KONE Half-Year Financial Report for January-June 2021

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Natalia Valtasaari: Good afternoon and welcome to KONE's Second Quarter Earnings Call. My name is Natalia Valtasaari and I'm Head of Investor Relations here at KONE. I'm joined today by our President and CEO, Henrik Ehrnrooth, and our CFO, Ilkka Hara. Henrik will start by talking to you about the second quarter highlights, both financial and business, after which Ilkka will go into a bit more detail on the financials and then Henrik will end by going into the guidance and business outlook, as usual, before we take your questions. So with that, Henrik.

Henrik Ehrnrooth: Thank you, Natalia, and a warm welcome also my behalf. And I would say again, a pleasure to present the results to you because we have some very good news to share with you today. We had a very good second quarter at KONE. We will start with some highlights. Our financial performance was very strong and strong across the board. Ilkka will talk about that more, but it was really both in orders and sales across businesses and regions, very good.

You can also see that the market recovery solidified, and really good recovery in many parts of the world. There is a small drawback though of this recovering economy overall and recovering markets, and that's clearly where we can see the impact on input costs and on logistics and so forth. But we'll deal with that later. The good news is that we have been able to start to improve our pricing to compensate for this, so we are definitely going in the right direction here.

For the business highlights, we like to always talk about our strategic targets and we have updates on two of them. Related to our employee engagement and customer loyalty, we had results for both of our annual surveys there in the quarter, and the results were again very good for both. So I'll talk more about those as well. So overall, I must say I'm very pleased with our second quarter performance and overall how we operated throughout the period.

Let me go to numbers. I talked about growth and also we had margin expansion. So orders received grew 17.2% and reached €2.4 billion; very strong orders received growth, really, as I said, across businesses, across regions. Very happy about that. Very solid order book at €8.3 billion. Also, our sales grew by 12.7%, also here very broad-based good growth, €2.8 billion. Perhaps the highlight in our sales growth was the very strong growth in our maintenance business. As you remember, it was very resilient throughout last year. Now, it grew well because we grew both our maintenance base, we grew repairs very well and also value-added services performed very well. And how we were compared to 2019 here was also very strong. So overall very good there.

Operating income, €367 million compared to €350 million, so a good growth there. Our adjusted EBIT grew from €325 million to €374 million, and adjusted EBIT improved by half a percentage to 13.3%. And also cash flow, which last year was really exceptional, is €592 million. I would say, the €513 million we had now was outstanding. €513 million of cash from operations compared to an EBIT of €374 million is just a very, very good number. And of course, earnings per share as well, 17.6% growth to €0.55.

So overall, I would say great numbers across the board on Q2. As we always say, one quarter is a very short period of time. Now we have also half a year to look at and we look at the first half year, in its totality, very robust. So orders received almost €4.5 billion, growth of 9.3%. Also, sales growth at €5.1 billion, 11% growth. Also here, very good. And operating income from €530 million to €616 million, so 20% improvement. And adjusted EBIT from €530 million to €624 million and 0.9% improvement in adjusted EBIT margin. And cash flow at the extremely good level of last year of €939 million, so very good and earnings per share, €0.92.

I would say that the strong performance we have had in what I would say is a very changing and challenging environment, as being good. The way KONE's teams, all of our employees have dealt with a very changing situation, dealing with challenges as they come, has just been exemplary. I could not be more proud of the team. Everyone has done just a phenomenal job, and of course a huge thanks to everyone for that. [Inaudible] environment to live in today but I think we are dealing with the environment quite well – actually very well.

So, some business highlights. As I mentioned, our first strategic target is KONE to be a great place to work. We did our annual employee engagement survey in the months of May and June this year. Results were very strong, getting employee engagement clearly above so-called high performance benchmark norms. We came slightly down from last year, but last year we had a real big jump and they're slightly down, but engagement at very good level. The commitment to stay at KONE and commitment to go the extra mile, all of those numbers were very good. So we have a good situation here.

We also did our annual customer loyalty survey in the beginning of summer. Good improvement in all businesses, strongest improvement in our new equipment business. And we had broad-based improvement here as well. So what is it that customers are saying? They very much appreciate our products, our product quality, KONE as a partner, our reliability. So all of those were definitely strong points. Clearly, we have areas to improve and we look at this very much in detail in a very self-critical mode and still, we can communicate better with our customers and improve our productivity in that way. So results, again, took us in the right direction.

That is [inaudible] development. Next, I'll go to overall market development, how the external markets developed. And let me start with the same chart we have had now for a number of quarters where we looked at elevator usage in a few markets. And as I mentioned before, we look at this because this is a good indicator for the maintenance activity. You remember we started to look at this data the beginning of the pandemic and looked at it since. And we can see of course that the activity has increased and usage increased a lot in most markets since beginning of the year, except for some markets in Southeast Asia, like Singapore with new lockdown slightly down after having recovered quite well. But in Europe, North America, strong recovery. And we don't have China here, but of course that's really at a normalized level. But it's also interesting when we look at this in more detail on a segmental basis that we know the residential has been strong throughout, but also what has been very strong recovery has been in hotel leisure, in also shopping centers, so retail. So we can see that people are traveling domestically, so more domestic tourism rather than maybe cross-border tourism, and also back to the shopping center, so forth. Offices[?] still lagging, but perhaps in North America, Europe, we expect that to start coming back probably sometime in September. So this tells us a lot and we can also see, as you saw from our – and you will hear from Ilkka, that our maintenance business very much at normalized level. So this is something we do track, we have roughly 100,000 connected units behind this data xo I think it's quite meaningful.

So then about new equipment markets. So, as I mentioned, good recovery and actually better recovery than we would have expected beginning of the year. North America, clear growth – actually North America market about that same level as for the first half of the year before and strong recovery in Q2. Of course, United States [inaudible] quite a lot down in Q2 last year, but now recovered nicely. Europe, Middle East and Africa, a slight recovery. We have to remember that central[?] and north Europe, actually very small impact last year. And strong growth in Asia-Pacific, China from an already good level last year when markets recovered strongly, and rest of Asia-Pacific, strong market recovery from, of course, a low level last year.

What is interesting to follow is that, for example, India, where the COVID situation continues to be very challenging, markets are recovering strongly. So, my read of this is that most markets' economies learning how to live with this pandemic and we can see the strong, underlying demand being in the markets and therefore also recovery.

Service markets, overall maintenance markets, recovering. As I mentioned, they were really starting to normalize – not all segments, but overall, the good level. And modernization markets recovered strongly, so strong growth in North America, fair growth also in Europe, Middle East and Africa, and continued strong growth in Asia-Pacific. So overall, good markets there.

But if you look a little bit more in detail at the important China market, number of units ordered markets continued to grow significantly year-over-year. And as you remember, market already last year was the good, recovered strongly and continued to grow from that. But competition in China is intense, there's no question about that. However, given the cost pressures that we've seen throughout the year, we are starting to see that prices are starting to improve and the direction is clear and is the right one, they are improving. Overall, macro momentum in China is solid, although perhaps moderating. But in the real estate business, investments and sales remain strong. Perhaps the biggest challenge for developers is the overall financing environment. But if we look at the KPIs we've shown here, real estate investment up well year-over-year, and clearly our CAGR up over 2019. And same thing with sales volume and price is obviously improving. So overall a good situation there. And we expect Chinese markets remain very solid also rest of the year.

Now, as I mentioned that this good recovery we've seen in the world economy, good recovery seen in our markets that the drawback it has had is that material prices, steel, copper, and the like, are at high levels – have now stabilized but at a high level. And then of course, everyone knows that every industrial company involved in global businesses, and particularly deploying advanced electronic components, have had challenges with component availability and components prices, and also sea freight costs have increased, I would say, dramatically. Electronic component availability will continue to be an issue throughout this year, probably next year. For KONE, the situation is improving clearly towards the end of the year as the result of actions we are taking ourselves. So broadening our supply base there through design changes. So we are working on that and that's going definitely in a good direction. We also expect that should start easing beginning of next year, sea freight probably sometime beginning next year should start easing. So they are probably more temporary.

Good news as well is that the pricing environment has started to improve overall. And of course, that's something that we are looking to capitalize on. Perhaps the most important factor, though, is that we have constantly be able to deliver and delivering on our customer promises. And that's, of course, the focus we have that costs have been higher, but our focus is to fulfill our promises, which we have been doing.

With that, I will hand over to Ilkka to dive a bit deeper into our financial performance.

Ilkka Hara: Thank you, Henrik, and also warm welcome on my behalf to this second quarter results webcast. And as you already saw, I have some good news to share when it comes to our performance in second quarter. And I'll start with orders received. Orders received for the quarter were €2,411 million, which is a strong growth of 16.2%; on a reported basis and on a comparable basis, 17.2%. So very good performance there. Also, what I'm pleased about is the fact that we saw strong performance in all businesses, as well as in all geographies behind these numbers.

If you look at particularly China, the large market there, and our orders received development, we saw both in volume as well as in monetary value, our orders received growing significantly. And pricing contributed slightly positively, while mix was slightly negative in our orders received in China. But, overall, significant growth continues there.

Then Hendrik talked already about pricing, which starts to improve during the second quarter. But despite that, the margin of our orders received declined slightly due to the increasing costs that we've seen, especially driven by the electronic components and raw materials here.

Then to sales. Our sales grew 11%, reaching €2.8 billion. And again, in sales, I'm pleased about this, the broad-based development and positive direction. From a business line perspective, we saw the highest growth in the modernization business growing 18.8%. Also, our new equipment grew 12%. But maybe one of the highlights for this quarter's results is the modernization – sorry, maintenance growth at 11.7%. We saw higher than normal growth in the contract revenue, so the basic fee we get, and also the discretionary part grew strongly. So the recovery is happening also visible in the data that Hendrik shared earlier about the usage.

But then on top of that, we continue to see an increasing impact from our value-added services; especially 24/7 continues to gain momentum as we go forward. Geographically, we saw growth in Americas of 6.7%, EMEA grew 12.9% APAC grew 14.9%, driven by the very strong performance that we continue to see in China in our deliveries.

And moving to adjusted EBIT, which for the quarter was €374 million, growing 15.2%, but also our profitability improved from 12.8% to 13.3%. We saw positive impact from the improved pricing that we've had in orders [inaudible] earlier now being delivered, impacting our adjusted EBIT. Also, due to the strong performance on sales, fixed cost absorption was very good and given the environment, we also continue to see somewhat lower than normal discretionary spend at KONE.

With those, we were then able to counter the impact of rising costs that we saw in Q2 as highlighted already earlier.

Then to cash flow, which continued to be on a very strong level, reaching €530 million in the quarter. There, improved operating income contributed positively, but also net working capital continued to be developing positively in the quarter. Overall, very good performance for cash flow for the whole business.

With that I'll hand over back to Henrik to talk about market and business outlook for the remainder of the year.

Henrik Ehrnrooth: Thank you. Let me wrap up with our outlook. The market outlook and for new equipment, here we continue to see a good recovery. In China, the equipment market expected to grow clearly compared to 2020 but remember that 2020 was already a good year, given the very strong recovery we saw in Q2, Q3, Q4 last year. Rest of the world markets also expected to grow significantly outside China and Asia-Pacific. North America, also a good recovery, and then some recovery also in Middle East, Europe and Africa. And we have to remember, for example, central and north Europe was pretty good throughout last year.

Maintenance activity is normalizing, as Illka was talking about, as we can see it also in our business, but overall the markets. So they expect it to grow clearly in Asia-Pacific and continuous slight[?] growth in other regions. And a good recovery of modernization markets across all areas – of course, strongest growth in Asia-Pacific. So overall a good market outlook situation for the second half.

Our outlook, we have now six months behind us so we specified our outlook a bit, expect now sales to be in the range of 4-6%, 2-6% at comparable currencies. And adjusted EBIT margin, we expect that now to be 12.4% to 13%, compared to 12.4% to 13.2% previously. And, of course, assumes that exchange rates stay at this level – if exchange rates stay at this level, there will be minimal impact from currencies compared to previous year. We have a number of good things driving our performance, as we could see in Q2. And our competitiveness is in good shape. We have a solid order book and maintenance base as a result. And we have had a continuous good improvement in our quality and productivity. So with that, we've been able to already offset a bunch of the headwinds that we have seen.

[Inaudible] our result, we can see that the global supply situation I was talking about is having an impact. We expect that the increased component logistics across the various raw material or material and other components costs are going up, full year impact about €175 million. So [inaudible] clearly higher than what we had expected before. And as I mentioned, we expect that the electronic components, given the actions we're taking, should start easing towards the end of this year and logistics start easing next year. So they have more perhaps temporary in nature. Despite this, we continue to invest strongly in our capability to sell and deliver digital services and solutions because we see good growth here. I think we are really leading the market here and we want to continue to do that when we're bringing new services and solutions onto the market. And again, as Illka mentioned, the growth we had in the quarter and our 24/7 connected services was excellent. So continue to build momentum there.

So in summary, very strong financial performance across the board. And I would say that we are addressing the increasing costs from a position of strength. So that is the environment, but we are dealing with it. And the momentum in our value-added services continues to improve. We had very good sales growth and very good performance there. So overall, I must say that I'm very pleased with the performance of the second quarter and how our team overall that had been dealing with the changing environment that we see in the market.

And with that, we are ready to go over the questions.

Operator: Thank you, ladies and gentlemen, if you would like to ask a question, please signal by pressing star one on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Again, please press star one to ask a question. Our first question comes from Jeff Sprague of Vertical Research Partners. Go ahead.

Jeff Sprague: Yes. Thank you. Good day, everyone. Jeff here. Two questions for me. First, just on China, you mentioned some of the developer issues –

Henrik Ehrnrooth: Sorry. Jeff, we can hear you very faintly. So technicians here, we could hear the others also very faintly, can we try to…?

Jeff Sprague: Is that any better?

Henrik Ehrnrooth: This is perfect. Now, it's much better.

Jeff Sprague: Okay, great. Yes. Thank you for interrupting then. Two questions first on China, right? We've seen a number of mixed signals. We saw developers are being required to disclose their commercial paper balance, which would suggest there's some restrictions. And then on the flip side, the reserve ratio requirements are going down, which suggests stimulus, right? So it seems like there's really a number of mixed signals from the government about what it wants to happen or what it sees happening economically. I just wonder if you could elaborate a little bit more on really the current state of affairs on the ground in China as a first question.

And then the second question is just on modernization in general and perhaps some of the discretionary maintenance. I would imagine there's a fair amount of pent-up activity given what happened last year. Is there any way you could size or put in perspective that pent-up activity, how long it might take to meet that demand and what your visibility is there? Thank you very much.

Henrik Ehrnrooth: Good morning. You take the financing situation in China. I'll take the [inaudible] maintenance part.

Ilkka Hara: I guess if I look at the overall China market and look at the context where we are there, we've seen from an overall perspective, the liquidity situation to be [inaudible] towards the developer customers. Overall markets, then being a bit separate. But I think for these developers, clearly, one of the targets for the government has been that they want to control the market and continue to see healthy development there. We've also seen regulation there, such as the pilot program with three red line policy, aiming to improve the credit worthiness of the developer base.

And, then lately, also talked about how and what to disclose on the balance sheet. But I think from our perspective that has not changed. It's been tight for quite some time. And naturally, we talk about pricing as a negotiation point, but also then, also, the payment terms are a negotiation point always. But we've seen actually, and so far being able to see quite a good development in our payment terms, and they remained roughly stable throughout the last quarter. So I think that's the situation from the overall market and our perspective.

Henrik Ehrnrooth: If I go to this modernization, discretionary activity, so clearly, there's probably some pent-up demand in some markets that there were a lot of – for example, the residential side in Europe, a lot of modernizations that didn't happen as housing association didn't have their meetings to approve the budget, or people didn't want jobs to be done in their houses while they were living there and working there as well. So there's probably some pent-up demand.

However, if we look at the fundamental demand in the market, it was growing well before the pandemic hit, then it was muted and now we're coming back. So probably some pent-up demand, but also fundamental growth is what we believe that there is. We believe that when a company is starting to bring people back to offices, the need for good offices is just very important. That's how you attract people back. And at least, our surveys and studies indicate that that's what companies want to do. So we believe there will be good activity there to make sure that offices are attractive and our residential side usage has been high. So all that, maybe some pent-up demand, but I would say still good growth is expected going forward.

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

Andre Kukhnin: Good afternoon. Thank you very much for taking my questions. And I hope you can hear me okay. Can I start with one going-back-to-basics kind of question and talk a bit about your relationship of the order backlog versus revenues? Because in the last couple of years, we've had this situation where we didn't really see much backlog growth, but it didn't stop from your – didn't stop your revenues from growing and the new equipment specifically within that. And just wanted to get a sense on how you view the backlog rolling out and whether anything has changed in the last couple of years that maybe made conversion faster, so there are more orders that are delivered as you go so that they don't make it into the backlog. Could we start with that please?

Ilkka Hara: Well, maybe I'll start there. So we've seen somewhat increasing rotation in our order backlog due to China market being faster and faster in the last, I would say, few years, but then obviously from last year's perspective, also the market environment impacted order book rotation somewhat. So we saw book to bill being a little bit less than one during the second half of last year due to the strong deliveries. And now for the last couple of quarters, the order book actually, quarter on quarter, has been growing. So I wouldn't say that there's been a big change, but those are the dynamics behind it.

Henrik Ehrnrooth: Perhaps, if you think about in China, one of the ways the developers are improving their financial situation is improving their lead times. How long things[?] takes and work in progress. And that has really played into our favor because we are very quick from order to delivery. And that's an important competitive driver in China today. So [inaudible] maybe one of the drivers is perhaps slightly faster, but as Ilkka mentioned, no dramatic changes.

Andre Kukhnin: Thank you. That's helpful. And could I ask a question on pricing? You mentioned it quite a few times on the call. It sounds like it's new equipment oriented and quite China focused, but could you tell us whether that is the case or is it broader than that geographically or by product categories? And could you give us any idea on the size? I mean, we've got a whole bunch of other construction companies talking about 2-3% price increases. Is that a reasonable ballpark?

Henrik Ehrnrooth: I think we mentioned that the pricing environment has improved and we have slightly been able to improve our prices. We haven't talked about any specific numbers on that, but it's not only China, it's also Europe and North America, and clearly it's impacting all businesses. So, of course, the objective is both, for example, modernization and new equipment and spare parts and things like that. So of course the objective is in all areas. Now the improvement is slight, but our message is clear that we believe that direction is now clear here.

Andre Kukhnin: Thank you. And if I may, last one on raw materials, I know it's early to think about 2022. But could you give any indication, assuming obviously no change in spots from here, on what that headwind would amount to, from a raw material perspective, given that you've just moved[?] the estimates for 2021?

Ilkka Hara: Well, first of all, on raw materials, and I would say raw materials then as we talked about the electronic components, as well as then logistics, all of that is included in the updated €175 million headwinds that we see for this year. And that's clearly up from the – in conjunction of our Q1 results; we said €100 million. And most of that increase actually is coming from the electronic components and logistics. Those two components we expect, as Henrik talked about, to be more temporary in nature, but just looking at the raw material part of it, given how the comparison works, so we do expect to have a headwind to 2022 especially in the beginning, Q1 to Q2, where we saw less of that impact.

Operator: Our next question comes from Guillermo Peigneux of UBS.

Guillermo Peigneux: Hi, good afternoon, Guillermo Peigneux from UBS. I want to labor actually on – follow up on the last two questions. First, I think on your outlook, you say China significantly up during the first half, and then, clearly up for the second – high for the second half. Could that mean that in the end, there's no growth in China for your second half or for the outlook of the year? This is when you say clearly up? So I just wondered about the second half growth outlook for the China market in your view. Then the second one is on –

Ilkka Hara: So we take that first and then we can go to the second question. You have to remember how the China market developed last year. First quarter was clearly impacted by pandemic. Second quarter to start to recover, very strong recovery and actually, strong growth year-over-year in Q3 and Q4. So the comparison point second half is clearly different than it was for the first half in China. I think our message is that we expect markets to be really solid in China for the rest of this year.

Guillermo Peigneux: Thank you. But because it changes from significant to clearly for the final year. I was wondering if that means that globally a lot more difficult in the second half, but maybe –

Ilkka Hara: Growth rate will be lower in the second half, but the comparison point is also much higher.

Guillermo Peigneux: Thank you. That was the clarification I was looking for. Then second is when it comes to your margin commentary about what's coming into the backlog at the moment. I wonder again, on the previous question, whether you could pinpoint here with the backlog in hand that you do have for delivery next year, whether we could see already that that level is below current[?] level.

Henrik Ehrnrooth: I'll take it. So, as we said already now in Q1 and Q2, it is slightly lower, the orders that we booked there, but then when you look at the total order book, mix plays an important role there. So it's not that good of a proxy[?] to look at comparison point there, but clearly now in Q2, we start to see prices improving, countering some of the increased headwinds from the course[?]. So, so that's clearly the right direction.

Operator: Our next question comes from Klas Bergelind of Citi.

Klas Bergelind: Yes, so I want to come back to cost again. Obviously material increase, but driven by temporary factors, but thinking about 2022, I think you, Ilkka, gave an indication of, at the last conference call, of what it could be from the steel[?], some €30-35 million for the first half. Now we've had steel costs going up sharply in the second quarter, steel in Europe is continuing to trend higher and given the hedging, will that be a big number for 2022? I was start there.

Ilkka Hara: I'm not sure I give an exact number on the last call for 2022. I said that there's a headwind there and it is somewhat bigger now due to the development, and mostly impacting then first half next year [inaudible] comparison [inaudible].

Klas Bergelind: If I ask it like this, instead, the €175 million, it seems like raw materials for this year is a small part of that €25-30 million I heard when I spoke with Natalia before. How will that grow, do you think? Is it €35 million, €50 million? Is there anything you can say at the current levels and given your hedges? Or are we just going to get, 'It will be a bigger headwind. Yes, we have some sort of quantification.'

Ilkka Hara: Well, naturally, I mean, it's also a – reality is that at this point of the year, there's still many moving parts before we get to 2022. Orders to come in and also, then where and how we deliver those next year. But if I think about the €175 million now, the biggest change from €100 million to €175 million during the quarter was due to the electronic components, as well as the logistics. And raw materials continued to be on the high level. And on other raw materials, then the impact is more to watch the first half, but I wouldn't go to too much detail yet. We'll update as we get to closer to 2022 on that one. I think it's always important to think about the context that all of these that we're talking about, that if you look at all the costs, volatility has been very high, situations have changed very rapidly. So I think now, of course, we have new contractual rates for sea freight and things like that for Q3 and partly Q4, but what is going to be next year, I think that's still open [inaudible] raw materials. So it's just too early to say. The only thing we know is that if all this situation has changed rapidly and direction of course, is something we don't know, if it will continue doing that, but that is just the context of the environment. And the context of the environment, we all have to live in business. And as I said, I think we've done a really good job in dealing with those rapidly changing situations.

Klas Bergelind: Good, good. My final one is on service. If [inaudible] can try and back out, I know this is difficult, but how much was pent-up demand that we open up versus more acceptance of the digital offering, whether that's offering even more accepted this quarter? Because the levels we see quarter-on-quarter, particularly on the maintenance side, was quite a big surprise I think for everyone, [Inaudible], yes, definitely, more than just pent-up.

Henrik Ehrnrooth: I think Ilkka talked about it already, that it was actually a combination. If we look at discretionary, activity was clearly above 2019 levels as well, so maybe there was some pent-up, but the main thing is that we had a more normalized activity. Also, we had all of the parts in maintenance grew, so good growth in maintenance base overall. Very good growth in our digital services and pricing continued to be very good there as well, which is important. So we continue to sell very well our digital services at good prices, and then also good repair activity. And in repairs, maybe there was some pent-up demand but it really shows that market is coming back here. And you have to remember that last year, I mean, we still had – despite the environment, we had a couple of percent growth in our maintenance business, it wasn't a slump. It was just a little bit lower, very resilient. And now we floated[?] back much of that.

Operator: Our next question comes from Rizk Maidi of Jefferies.

Rizk Maidi: Yes. Hi, thank you for taking my questions. I'm going to go back to the cost again. Can you please just help us spilt out that €175 million between what is pure raw materials versus the other components, logistics, et cetera?

Ilkka Hara: Well, I would say most of the increase is – from €100 million to €175 million is coming from logistics and electronic components, which roughly I would split that maybe into half. And, then most of the 100 – a little bit more than €100 million is then the raw material impact out of that. So that's roughly the split and I always say that we don't really buy raw materials. What we purchase is components for our equipment, but those components naturally have a tight connection to raw materials. So we try to give you a picture of the impact of those changes. So, it's also a bit of an estimate just to provide transparency.

Rizk Maidi: Okay. Thanks. And just the number seems to be way higher than what we've had during the last inflation environment of 2017/18. Is there anything that has changed in your relationship with your component suppliers? I understand that most of the direct material costs is through components or is it essentially those logistics, electronics, et cetera, that is driving the bill higher this time around?

Henrik Ehrnrooth: I think the difference is that – our supply chain is fundamentally similar to what is back then. The difference is that I don't think we've seen for decades a situation where all costs in a synchronized way would go up so much. That it was then more certain materials that were going up, but now we're seeing it across the board. That's perhaps the difference between now and going back a few years.

Rizk Maidi: Okay. Thank you. The second one is just a clarification really on – so what we're hearing from some of your competitors is [inaudible] headline[?] policy has so far not had any big impact on the market demand at least, but some of your competitors are seeing tougher pricing, but also different payment terms. I think Ilkka touched on this a bit earlier. Can you just elaborate on whether you've seen something similar at all?

Ilkka Hara: Well, I always say that when we talk about negotiations with customers, so pricing is one component. Then you have the commercial terms, including payment terms there as well. And we've seen that our developer customers have faced liquidity challenges for now a number of quarters. So [inaudible] even tighter negotiation on the payment terms. But as I said, so far, we've been able to maintain a good payment terms and they haven't changed overall. So, I think that's positive development from our perspective, but the pressure continues to be tightening there.

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

Lucie Carrier: Good afternoon, everyone, and thanks for taking my question. Apologies, maybe to come back on the guidance for 2021. I know it's a bit more short-term focused, but I wanted to understand a little bit more your assumption around the second half of the year, because you are at 11% organic growth in the first half. So virtually, you're guiding for about zero in the second half. Appreciate maybe the second half comm[?] base in China is a bit more demanding. But it's not that easy – it's not that difficult necessarily in the other regions. So I was just wondering if the orders you have taken over the last nine to 12 months, or maybe longer dated, or why you are assuming so little growth in the second half.

Ilkka Hara: Well, if I start the guidance for second half, naturally, as you said, that the comparison point is tougher when it comes to the second half, and especially in China, where we saw very good recovery throughout last year, since second quarter. And you have to also remember that even though we did have increasing impact of pandemic in number of markets in second half, actually, our performance was better, as we said, then we learned to live with the pandemic more and more there. So that's the background for the guidance. So, we continue to see that the business develops positively but the growth is less than we saw in the first half.

Lucie Carrier: Okay. And then secondly, around the guidance for the margin on that front, you have an incremental cost of about €75 million from the headwind from components and logistic. I was just curious to understand whether you are seeing a higher potential in terms of your savings benefits, because I think you had initially guided for a relatively modest amount of savings for 2021. And because – or if you were expecting quite a lot of benefits on the mix maybe more skewed to modernization and maintenance in the second half. Because if I look at the leverage you've had so far this year and then extrapolate that, it looks like the high end of the margin targets, let's put it this way, is quite challenging.

Ilkka Hara: Well, I think overall, given the increase in costs, we've been able to counter that with good productivity, quality improvements, as Hendrik already highlighted. And that's been helping us to be able to perform quite well. And the guidance has been less impacted than the headwinds we've seen. So I think it's just a mix. And then if you look at it from a first half perspective versus second half, so we are expecting more of that impact from the €175 million to be impacting Q3 and Q4 than we saw in the first half.

Operator: Our next question comes from Andrew Wilson of JP Morgan.

Andrew Wilson: Hi, thanks for taking my questions. I just have two. On the modernization side, I'm interested in a couple of comments you made, I think, to the very first question. Just, are you seeing a change in terms of the types of inquiries that you're having on the modernization side with it being that customers obviously thinking about repurposing buildings or potentially seeing an acceleration in some of these areas, which we expected to maybe be modernized a bit more quickly than they ultimately have been? I'm interested to see if you're seeing a change in some of the incoming, I guess, requests and inquiries from customers.

Henrik Ehrnrooth: I think it depends a bit on market, but what is interesting to see is that I think in North America, we're experiencing what we saw after the financial crisis, that actually modernization came up first, because if you had an old building that didn't have tenants, to make it competitive, you had to modernize it – of course, it's not only about the elevators, it's general modernization – to make sure that you have something that's going to attract employees. Because I still believe that that is going to be for offices, really critical to bring people back, is to make sure that you have offices that are fit for purpose, that are attractive and are good places to work. So people can really feel the benefits of coming there. And that's a lot of discussion that we can hear. But also in people's homes, as [inaudible] going to be a much more mixed [inaudible] work and people are going to be more home and expect more out of them.

And then on top of that, you have the EU requirements, which you can see, or the Recovery and Resilience fund, much of that money is going to modernizing, upgrading buildings to make them more energy efficient and smarter. So we think all of these things will drive and create the good gross environment for modernization of the coming years. We could see that already before the pandemic, but perhaps slightly different drivers, but that's why we are positive about the longer term outlook for that business. Maybe the short term, there was some pent-up demand, but we still expect to see good growth going forward.

Andrew Wilson: And maybe just a quick one, it's probably for Ilkka, and apologies if I missed this, but can you provide us with a split of the €175 million cost headwind between the first half and the second half? I'm just interested in terms of how that [inaudible] to help us a little bit with our models for the second half?

Ilkka Hara: Well, I would say that's on rough terms, maybe first half, one-third of that impacting first half and then the rest more towards Q3 and Q4, quite equally impacted there.

Andrew Wilson: That's very helpful, thanks for the time.

Operator: Our next question comes from Martin Flueckiger of Kepler Cheuvreux.

Martin Flueckiger: Yeah. Thanks for taking my question. Good afternoon. Just on your efficiency gains and productivity improvements that you've mentioned, I appreciate you're talking about your headwinds from higher input costs in quantitative terms, but could you possibly also elaborate a little bit in terms of numbers, what you were expecting for cost improvements from these efficiency and productivity gains that you're targeting? That will be my first question.

Henrik Ehrnrooth: I don't think we have a specific number. This is really across the board. Of course, we have targets for many different ones because remember, this comes in so many different forms. It comes through maintenance productivity, it comes through installation productivity, it comes through general quality, it comes from supply chain and it comes from also our product cost competitiveness. And actually, we've seen good improvement in each of these to offset some of the costs, but each of them, it's a few percentage points, but if you normally do two or three, and then you can do, instead, three to four or something like that, it starts to have an impact, but that's the magnitude we're talking about.

Martin Flueckiger: Okay. Thanks. And then the second one, I seem to remember that you've been doing quite a number of smaller acquisitions, particularly on the services side, in the past. I was just wondering whether you could talk about whether they've been again, numerous acquisitions in Q2 and what regions you made those and what the actual impact was on your sales growth at comparable exchange rates.

Ilkka Hara: So our strategy, looking for nice, smaller maintenance companies that we can acquire and add to our maintenance base, hasn't really changed. It continues to be the same. We're very interested to look for those. At the same time, if you look at over time, the challenge is more finding willing sellers than our appetite there. And now I don't think there's been a big change, but [inaudible] we've been able to know close lately that are positively impacting. But that said, focus is more Europe and especially south Europe and I guess now North America is also one where, time to time, we find opportunities there. And it brings some growth, but obviously it varies a lot then between quarters. It's not the big number. The driver for the maintenance growth clearly was other things than acquisitions.

Martin Flueckiger: It's fair to say that the impact that the group level is less than half a percentage point.

Ilkka Hara: Yes.

Operator: Our next question comes from Joel Spungin of Berenberg.

Joel Spungin: Hi, good afternoon. I've got a couple. Maybe just to start, could you maybe talk a little bit about your thinking around that long-term potential for the market in China? Particularly, as we look into 2022, obviously we've come off the back of a couple of good years. This year has probably been better than expected. Do you think that momentum can continue much longer or are we inevitably going to see some sort of normalization in market growth rates?

Henrik Ehrnrooth: I think we haven't given estimates yet for China into 2022. We expect the markets to finish on a good note this year, probably, then I would expect them to start on a good note next year. Probably not growth rates that we see now, but solid market is what we expect. Growth rates, we have to see what those are. It's too early to say now. I think fundamentally, we look longer term, we expect [inaudible] markets to be solid. Perhaps then more of the growth going forward is going to come from services, why we are putting so much effort into that now. And that's where we see a lot of opportunities. So overall, we continue to see that there are good growth opportunities in the China market overall.

Joel Spungin: Okay. Thanks. That's helpful. And then maybe just some clarification, just in terms of your order intake number, the 17% that you recorded for the second quarter, I mean, obviously you said within that, obviously, China grew significantly but EMEA was up slightly. What I'm curious about is Americas, which is obviously the smallest, probably[?], contributor of the three regions. But it must've grown at an extremely fast rate to reconcile to the 17% order intake growth overall. Can you maybe just give it a little clarification on what happened there?

Ilkka Hara: Yes. You have to remember that the comparison point for Americas last year, Q2, clearly, was impacted strongly by the COVID in Americas. And we did see a significant growth in Americas order in the quarter.

Henrik Ehrnrooth: Let me be a little bit more [inaudible], we had actually extremely strong growth in order received in North America in Q2. So that's right, that's right. We had a phenomenal performance there.

Joel Spungin: Okay. Okay. Thank you. And then maybe just a very quick one, just in terms of your comments on pricing, and you obviously mentioned that the pricing environment improved in the quarter, I'm just curious to understand maybe a little bit more about what maybe lies behind that, what explains the improvement in the pricing environment in the recent months.

Henrik Ehrnrooth: I think everyone in the market is seeing the same pressure. Of course, our customers are seeing the pressure from many different perspective. Of course, therefore, they want to push back. But I think there is a recognition that costs have gone up significantly. We have compensated much of that. Not everything has been put through directly to customers. But we can see that there's a better – start to be a better acceptance on and more companies – not everyone, but more companies have started to look at price increases. And we have been very focused on that and we're starting to see some of that coming through. And, of course, it has to do with your competitiveness as well, that if you are competitive, I think you can do it. And I think it's the right thing to do in a high cost increase environment that we are in now. It doesn't happen overnight. It's hard work behind it and consistent work. And I think our message very clearly that, yes, it's slight improvement now, but when we look at our data, the direction is clear.

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

Nick Housden: Yeah. Hi everyone. Thank you for taking my questions. My first one, it's a bit of a broader question about the Chinese market, again. In the past, you've spoken about consolidation among Chinese property developers being a catalyst for [inaudible] and, indeed, for other established OEMs to gain market share. Can you just give us an update on how this process is moving and whether it's accelerated or stalled in the past 18 months or so, and just what the situation is there? Thanks.

Henrik Ehrnrooth: We have seen a continued consolidation, if you look at the top 50 or top 100 developers in China. So we've seen a continuous consolidation, perhaps not as fast as it was before. As we talked before, there's a strong focus to improve the balance sheets of many of the big developers, but still, many of the big developers have stronger balance sheets, so they've been able to then participate in land purchases and that way grow. So they have been growing and that consolidation has continued perhaps as not as fast as before, but likely to continue the same trend as we've seen so far.

Nick Housden: Thanks, that's helpful. Just one more quick one. You mentioned earlier in the call about KONE having a very quick order to delivery time again in China. I'm just wondering how that compares with other OEMs. Is that a big differentiator between KONE and other major OEMs, or is it more an advantage that all of the major companies have versus some of the smaller, more local players?

Henrik Ehrnrooth: I can't talk about all of our big competitors, but my understanding is that we have the shortest order to deliver turnaround times in China for the big customers. But clearly everyone is working on that. But that's been a source of competitive advantage and doing that consistently in a good way.

Nick Housden: Very helpful. Thank you.

Operator: Our next question comes from Tomi Railo of DNB.

Tomi Railo: This is Tomi from DNB. Can you perhaps comment, the growth rates in terms of Chinese maintenance and modernization in the second quarter for you?

Ilkka Hara: We continue to see similar good growth in maintenance in China that we've seen before. So maintenance revenue growing double and also our maintenance base growing slightly higher than the revenue there. And on the modernization, we've continued to see good growth there. Remember that the base still continues to be small, but over the last year, 30+% growth has been the base there. No change there.

Operator: Our next question comes from Maddy Singh of Bank of America.

Maddy Singh: Thanks for taking my question. Just a couple of them. First is a quick follow-up on the pricing comment. When you talk about price increases, are you talking about year-on-year increase or a sequential increase in prices? And also just on that, it's my understanding that so far, price increases have not been enough to offset the cost increases until now. And, obviously, you'd hope that it does that in future.

And the second question is on your order backlog as it stands now. Can you confirm whether the margins of the overall order backlog is lower than current reported margin levels during the quarter? So below 13% level, basically. Yeah.

Ilkka Hara: Let's start with a pricing question and on the pricing, normally when we comment, comparison period is year-on-year and there's slight seasonality impact in that commentary. But as we now talk about improvement in overall pricing environment, I think it's true both year-on-year and quarter-on-quarter on a high level.

Then on the order book margin, so what we book to order book, so, as I said already earlier, so it is not a very easy comparison point to give, or not very good one, as you have in the order book, a higher number of major projects, for example, and also, the rotation in order book is different between the regions. So, we haven't commented that much on order book margins versus what we book.

Maddy Singh: But can you also confirm whether the price increases so far have been enough to offset the underlying costs increases? But you would need price increase –

Ilkka Hara: Yep. So that, I actually already commented that we start to see prices going up, but not enough to counter the cost increases.

Operator: Our next question comes from Lars Brorson of Barclays.

Lars Brorson: Hi, maybe I can follow up on that pricing question, Ilkka, and maybe just start by saying you give by far the best commentary and visibility on pricing in the industry. Thank you for that. But let me just pressure, maybe, a bit on new equipment pricing in China in particular. I think what I pick up from your competitors is that price increases has been far easier[?] in Western markets than they have been in China, at least reasonably. I wonder whether you can give a bit of color around the new equipment pricing trend in China. So, like-for-like prices slightly higher, we're talking 100 basis point. And can you give some color on market pricing? And can you also give, perhaps Henrik or Ilkka, a little bit of color on what you see in your base business versus larger project business? I'm still assuming that the latter is far more price competitive. I'll start there. Thank you.

Ilkka Hara: Many questions. I'll try to take all of them. Your question on, where do we see pricing developing between areas, I think first I comment particularly China due to the size of that. And also, it's easier to take the mix out there. We've seen now prices improving in China slightly in Q2.

They were flat or more stable in Q1. So that's one thing and there clearly, overall market, despite being competitive, there's a strong growth there. So that's an environment where you normally also see better pricing environment. But now we've also seen, during the second quarter, that we start to see signs of improving prices in Europe and in North America as well.

I don't know, Henrik, if you have more to add.

Henrik Ehrnrooth: I don't. So I think that clearly markets are very competitive, there's no question about that. At the same time, everyone is facing the same environment in the markets. So that's also important to remember.

Lars Brorson: Can I just ask specifically, is it not easier to put through price increases in your base business and then your last project business? That's historically been the case at least.

Henrik Ehrnrooth: It was a bit garbled, but I think it was volume business versus major project business. The line was disturbed there, but clearly the bigger impact is always the volume business. But major projects also there, we've seen a good development. Both are extremely competitive, no question, but I think we've similar trends, I would say.

Lars Brorson: Thank you. It sounds like you can't hear me particularly well, but maybe I can ask, if you can hear me, a little bit –

Henrik Ehrnrooth: Now we can hear you.

Lars Brorson: Okay. Thank you. Around key customers in China, I'm not sure whether you can give us a percentage of group sales from [inaudible] or China sales. But maybe more broadly, have you quantified the customer group that may be at risk? And if so, can you give us a little bit of color around that risk assessment?

Ilkka Hara: Well, I don't think we've commented individual customers as such, but obviously China now has bigger customers than in other markets. But it's also good to remember that still compared to the group total, we're talking about maybe a percentage point or two on the big customers. So it's not as if the business is very concentrated as such.

Henrik Ehrnrooth: Clearly we are managing risks all the time and so far, fared quite.

Lars Brorson: Understood. On your repairs business, the last three quarters, you had a handy little heat map chart for your order trends by region and segment, which you've taken out. I just wondered, and I was late on the call, so apologies if you've already covered it, but your repairs business, is that tracking[?] your elevator usage[?] that [inaudible] growth year-over-year? Are you able to give a bit of color on that please?

Ilkka Hara: Well, glad to get the feedback that it was useful and sorry for dropping it for this quarter, as we saw more green everywhere there. So I think that's the answer. It didn't give much of a difference between the different areas anymore. And maybe you missed it during the presentation, so we went through the maintenance business, which grew very nicely, and we saw across the board, very nice growth. The basic maintenance business with the contractual revenue grew more than normally. Also, the value-added services contribute to the growth. So we continue to see good momentum for services like 24/7 connected service. But then the highlight was the discretionary part so that grew much faster than the maintenance business in general. And, that's I think a comment across the globe.

Operator: Our next question comes from Debashis Chand of Société Générale.

Debashis Chand: Thanks for taking my questions. My first question was on one of your key competitors investing on ramping of [inaudible] in its installed base. So do you see that could potentially change the competitive environment for the digital services or to put it another way, do you see it could push KONE to adopt a kind of a similar strategy in the future?

Henrik Ehrnrooth: I would say that I think everyone is investing in various different digital services. We feel good about the competitiveness of ours. I think the fact that we're able to achieve a premium pricing for them talks a lot about the value of these services and the value we can deliver to our customers for them. Clearly, we're coming out with different types of service all the time. Some perhaps more basic, some more advanced. So I think this market will continue to develop, but we see that our approach is working. We are selling these as commercial services because they really add good value to our customers. And we put in a lot of money into the development of them. So that seems to work, but clearly, competition is going to do different things and that's what the competitive market is all about. I think it just verifies that there's a need for such services, and I'm very pleased with the value we can provide.

Ilkka Hara: And maybe to add to that, so it's not that we only invest in the development part. We continuously invest also to the go-to market effort. That's been something that we've continued to do for quite some time. So, I think in that sense, we are, from our perspective, in a good position.

Henrik Ehrnrooth: I think what Ilkka mentioned is just worth highlighting that going to selling different types of services to customers always takes different commercial skills that we have really built up over the past years. And I think that this is a really an important competitive advantage. And if you don't do that, then I think you're going to be behind in the future. So that's a choice we've – a conscious choice we've made. That's what we believe in.

Debashis Chand: Thank you. Secondly, one clarification on the growth guidance, looking at flattish growth outlook for the second half. Are you looking for low[?] growth in China in the second half? [Inaudible] see China declining in the second half?

Henrik Ehrnrooth: We don't guide specific markets. I think we show we have a solid order book and orders have come in at different times and this is what we expect now for second half overall.

Operator: We can go to Andre Kukhnin of Credit Suisse.

Andre Kukhnin: Thanks so much for taking the follow-ups. I wondered if you could tell us your maintenance base growth in H1 so far in units.

Henrik Ehrnrooth: Over five.

Ilkka Hara: Probably something in and around that.

Henrik Ehrnrooth: Normal, good growth.

Andre Kukhnin: Great. Thank you. That's just to help calibrate against [inaudible] what's come back to trends, et cetera. And China business –

Henrik Ehrnrooth: Sorry to interrupt, but the maintenance base last year was, of course, very little impacted by pandemic. There were some, but very little. So it was really a discretionary activity that was impacted more or last year.

Andre Kukhnin: Exactly, that's what I was thinking is that you were, I think, four[?] [inaudible] something and the growth should have been a couple points higher, given price, given digital, et cetera. I think, I guess we're catching up this now to the trend. And on China business mix, is service – is maintenance and modernization still circa 15%, or have we moved past that point towards 20%? And modernization, you said it's a very small base, but is it nearing 5% of your China business or still far off it?

Ilkka Hara: It's a bit more than 15%, but not quite 20% in total right now. And the monetization business, it's closer to 5%.

Henrik Ehrnrooth: Probably slightly below.

Ilkka Hara: Yeah.

Andre Kukhnin: Perfect. Thank you. And is there an update on China regulation change? We know that they keep piloting and trialing the replacement of mandatory visits to – on-demand visits to 24/7 monitoring. Has there been any movement on that front?

Henrik Ehrnrooth: Those pilots have continued. My understanding is that the results are good for them, but no real updates on that regulatory front yet.

Andre Kukhnin: Very clear. Thank you very much for your time.

Operator: Ladies and gentlemen, that concludes all the time we have for questions today. I'll hand the call back to your speakers for any additional closing remarks.

Natalia Valtasaari: Yes. Well, thank you Henrik, thank you Ilkka for the presentation. Thank you to everyone who's participated, everyone who's asked questions. It's been a very lively discussion this time around, which is great. If you do have any follow-ups, please do feel free to reach out to either me or the rest of the IR team. And yeah, with that, I'm wishing you a great rest of the summer.

Henrik Ehrnrooth: Thank you everyone.

Ilkka Hara: Thank you.