we can see that the programmes we have initiated over the past years is having a positive impact on growth. There is nothing special there. Good growth in Asia Pacific, but actually many European countries we're growing quite nicely as well.

Glen Liddy: And do you suffering much from rising wage costs particularly in the Europe and the US?

Henrik Ehrnrooth: Clearly that is an impact and one is to constantly get more productivity. Clearly wage cost growth has been higher this year than in past year quite clearly higher. So, with that, you need to constantly drive productivity and pricing and that we have done.

Glen Liddy: And in China, there seems to be sort of ongoing consolidation of property developers. Is this resulting in them being tougher at negotiating whether it be on price or terms and conditions at all yet?

Henrik Ehrnrooth: It's clear that – the top 50 or top 100 developers are constantly taking market share in China. And they have better access to financing and a very tight financing market. And it's clear the bigger developers have more professional, for example, sourcing organisations. On the other hand, we have a very good position with them. They really understand the added value that you have and we see it as an opportunity to work closer with these bigger developers.

Clearly, they are good and professional companies and in that way. But we see it as okay thing and we are growing nicely with them.

Glen Liddy: Are they significantly more likely to sign up to longer term service agreements?

Henrik Ehrnrooth: On average, yes. But yeah, they are more prone to also on perhaps service because they all have a important brand to also look after and therefore they need good services and good functioning properties that they develop.

Glen Liddy: Thank you. And, finally, I mean, you said the margin in the order backlog is stabilising. Is it still running below the margin that you're operating on for sales?

Ilkka Hara: We are at pretty similar levels now.

Glen Liddy: Okay. Thank you very much.

Operator: We'll take our next question from Zexi Wu at Bank of America Merrill Lynch.

Zexi Wu: Hello. This is Zexi from Merrill Lynch. Just two quick questions, please. First, you seem to gain market share in China since the beginning of the year. Just wondering whether you could please tell us what's driving that? Is it because of the real estate developer consolidation or you become more aggressive on pricing. So, that's question number one. I'll ask question number two after that. Thank you.

Henrik Ehrnrooth: You know, our market share will always fluctuate in market quarter-to-quarter. First six months of this year we have had a higher growth than the market overall in China. Yes, we have a good situation with the large developers that has probably helped. Overall, our objective in China in the past year or past years has been to primarily focus on market share in monetary volume terms as the market has been stable or declining in a very, very competitive market. And again, we saw in the quarter that our performance, if you look at monetary value, was better than most in units. So, in that sense, we are – from that perspective, we are going in the right direction but we have to remember that market share will always fluctuate quarter-to-quarter.

Zexi Wu: Okay, thank you. And that's very helpful. Then second question just need a clarification over the cost saving. I think you just said you're still guiding for EUR 50 million cost saving run rate at the end of this year I think. But – so, is that still the case or –

Ilkka Hara: That is still the case. So, run rate savings by the end of year of EUR 50 million.

Zexi Wu: By the end of the year. And EUR 100 million by 2020 I think?

Ilkka Hara: By 2020, yes.

Zexi Wu: Okay, thank you. Maybe one quick follow-up. So, I think you have a plant in Mexico if I remember correctly. How do you think the situation over there given current trade world scenario?

Henrik Ehrnrooth: Currently that is operating fine and we have to see how the situation develop. Yeah, we have a component factory in Mexico. As I mentioned earlier, I think it's – I wouldn't speculate on what's going to happen and what the development is going to be. Of course, we're looking at the situation following the situation very closely.

Zexi Wu: Got it. Thank you so much.

Henrik Ehrnrooth: Thank you.

Operator: We'll move next to Rizk Maidi at Berenberg.

Rizk Maidi: Yes, good afternoon. Maybe just start with France. We're hearing housing starts and house permits are actually down year-to-date. I'm just wondering if you could remind us of what your French exposure is and if you've seen any of this into your new equipment orders?

Henrik Ehrnrooth: So far, actually recovery in the French market. Housing starts and permits will always fluctuate. We have very strong position in France. It's a significant important market for us, one of our top five markets. But it still, as we know that we don't have individual country exposure there are very big apart from China and US. But so far, we are actually seeing a positive development in the market. I think housing starts usually fluctuate a bit more than actual activity – sorry, the permit – fluctuate a bit more than actual activity.

Rizk Maidi: Okay, thank you. And then maybe just to go back to the first question on this call. I think you tried to explain basically the disconnect between construction activity in China and elevator demand in China. But Henrik, do you think that the elevator intensity is actually the main explanation for this. Is elevator intensity coming down in China?

Henrik Ehrnrooth: I don't think elevator intensity is going down. It's actually come up a lot over the past years. It's probably more stable now. I think if you look at just total construction in progress, that is stable. If you look at total number of apartments that have been completed, that's actually down. And that mirrors our industry quite well.

Rizk Maidi: Okay. And then finally just a housekeeping kind of question. You usually comment on the China service exposure and the growth rates there. I think last time you said it's slightly above 10%. Is that still the case, and if you can just give us just the growth rates there, please?

Henrik Ehrnrooth: It continue to grow in double digits, so it's similar development we've seen before. So, good growth rates. And if you look at number of units, they continue to grow much stronger than that.

Rizk Maidi: Thank you very much.

Operator: And we'll take a follow-up from Andre at Credit Suisse.

Andre Kukhnin: Yes, thanks for taking the follow-up questions. Can I talk about China a little bit? Firstly, on pricing side. Are you not a little bit disappointed that there has not been more of a follow-through on the price increases from kind of more mid-tier players and maybe from the Japanese peers of yours, not to comment on any specific competitors. I know you don't do that. But, generally, everyone seem to be in the same boat, everyone has got margins down because of raw materials and they kind of pricing legacy. It just seems strange that there is a bunch of European companies or western companies pushing for it and there is no follow-through from the rest of the market.

Henrik Ehrnrooth: I mean, we can see it is a very competitive market. And as you say, that everyone clearly is suffering from increased input costs. So, we can see that number of the mid-sized and small players are under quite a lot of pressure financially as a result. It's always a competitive market, we can't comment, we can't say what other people do or should do. What we can control is what we do ourselves and I think our direction has been pretty clear.

Andre Kukhnin: And do you see the competitive landscape changing at all in terms of kind of the rate of exiting versus joining the industry? I mean, we also follow the large players, but on the smaller tail?

Henrik Ehrnrooth: Yes, so many of the small players, I don't think it really matters if there are few exiting or entering. I mean, we expect that the China market will continue to be clearly the world's largest market. We are very happy to be the market leader there. It's going to be the world's largest service market in coming years both in units and in value.

So, I think we have a great position here. It's clear that lot of other people see the attractiveness of Chinese market the same way. And that's why it is a very competitive market and there is no reason to believe competition will decrease there. And that's where we continue to drive and improve our business.

Andre Kukhnin: Got it. And on the non-residential part of the market and particularly on the infrastructure side where we don't have as much data. What are you seeing in terms of the market development for elevator orders? I think last year was very good year, so there is a bit of risk of the sort of boom starting to run out of steam, whether you agree with that or not? And also, connected to that, I think you launched a new offering on escalators specifically in China if I'm not mistaken. Is that yielding results for you already or is that too early to say?

Henrik Ehrnrooth: First, I would say that if we look at the overall infrastructure expenditure in China, it was lot of focus on that in the past years. We're probably seeing that declining overall a bit. We're probably going to start seeing that in our market. But we have to remember that it is not a huge segment for our industry. It is an important segment but not by far not the largest.

Yes, I think we have strengthened our position. I think we are – and the infrastructure offering is not only for China. We have lot of infrastructure opportunities in the coming years in rest of Asia. Actually, lots of them there in Europe, in Middle East. So, infrastructure is going to be important, and I think we are strengthening our position there as we speak; and that we can see already.

Andre Kukhnin: Okay. And just to calibrate it, infrastructure is about sort of 10%, 15% of the market by value and towards low end of that in units without the right ballpark?

Ilkka Hara: Yeah, about roughly.

Andre Kukhnin: Great. And last question, just staying on your business in China specifically where we obviously have idea on the number of units about 100,000 and in maintenance base of I think now surpassing quarter of a million. If you have an opportunity to add something that is kind of a third of a size of your business there, do you think that would be immediately synergetic or is it really too much of an integration exercise given how spread out the countries and how quickly everyone is grown there with various kind of structures? If you could talk about that.

Henrik Ehrnrooth: If I look at China, as you know that our focus in China specifically has been organic growth. And the reason we are focused so much on organic growth in China is that there is plenty of it there particularly in the services side. And we want to keep laser focus on that.

I think if we look at our position in China, there has been some of the smaller mid-sized brands, possibilities to acquire them, but that hasn't been interesting to us given the position we have with KONE and GiantKONE. I think we cover the market very nicely. I think we have a good position here. Good bigger service portfolio be interesting to us. Yes, if it would be a harmonised and good portfolio. But at the moment, in China specifically, we're focusing very much on organic growth.

Andre Kukhnin: Got it. Thank you very much for your time.

Henrik Ehrnrooth: Thanks.

Operator: We'll go next to Lucie Carrier, Morgan Stanley.

Lucie Carrier: Hi, hello. And thanks for taking my follow-up. The first one I had was around your price initiative in China. It seems indeed that you are increasing the prices more than what we see at some of your competitors. However, we've also seen that you've been outgrowing. Are you going to – I mean, in terms of your pricing strategy at the moment, are you still pushing for further price increase because you think you have sufficient leverage to do so or you think that considering what you have achieved already and have balance price and raw mat at the moment, you're probably going to slow on the price initiative? So, that's question number one.

Henrik Ehrnrooth: I mean, as always, we don't comment on our commercial strategies going forward. And I think the only thing I would say that it's clear that in the China market for everyone, us included that price increases are important. But how are we going to drive our company commercially going forward is not something we comment on.

Lucie Carrier: Okay. And my second question was, it was a follow-up actually on the question you had earlier on the start and the start which has been actually quite strong since the second half of '16. Do you think that – well, first of all, you explained very well that there is some delay for you in terms of the elevator when it comes into the building. But do you think as well that maybe we haven't seen momentum in the elevator market because the inventory in the building channel required high and could actually – could strengthen the start give you some leeway even into momentum in 2019 considering that you mention the inventories in the building channel are now much healthier? And so, the start could proceed considering the inventories are low.

Henrik Ehrnrooth: So, I think we have to say it's too early to comment on 2019. Clearly the demand for elevators and escalators is totally linked to overall construction activity. So, I think we need to follow how construction activity develops, how well the starts translate into higher activity there. That is what's going to drive. So, I don't have a perfect answer or visibility into how this is going to – the starts are following through.

But we also have to see that things that are holding back growth instead are the restrictions on property purchases as well as a very tight liquidity situation for developers. We don't see that changing any time soon.

Lucie Carrier: Thank you.

Operator: We'll go next to James Moore at Redburn.

James Moore: Yeah, good afternoon, everyone. Thanks for taking the questions. Apologies, I joined a little late, so I apologise if there is any repetition. But China, I wonder if I could start with the order pricing. I think you commented that quarter-on-quarter sequential pricing stable but year-on-year order pricing is up slightly, which is sort of up 0% to 5% which is quite a big band. I wondered if you might be able to help us a little more on that. If you could give us the number whether 1%, 2%, 3%, it would be great. But if not, can you possibly say if the year-on-year percentage number in the second quarter was the same, better or worse than the year-on-year number you saw in the first quarter in Chinese order pricing?

Henrik Ehrnrooth: Not that different. I mean, we're talking a few percentage points. It's not zero. It's not 5%, somewhere between. So, you always have to remember is that there are so many different products, there are so many different variations. So, you have to look at the total situation. I think what we have seen is that we've been able to slightly improve our pricing; and on a year-on-year basis, I think Ilkka mentioned already, that that has helped us stabilise our margins. But clearly, we have some way to go to get back to margins where we were some years ago.

Ilkka Hara: Yeah, it's something where the momentum and the direction is more important than the exact number because it is – like-for-like pricing is difficult with the product mix as well as – and within the products even different numbers floors and so on. So, I think the direction is the more important part there.

James Moore: I appreciate that. Thank you. And maybe I could switch topics. With the recent events that your German peer and given that you've been very, very open in the last few years about your interest in the possible combination, I wonder if I could ask a conceptual question about synergies that could be possible in a potential combination of large elevator manufacturers. But beyond the normal SG&A fixed cost savings which every merging entity we talk about – and again this is a conceptual question, where would be a good area to find synergies in that sort of combination? Are we talking service technicians or somewhere else?

Henrik Ehrnrooth: Well, first, if you know that we don't comment on rumours and we haven't speculated any potential synergies in any potential combinations. I mean, I think what we have said consistently is that we think consolidation in our industry makes sense. And there are number of different opportunities for that. Taken a bit of a background is that about half of Europe's service basically served by small and mid-sized players. Lot of potential there. We have lot of Japanese players, Chinese players, mid-sized German, Spanish and all of that.

So, we've got lot of different opportunities for further consolidation. And we are driving with lot of small acquisition every year. And in this smaller acquisition, it's density of maintenance base that drives opportunities.

James Moore: Thank you very much. And again, switching topics. On raw materials, you've maintained your views that this year but that latest commodity prices – and that I know it's early but could you give us an idea as to what the spill over could be our current commodity prices into next year? Is this a similar magnitude to this or is that changing?

Henrik Ehrnrooth: Well, it's very early to comment 2019. We still have 2018 to finish first. And country product mix and obviously raw material prices will change by the time we get there. But as we see the world now, if you look at the raw materials where they are, it's reasonable to assume that there is a slight headwind in 2019 but not at the magnitude that we are seeing this year.

James Moore: Thank you. And lastly, if I may, the Chinese housing sales or transaction growth rate is running quite a bit below starts year-to-date. And recently house purchase restrictions have tightened a fair big. Some others in different construction-based industries, maybe locks, have talked about some new weakness in Chinese demand. You're obviously not seen that in the current quarter. But are you seeing any new weakness in conversations tendering activity out in the market or is it steady as you go on that front?

Henrik Ehrnrooth: I think our outlook for the full-year of the market is what we see stable or it could be slightly down. But pretty much as we've seen for the first half of the year.

James Moore: Thanks, Henrik.

Operator: We'll move next to Xing Lu at UBS.

Guillermo Peigneux: Hi, it's actually Guillermo Peigneux from UBS. Same as James, I joined a little bit late, so apologies if this has been asked before. But of all the questions that have been asked, I have actually two more. One is related to the renminbi. Is your current guidance on EBIT on the currency reflecting June end renminbi or an average for June? And second, whether you could give us sensitivity to renminbi fluctuation and your operating profits. And I have a follow-up as well.

Henrik Ehrnrooth: In our guidance as of June end what we know.

Ilkka Hara: And any big difference to where we are today?

Henrik Ehrnrooth: No big differences there, so.

Ilkka Hara: Slightly weaken, not in the big scheme of things.

Guillermo Peigneux: And is it fair to assume that 10% depreciation on renminbi from here would impact your operating profits by 5% roughly speaking?

Henrik Ehrnrooth: I don't think we've given a sensitivity exactly there. It's clear that China is a profitable market for us, so therefore a weaker renminbi has some impact on our profitability. But overall, as you've seen over the years, it hasn't had a major impact on our profits. So, it's been similar on top line and bottom line, perhaps a little bit more in China on bottom line and top line.

Guillermo Peigneux: Okay. And last but not least, could you comment a little bit on the current situation on after market in Southern Europe? In the past, you commented on the competition levels has been high. But I wonder whether that situation is increasing in terms of competition or is stabilising a bit now?

Henrik Ehrnrooth: Not big differences on what's been on development of market. So, pretty similar to what we've seen.

Guillermo Peigneux: Okay. Thank you very much for your time and answers.

Henrik Ehrnrooth: Thank you.

Operator: We'll go next to Mattias Holmberg at DNB.

Mattias Holmberg: Hi, thank you. So, it's kind of a detailed question here. But you now guide for FX to have a negative impact of EUR 35 million on EBIT in 2018, which is EUR 5 million less than the previous guidance. And my question is simply, given that you have left the EBIT guidance for the group unchanged at EUR 1.1 billion to EUR 1.2 billion, does this imply that you have now assumed a slightly weaker underlying profitability, i.e., excluding FX or is this EUR 5 million adjustment on the FX guidance sort of within the margin of error on the group EBIT guidance? Thank you.

Ilkka Hara: I think it's the latter, margin of error.

Mattias Holmberg: Thank you very much.

Operator: Now, we'll go to next to Omid Vaziri at Jefferies.

Omid Vaziri: Yes, good afternoon. Thanks very much for taking my questions. Are you able to update us on the latest conversion rates you're achieving in China with respect to the service maintenance? And if you are taking share, is it on tier one and tier two players install base or is it on the locals?

Henrik Ehrnrooth: Well, first, our conversion rates have slightly improved, not material but slightly improved particularly with the KONE brand. So, that's good. We can see that our customers are more and more wanted to have a good and high quality service, which we do provide. We have to remember that when we take share here, when we increase our conversion rates, it's on KONE equipment. And, actually, the dynamics in China are slightly different than many other markets.

Remember that in Europe and North America, many other Asian markets, a big part of our portfolio is other brands than KONE elevators. But in China virtually everything is KONE elevators. So, the competition there are the small and mid-sized players. We don't necessarily compete with the big other OEMs on the service base. So, it's with the small independents that we compete there.

Omid Vaziri: Thank you. And are you able to provide perhaps an updated range of conversion rates being achieved of late or is that not available?

Henrik Ehrnrooth: Yeah, KONE brand it's more than 60%.

Omid Vaziri: Lovely. Thanks very much. That's all from me.

Henrik Ehrnrooth: Sure.

Operator: And that does conclude the question-and-answer session. At this time, I'll turn the conference back over to management for any closing remarks.

Henrik Ehrnrooth: Thank you. And thanks for all the questions and the discussion. I think just to summarise where are we're going, I would say that there are many good things in our development with the growth in orders received, our maintenance business, how that's growing. And as I said, the actions we're taking to improve our margins are taking us in the right direction, although it's clear that we are not happy where we are on margins. But I think many of the fundamentals to improve are there and also some of the longer-term fundamentals like loyal customers and increasing motivated employees are also there.

So, with that, I would like to thank you all for participating and speak to your next quarter again. Thank you.