KONE Q3 2016: INTERIM REPORT FOR JANUARY-SEPTEMBER 2016

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Sanna Kaje: Good afternoon everyone, and welcome to KONE's Q3 results presentation. My name is Sanna Kaje and I'm the Head of Investor Relations. I have here with me today our president and CEO, Henrik Ehrnrooth and CFO, Ilkka Hara. As usual, we will start with a presentation by Henrik on the highlights of the quarter.

Henrik Ehrnrooth: Okay, thank you Sanna, and also, welcome everyone, both here in the room and everyone following the webcast. It's again a great pleasure to report to you the results that we have achieved in the third quarter. We had a good performance again. And I'm particularly pleased that we have continued to perform strongly in an environment that we all know that has been challenging already for a while. So, I think we have, again, clearly demonstrated, but also in a more challenging environment, that we can continue our good performance and find good opportunities out in the markets by working with our customers.

As usual, I'll start with our key figures, go a little bit deeper into some of them, then I'll talk about some of the areas; how we have developed KONE and some developments in our programmes; and after that we'll talk about markets and then wrap up with our outlook for the markets as well as KONE's outlook.

Well, let's start with the key figures for the third quarter of this year. As you can see from the heading, we had a solid development on a broad basis. Our orders received where 1.77 billion, growth of 0.4%, but if we look in comparable currencies, growth was now 3.3%. This, I'm pleased about. Our order book remains very strong at 8.7 billion. Also it's grown at 5.6% in comparable currencies from last year. This naturally gives us a good situation for the coming years. Our sales, €2.17 billion; it declined slightly, if we measured in reported currencies, however in comparable currencies, we continued to grow, and we grew at 1.9%. What is most important with this is that we continue to grow profitably. Our EBIT was 331 million, and we can see improvements in our EBIT margin from 14.9 to 15.3%. And this was a strong performance. We also continue to have strong cash generation – continued very positive cash generation over 400million cash flow in the quarter and also our TPS[?] improved.

Now, as we've always said, one quarter is a very short period of time to look at our performance, and it's always better to look at slightly longer period of time. And now, at this stage of the year, we naturally have nine months to look at, we can see how we've done on a slightly longer term. For the first nine months, we can say it's been a continued good operating performance. Our orders received at just shy of €5.8 billion, they declined 3.8% or 1.2% in comparable currencies. Sales has continued to grow, at 6.2 billion; 1.7% growth, but again, in comparable currencies, in this type of environment, what I believe is a very solid number, 4%. But again, here, perhaps if you look at the first nine months, the highlights are our EBITs are more than 900 million for the first nine months. Improvements on margins from 14.2 to 14.6%. And what I'm very pleased about is the very strong cash flow we have continued to drive at KONE. 1.1billion of cash flow for the first nine months is a very strong achievement, and I'm very happy about that. Our EPS has also improved from 130 to 142 for the first nine months.

I think it's clear to everyone that performing strongly in an environment like this requires a committed, motivated, dedicated team; and this, I believe, we definitely have at KONE. Everyone at KONE has continued to really look at opportunities, look to find opportunities how we can improve in this environment, and this we've done. Again, my heartfelt thanks to all KONE employees for the great work that they have done during the first nine months and ongoing – what they do for us as a company to drive us forward.

So, those are the key numbers. Let's go a little bit deeper into orders received, sales and EBIT. In orders received, growth of 3.3% in comparable currencies, and here what I'm very pleased about is that we had a very broad based strong performance. And that compensated the challenging situation we are facing in the large Chinese market. Here in Europe, at least in Africa, we continue to grow in double digits; a very strong performance. Also, in North America, we continue our solid growth from a good level, and also the rest of Asia Pacific grew in a good way. So, we can see that the objective we have had during the past years is to find broader based growth to compensate for what we have already known for a while; that the Chinese market is getting very difficult. This we are definitely delivering on. If you look at my[?] business, continued double-digit growth in a modernisation[?] business, which I'm very pleased about, also here the efforts we have put in over the past few years to strengthen our modernisation business and drive growth is happening. We also had a better month now, a good growth in our major projects business. If you then look at China, I know there's always a lot of questions about that, and of course it's an important and big market for us. So in China now this quarter we did outperform the market. Our orders received grew at close to 5%. If you look at our orders received in monetary value, they declined in high-single digits. So we can see that the market continues to be price competitive and we can continue to see a shift in what our customers prefer to lower specification products. So, if you look at this in combination, impact for us continues to be roughly 5% in price and roughly 5% impact from mix to lower specification product. If you then look at the margins for our orders received, the most important point is that the margin of our order book remains healthy. However, given the price pressure that we have seen in China, the margins for our orders received in the Chinese market did decline slightly now in the third quarter. But overall, if we look at our orders received, I'm very pleased about the broad based strong performance that we have had.

If I enter into sales, the growth of 1.9% in comparable currencies and here the highlight is really our services business. Our services business, we have been delivering good growth in that now for quite some time and as we continue. Modernisation business continued solid double-digit growth at 13.4%, and our maintenance business also very solid, good 6.1% growth. The business then compensated the slight decline we had in our new equipment business. Also, if we look at this by region, growth[?] Europe, the Middle East, and Africa and the Americas growing at good rates and compensated for a decline in Asia Pacific. So here, Asia Pacific outside of China continues to record strong growth, whereas our sales in China now decline at around 10%. And it is of course a natural consequence of the fact that our orders received start to decline earlier this year, and order to delivery [inaudible] times are about six to nine months. So, I think this is totally logical. But overall, very pleased about the growth in our service business, where we've actually been growing at a good rate in all geographic regions.

I then turn to our operating income, our EBIT. Here, again, very pleased that we continued our profitable growth, and improved our margins from 14.9 to 15.3%. And the driver of the good improvement in our margin was the positive development we have had in our services business, both maintenance and in modernisation. Here we're both growing at good rates, and be able to improve our margins through the work that we have done. It's clear that profitability in new equipment declined slightly, but remained at a good level, but that was because sales declined in new equipment. We also continued to have other areas that burdened our EBIT development, such as continued increase in investments in research and development in IT, and also foreign exchange continues to be a clear headwind for the quarter – the headwind from foreign exchange is about 30 million. For the first nine months so far, the headwind from currencies is about 30 million. But overall, through good development and the actions we have taken, we have been able to continue our good profitable growth.

If you then turn to our sales split, as a natural consequence of the fact that our services business has been growing faster; and new equipment business, their share of sales also increased, and particularly in modernisation. That is a slightly more balanced, overall sales mix. If we look by area, that shows that North America is increasing share as that's the fastest growing area in terms of sales at the moment. China represented about 30% of our total sales in the quarter – a little bit over 30% of the sales in this quarter. A little about our financials, and you can see that we had a good performance, and I'm pleased about the achievements.

Let me then next go to how we develop our business, [inaudible] again some highlights from our development programmes, after which I will go into more detail into our markets, as well as our outlook. But starting with our development progress, as I believe it's familiar to all of you, we are now in the third of year of the current set of development programmes, and these are coming to the end at the end of this year. We have had a lot of good achievements, and we continue naturally to drive them with good momentum towards the end. I've two highlights here. In Q3, as usual, we have completed our annual customer quality[?] survey, where we got feedback from more than 30,000 customers from around the world. The results remained at a high level. But perhaps the most important development is that we had a good development in our services business, and that's really thanks to this structured approach we have had to drive actions based on feedback we had from customers and improved customer communications. These are very important to our services business, and we're very encouraged that what we do we can see the results and that's why we are continuing to drive forward those actions.

The other highlight I wanted to bring up here is our most competitive People Flow solutions, development programme here. I'm very pleased to say that we have a very good momentum in the adoption of our key high rise technologies; really technologies where we deliver very unique value to our customers, and where we have very strong differentiation. Our UltraRope hoisting technology has good momentum, and it has been ordered to some very prestigious buildings around the world, and we have a good vendor pipeline for it. Our JumpLift construction time[?] elevator has great momentum. This is really a unique solution that KONE provides; how we help our customers speed up construction work, make it safer and better. We have a number of great customer testimonials, and usually when customers start using this, they realise that the productivity they get out of the construction for high-rise building is very, very strong. And we can see that great development for that solution. And also, I would say virtually all of the commercial buildings where we are delivering the solutions to our customer, we also have a People Flow intelligence to make People Flow in the building smoother, better, and with a better experience for the users and better monitoring for the building owner. So overall, good momentum in each of these. And also, a very nice accolade we had during the quarter is the *Forbes Magazine* every year release their 100 Most Innovative Companies in the World; we were sixth year running on this list as the only company in our industry and we were ranked number 56. So this is of course a nice encouragement and recognition for all the work we have done. Naturally, the way we measure the success of our innovation is how our customers view it and the adoption and the added value we can provide to them. So it is of course a nice encouragement to all of our teams for the good work they have done. So that was about our development programmes.

If I then turn to markets, because so far it's been about how we developed, but now let's talk about markets in more detail. And let's talk about new equipment markets, and I'll take them in the size order of the markets, and start with Asia Pacific. Now in the quarter, we did see that New Equipment Markets, in Asian Pacific, stabilised. And the reason for that is that the decline in the China market moderated in the quarter. So, it declined only slightly now in the quarter, although price competition did remain intense in the Chinese market. The rest of Asia Pacific, slight growth and [inaudible] growth in India. Then, if we look at Southeast Asia, as a market, pretty stable but mixed. And Australia, slightly declined from a high level. As you know, Australia has been developing very positively already for many years. So it remains strong, but came slightly down from a high level. I'll come, at the end of this, again a little bit back in more detail to China. Europe, the Middle East, and Africa and we saw some growth in South Europe; that's positive. As we have predicted, the market is recovering; not fast, but it is going in the right direction. However, Central North Europe now in the quarter was a slight decline. We continue to see good momentum and potential in the market. However, if we compare to the quarter last year, there was quite a lot of activity in the third quarter last year. And then on top of that, Brexit also had an impact on the market. So, we saw a slight decline, although we think that many markets there's good momentum, particularly Germany is developing nicely, as are many of the Nordic countries. Middle East brought a stable[?], despite the uncertainty in many parts of the region. North America, as you know, we are in the seventh growth year for the market, so it's at a good level, and it continues to grow slightly from there. Also this has made – the pricing in the market has continued to improve slightly. So, overall, we can see a mixed environment for new equipment.

Let me again – let me pause here and talk slightly more detail about China. As I mentioned already in Q3, the market declined now slightly. The decline moderated somewhat compared to the first half of the year. Year to date, our estimate is the market has declined at about 5%. However, if we look at the monetary value in the market, that has declined significantly more, both as a result of price competition and also what I mentioned, customer preference going more to value – to affordable products. So therefore, we can see a clear impact on this. Price competition has continued to be intense, I would say trends pretty much the same as we have seen earlier in the year. As I already talked, what I'm pleased about is that in this quarter, both in [inaudible] units and monetary value, we did outperform the market, but in units we were [inaudible] up at close to 5% then in monetary value, our decline was high-single digits.

Now, what has been happening in the Chinese market? We of course all see that the market for real estate, for residential real estate, has been very active. Prices have gone up a lot. That is particular in a limited of the higher-tier cities, where momentum, from a property market perspective, is very strong. However, as we know, lower tier cities continue to be an excess supply, which is putting a limit on the development there. But if we look at still the real estate investments, they're growing only slightly, and one can question that, why is the market not growing faster given the very positive momentum and the strong market for residential apartments in particular? And we have two situations here. I think we all understand why lower tier cities are not developing better, because the inventor[?] is there. Although they're coming down, they remain at the level where there is still room to be worked on, and therefore of course developers are cautious in starting much new in these areas. If you then look at the higher tier cities, what is restricting developers from accelerating the development and meeting more of this demand are very high land prices. So that is putting a limit on the development potential in the higher tier cities. So we have these two areas that are impacting, and we can also see that in – particularly tier one cities, there has been a lot of restrictions imposed by the government to cool down the markets overall in these cities. And we see that growth has spread more tier two and tier three cities in the vicinity of tier one. So, markets continue to be challenging, particularly the residential side, which is the segment that is declining. As you know, our approach continues to be that we are no maximising market share. What we want to do is find a good balance between pricing and volume to have good development. And I think as we've shown, we've done this so far this year.

If we look at the markets, what you see from our outlook is that we have slightly changed the outlook for the Chinese market for this year. Earlier, we expected a market to decline between 5 and 10%. Now we expect that the market will decline at about 5% for the full year. This is because this moderation or decline started perhaps a little bit earlier than we had expected, and also the year to date decline is about 5%, so we expect similar level for the full year. So that is again a little bit more in detail on China.

And let's then go back to our markets and go back to our service market. And I'll start with maintenance. Start with largest markets in Europe, Middle East, and Africa. Here, markets continue to grow, although clear difference market to market and price competition continues to be intense. Similar situation in North America, some growth and price competition rather intense personal[?] plus[?] intense as in Europe. And Asia Pacific here development continues to be positive throughout the region because of high new equipment deliveries over the past years. In modernisation, markets grew somewhat in Central North Europe, and South Europe here we also have positive news in that we're starting to see early signs of recovery in many South European markets. That's good, after many years of decline. So that is definitely positive news. And most North America and Asia Pacific markets are at good levels and growing slightly.

Let's wrap up with our outlook. New equipment markets, here Asia Pacific as I mentioned, China is expected to decline at approximately 5% in units ordered. However, competition is expected to continue to be tense[?]. And rest of Asia specific, some growth. Europe, Middle East and Africa – grows slightly in Europe and stable in the Middle East, and North America continues the same development we've seen so far. So, slight growth from a good level. And maintenance, very much the same trends we've seen so far with overall growth, but it differs country to country with the best growth of course in Asia Pacific. And in modernisation, also pretty much the same trends we've seen so far; growth slightly in Europe and continues to grow in both North America and Asia Pacific. And in this is environment, what do we expect from KONE? Here we can say that our outlook, we have specified it. We have now nine months behind us, so we can make a little bit tighter range. We expect our sales to be in between 3-5% growth in comparable currencies. Previously, we expected there to be between 2 and 6%. So, we can see we've just narrowed the range. In EBIT, we expect our EBIT to be in the range of 1 billion 260 million to 1 billion 320 million, assuming the translation exchange rates remain at the level of January to September. If they remain on that average level, then the headwind from currencies for this year is about €45 million. So a little bit more headwind that we saw when we gave our guidance in Q2, and previously we had 1 billion 250 million to 1 billion 330 million. Also here, despite the fact that we had a little bit more currency headwind, we have tightened the range a bit.

And then just to wrap up highlights of this quarter. I'm very pleased about the orders received growth, because the good development we have had on a broad basis. Also, strong development in EBIT driven by the positive development we have had in our service business. And we can see that, even in difficult environments, we have been able to find good opportunities to develop KONE going forward.

So with that, we have time for questions.

Sanna Kaje: Thank you, Henrik. Yes, now it's time for your questions. And please, let's take one question at a time. Do we have any from the audience? I guess not. Most of the people are following us over the telephone lines, so Moderator, I'll hand over to you.

Moderator: Of course. There are a number of questions in the queue currently. And as a reminder, it's *1 to ask a question.

We'll now take our first question from Ben Maslen of Morgan Stanley. Please, go ahead.

Ben Maslen: Yeah, thank you. Good afternoon, Henrik. A couple from me, please. Firstly, just on China. You've raised your – you've nudged up your guidance for this year, but I think at the Capital Markets Day you gave a preliminary view on 2017 that the market would be down, but down less than this year. I was just wonder whether that view on 2017 had changed at all given your tweak to the 2016 guidance, firstly. Thank you.

Henrik Ehrnrooth: So, in the Capital Markets Day, we said this that when we approach going into 2017, we expect that the decline will moderate. And as we've seen now already, we haven't given an outlook for all of 2017, as only – as we go into the year. And that's a trend we are seeing now, perhaps start a bit earlier than we had expected, but no, nothing new to report on view for next year.

Ben Maslen: Thank you. And secondly, you mentioned that you need to step up your investment in R&D or – and IT going forward. I just wondered whether you'd already started increasing that spending or we see that headwind coming more through next year?

Henrik Ehrnrooth: If you look at our report, you can see that R&D expenditure is up compared to sales 0.2 percentage points for the third quarter now compared – actually is today compared to last year. So we are – [inaudible] we can have a step change and it's particularly in the services side, perhaps, where investments are increasing more.

Ben Maslen: Got it. Thank you. And then, just looking at, you know, the dynamics in China. I mean, pricing sounds tough, just looking at your commentary, it looks like price mix was weaker in Q3 than it was in Q2. And you talk about slightly weaker pricing in the back log, which I guess is coming from China. You know, given steel's going up in China, wages are going up, I mean, how confident are you that you can maintain the current level of margins there? And I guess, the only way you can do that is with productivity. How much can you keep squeezing out productivity and offsetting what is, you know a tougher market? Thank you.

Henrik Ehrnrooth: Yep. You know, just to give you a perspective on this, as you know over the past couple of years we have had a very positive development in our overall competitiveness, productivity, and cost competiveness in overall, in China and elsewhere as well, but in particular in China. And, with that, we have been probably a little bit ahead of the curve of how prices have declined, and of course, one of the – but only one of the areas of help that has been declining raw material prices, so clearly you know we continue with our actions, we believe that there's continuous work that we can do. But raw materials, it's clear that they are – the trends currently for them are increasing. So that, as we now look, is likely to be a headwind. So, we have to see how we are able to continue this, but you know so far this year we have had a good momentum. And perhaps the raw materials that's a change in trend that we're looking into next year.

Ben Maslen: Thanks, I'll get back in the queue. Thanks Henrik.

Henrik Ehrnrooth: Thank you.

Moderator: We'll now take our next question from Klas Bergelind of Citi. Please, go ahead.

Klas Bergelind: Yes, hi Henrik. It's Klas from Citi. I was late on the call, so apologies if you have already provided answers for my question. Also want to get back to the price mix. The price mix last quarter was minus 10. I was wondering if it was similar this quarter. And then, back then you said pricing minus 5, and [inaudible] minus 5. Was [inaudible] the similar relationship this time [inaudible]?

Henrik Ehrnrooth: I would say very much similar trends, yes. I mean, of course, these are rough numbers. You know, we're not talking about the exact, but yes. Direction both are similar to what we saw in Q2.

Klas Bergelind: Okay. Then, we got some conflicting messages from your peers yesterday, with Schindler[?] saying that pricing is worsening and could land at 10% negative towards the end of the year, while [inaudible] said that pricing is now more stable. This obviously depends on each company's previous price levels, the comparative, and all the exposures to tier one through to tier three. If we focus on your net[?], can we talk a little bit about what you think about pricing going into the second half?

Henrik Ehrnrooth: You know, as always, we don't comment on pricing going forward. I mean, each pricing decision is a negotiation between us and our customers. We can look at what history has been. What we can see is that the competition in the markets remains intense, and we have this trend which we were talking about which continue. But pricing, we have to see how that evolves. You know, that's something we can comment once something outcome. But again, that's a – something we have with our customers in negotiation, each one separately.

Klas Bergelind: Yeah I know absolutely. Then, back to mix. You said lower is the [inaudible] down the[?] mix. Can you help us understand where you see customers trading down? If this is the result of mix between [inaudible] that you have lower demand in tier three/four which is weighing on the [inaudible], or do you also see customers trading down into tier one and tier two?

Henrik Ehrnrooth: It's not only in some cities. It's – I would say that because some high land prices and other cost increases in the development offers, they are looking at all options to find savings there as well. Also, there are a lot of good products in the lower categories. It's not that they are worse elevators or escalators, but strictly from the elevator side, we're talking about a more standardised product where you have less options when it comes to speeds and sizes and interiors and so forth. So, it's just that you're going to a more standardised range, and therefore it's more affordable. That is what we're talking about.

Klas Bergelind: Thank you.

Moderator: We will now take our next question from Andre Kukhnin of Credit Suisse. Please, go ahead.

Andre Kukhnin: Yes, good afternoon, and thanks very much for taking my questions. Just a couple, firstly in terms of your view of profitability on those low-end products, would you say it's different to high end?

Henrik Ehrnrooth: [Inaudible] as we discussed before, the good thing – the situation we have is that our foreign competitiveness is good on a broad basis. But, it's clearly to sell a more valued product, even if you have good percentage margin on that. The monetary value of your profit is going to be less. That's just a mathematical difference. Yes, we have good profitability also on more affordable products.

Andre Kukhnin: Great, yeah, sorry that was about margins rather than the absolute size of profit. Then, quite interesting to see your top line in China already declining at 10%, because [inaudible] just a little bit longer that you'll see it in Q4, beginning of 2017. The balance of volume verses price mix within that 10% decline is it comparable to what you're booking right now, what you been booking say in the last six months? Do you expect it to change substantially? And the reason I'm asking is that I think the message has been quite consistent so the prices were reduced at the beginning of the year by everyone, and that's sort of been the same trend. But, when we tried to run some kind of average selling price calculations, or change in value of your quarters in China ex FX, it seems to have quite a clear trend of first, worse volumes but better ASB[?] and now best of volumes, lower ASB and just trying to understand whether that's something that we should be actually focusing on and whether what you're seeing in your sales right now is representative of what you will see in six months' time.

Henrik Ehrnrooth: Yes, I would say this mix shift has probably something that started more you know Q2/Q3 this year. So perhaps that mix is still coming through look[?] at ASB on sales going forward. So, yes, of course a gradual shift is not going to happen overnight. In – this environment continues to have solid deliveries and I think that it's naturally that when the orders declined earlier in the year, we now start to see that in sales.

Andre Kukhnin: Right. And, just very last one if I may. Henrik, the beginning of the year was quite clear a message on China that, look, you're the biggest player now. You're not going to participate in price wars. You're not maximising market share. And we look for the mix of profitability and growth. And you said in this presentation as well, is this message absolutely firm right here right now as it was nine months ago?

Henrik Ehrnrooth: You're probably referring to the fact that now we grew faster than the market. You know, we have to remember that one quarter is a very short period of time to measure. You're going to have fluctuations from quarter to quarter. If we look at year to date, our development is probably roughly in line with the market. So, I think that the message is definitely still intact.

Andre Kukhnin: Got it. Thank you very much.

Henrik Ehrnrooth: Thank you.

Moderator: We will now take our next question from James Moore of Redburn. Please go ahead.

James Moore: Yes. Hi everyone. I've got some questions on China. I wondered if you could help us a little bit more on this price mix. I think you said units down 5 for you, and value – sorry, units up 5 and your value down high single digits. Does that mean that we're talking about a price mix that's sort of 12,13,14% so, a bit above what you saw last quarter? And I wonder if you could help us by splitting that? Is price a mix about half/half, or has there been a bit of a shift around?

Henrik Ehrnrooth: So, volume growth was at close to 5%. So, probably a bit less than that, then. And then high single digits. So we're still looking at roughly five and five. And the [inaudible] again, as we discussed in the previous quarter, it's not exactly, but that's roughly what we're talking about. That has remained reason – pretty much the same as it was in Q2.

James Moore: Thanks. And the service margin. You talked about that being up today and driving the better group margin. Can you say if the equipment margin is flat year on year or up year on year or down year on year on a global basis?

Henrik Ehrnrooth: Margin in new equipment continues to be good, but when your volumes are down, also there – you know, your absolute profits are down. So, the main improvement in profitability clearly came from services. And then we have to remember in the new equipmen, China was the one where actually the decline was coming from. That, as you know, is where we have higher margins than in other parts of new equipment business.

James Moore: So, is the percentage margin down in equipment globally?

Henrik Ehrnrooth: As a result of that, global basis will be slightly down, yes.

James Moore: Alright. And finally, I wonder if you could help us a little bit with the Chinese equipment margin today. I know you don't give it. A number of your peers have. And I think in 2014, you talked about it being broadly in line with the group, and I think you helpfully said in 2015 that it had gone up from that. And I guess that revenues are still rising or about to turn, but still rising this year in China. And is it fair to say that the Chinese margin has gone up again, and might we dare to think of it as high as 20% yet? I'm thinking about a starting point to try and model the challenges that may come.

Henrik Ehrnrooth: Okay. So, revenues for China for the third quarter were down, in total about – close to about 10%. But margins are good, so we have – if you look over the past years, back to 2015, we improved our margins significantly each year. So that has of course been important driver for our profitability. And if we have good margins in China – and now sales in the quarter in China, they've declined.

James Moore: And can you help us at all with the starting point verses the group, or is that difficult?

Henrik Ehrnrooth: It is about the group, yes.

James Moore: Okay. Thank you very much.

Henrik Ehrnrooth: Thank you.

Moderator: We will now take our next question from Lars Brorson of Barclays. Please, go ahead.

Lars Brorson: Hi Henrik. Just two questions from me, please. Just on the outlook for China and the slightly better than earlier expected, can you say by segment where that is coming? Is infrastructure proving to be stronger than you previously expected? You obviously announced a very large order yesterday in China; one of the biggest ever for you in that market. Or are you seeing something different in residential or commercial that's proving a little bit better? And as you look into 2017, I wonder whether you can give us a sense for whether you see some risk, particularly around tier one and two [inaudible] on the back of cooling measures we see coming through now.

Henrik Ehrnrooth: As you know, the residential market is clearly the largest market. Infrastructure's important, but it's quite a small part that segment – small part of the overall market. So that has continued to develop well because of stimulus measures. Also commercial more or less stable. So, I guess it is always the residential market where that, you know, drives quite a lot of the bigger movements. So perhaps they are a slightly better impact. And you're right, they have enacted cooling measures on some of the higher tier cities and we have to see how much that spreads and what the impacts are. But if you look at the transaction volumes and the prices are of course very strong. So if you look over a longer period of time, a healthy thing to cool down the situation a bit.

Lars Brorson: Thanks. Just secondly, a minor question perhaps, on your minorities line, is there any loss? Is there a special chart coming through or is KONE – GiantKONE in an underlying loss[?] rate[?]? Is there anything else in[?] your minority line that I'm missing?

Henrik Ehrnrooth: Ilkka, you want to take that?

Ilkka Hara: Yeah, sure, thank you. Yes, that's actually correct. So, the major driver of that is the closure of our acquisition of GiantKONE. And as said, so once that is done, actually we've seen less volatility going forward.

Lars Brorson: So sorry, just to be clear, so that's a charge, is it? Or is there an underlying loss in GiantKONE?

Ilkka Hara: No, it's an adjustment last week close transaction on what we had for the year, so yes, nothing material there.

Henrik Ehrnrooth: GiantKONE continues to have a good profitability.

Lars Brorson: That's what I thought. Thanks.

Henrik Ehrnrooth: Great, thanks.

Moderator: We will now take our next question from Manu Rimpelä of Nordea. Please go ahead.

Manu Rimpelä: Good afternoon. Can you firstly help me to understand the margin in the third quarter, it was very good, and you said in the second quarter that – I think you used a word like all the stars are aligned or it was a very strong performance. So, just wondering if that continued into Q3 as well. So, I mean are you being kind of able to run the whole engine in a lot better base now compared to previously, or is that the kind of board[?] that we're starting to see that service growth is picking up and that's driving the margin improvement more than what you're losing in equipment at the moment?

Henrik Ehrnrooth: I would say that we have been – each year, we have been able to improve our productivity and that continues. What I'm happy about – and that doesn't always happen. Where we were in Q2 and now in Q3, the performance was broad based for many different business and regions. So, we had good execution and a broad basis. And good execution means that you constantly, in this environment – I mean, you constantly to improve your productivity, you need to improve the value you provide to your customers to develop your pricing and so forth. So, all that has continued.

Manu Rimpelä: Okay. And then, one question on China from me as well. You are commenting about the weaker margins and order intake, so just trying to understand what has changed, because you didn't have that commented in Q2. So, what has changed between Q2 and Q3 to mean that the margins have become weaker?

Henrik Ehrnrooth: You have to remember that the margins you booked, that's an estimated margin that you have of what to deliver when you finish the project. And, you know because of the very good momentum we have had in our competitiveness and cost that we have driving in China, we have been able to be a little bit ahead of the curve, you can say, of price declines. Now perhaps they are – we can start see some headwinds in raw materials and others. You know, it's easier to be ahead of the curve and this is probably where the change is coming. We still continue to see a lot of opportunities, and we think we can improve our competitiveness. But then there are some things have been external tailwinds are now turning into sort of a headwind.

Manu Rimpelä: Okay. And then a final question in terms of pricing outside of China. So I mean, are we starting to see prices [inaudible] in North American services improving? I think you mentioned that the pricing has improved in North America [inaudible] related to new equipment or for services or both.

Henrik Ehrnrooth: In new equipment, we have been able to improve our pricing in North America. Services continues to be very competitive there, perhaps not quite as competitive as European market, particularly on new equipment, where the improvements have been seen. And you know, in Europe, in the stronger markets, you know we’ve been able to improve particularly where it relates to you know to compensate for costs of new codes and so forth.

Manu Rimpelä: Okay. And would you classify everything global excluding China about the pricing environment both in new equipment and services that we’re kind of starting to interface where you would actually be able to gain some pricing power again after years of not having so much?

Henrik Ehrnrooth: Well, we have to see. I mean, that all depends on how well we can deliver value to our customers because if we looked at the world economy as a whole, we all know that it’s quite fragile. I don’t think that the external environment will provide a lot of help to that. So, it all depends on how we can drive forward and provide better value to our customers.

Manu Rimpelä: Okay, thank you.

Moderator: We will now take our next question from Martin Flueckiger of Kepler Cheuvreux. Please, go ahead.

Martin Flueckiger: Yeah, good afternoon, gentlemen. Martin Flueckiger from Kepler Cheuvreux, thanks for taking my questions. Actually, a few of them have already been answered, but, so let me just stick to the ones that remain. Coming back to your statements on the market, the new equipment market in China. I just wanted to clarify, when you talk about markets generally, not just for China, but for all regions, do you talk about the relevant markets for KONE or do you talk about the entire market? That will be my first question.

Henrik Ehrnrooth: As we are not presenting, for example, South Korea and Japan, we don't talk about those. We talk about the markets where we are present. That's where we have an insight and understand what's happening in them.

Martin Flueckiger: Thanks. I understand that, but, you know, just within China – because the reason where I'm coming from is also some conflicting statements made by some of your competitors recently, compared to the ones that you've made in your Q3 reports today. I was just wondering, you know where the difference in assessment between the various peers comes from; whether it's the geographic positioning, whether it's the market segment positioning. What's, you know – again, is it the entire market presence[?] in China that you're looking at when you talk about market declines or increases, or is it just the market relevant to you?

Henrik Ehrnrooth: As you know, given the – I don't think anyone has as a broad of a footprint and broad presence in China as we do. Yes, we look at the whole market. And, you know, there's always going to be some differences between what we say and someone else says. We have to remember that market growth figure is not an absolute science. It's based on what we see and our judgement. I don't think that there are massive differences, but our approach in China is to understand the whole market because that's where we think that – that's the area of the market that we want to cover.

Martin Flueckiger: Okay, thanks. Understood. And then my second question would be on – I'm not sure whether that GiantKONE question previously that was asked, referred to the same item. I was looking at your minority interest, which is negative this year – this quarter. What was the impact there, sorry?

Ilkka Hara: Again, confirming what I said earlier, so. It's an adjustment due to the acquisition of the remaining stake in GiantKONE. So, it's not to do with the profitability of GiantKONE as such.

Martin Flueckiger: Understood. Thank you very much.

Moderator: We will now take our next question from Ryan Gregory of Liberum. Please, go ahead.

Ryan Gregory: Yes, good afternoon. Thanks for taking my question. It's just one on cash flow. In the quarter, your EBIT was up 2%, but your operating cash was down 7%, and we saw similar development in Q2 as well. So, I was just wondering, could you provide a bit more colour on your working capital? I see the cash flow from working capital this quarter was 40 million, which is about half what you've had historically in your third quarters. Is that just a function of the China order declines we've seen, given the favourable payment terms there, or is there something else going on? Thanks.

Henrik Ehrnrooth: You want to cover that?

Ilkka Hara: Yes. Certainly. So, I think overall, we were very happy with the cash flow, as such. So, 1.1 billion in the nine months this year is a good achievement as such. And naturally, there's many components that we work on, so. So we have a – outside of China, but China included as well, a good balance between advanced payment[?] and inventory. And in this typical environment, I'm quite happy with how we've performed on that one. And then, thirdly I think also to highlight that our receivable collection has progressed well, and we've seen progress across the globe, but especially in Southern Europe in general in that respect. So, all in all, I think a good progress there, given the circumstances.

Ryan Gregory: Okay. But have you seen any negative impact from China, since advanced payments?

Ilkka Hara: We haven't seen a change in payment terms as such. So, basically[?] that's part of a negotiation with the customers. And, obviously, any change in sales in China will have an impact there. But overall, it hasn't had a major change to the overall situation.

Ryan Gregory: Okay, great. Thank you.

Henrik Ehrnrooth: Ryan, perhaps the only addition I would have to offer – Ilkka said is, you know, you said if we continue to improve our working capital – and remember that working capital is negative to the tune of 1 billion, so continues to improve working capital and have better cash conversion than EBIT, I think that's a continuous very strong achievement.

Ryan Gregory: Yeah, sure.

Moderator: We will now take our next question from Andre Kukhnin of Credit Suisse. Please, go ahead.

Andre Kukhnin: Oh hi, yes, thanks so much for taking the follow-up. I just wanted to ask a more broader question about service looking to 2017. We kind of go across geographies and across maintenance verses modernisation. Should we think of any reason why growth should slow down in those end markets? When we try to add up, kind of install[?] base additions and try to run kind of service model, it looks, if anything, we should be accelerating. And on modernisation, it's harder to track, but you seem to be very firm on that than market and some of your peers are very bullish. Any kind of broader thoughts on that looking to 2017 without obviously an official outlook would be much appreciated.

Henrik Ehrnrooth: If we look at – just a bit more of a comment in general on next year. Our services which we have now been compounding that around 6% for the past two years, and for services like this, I would consider that day a strong number. And, of course, what's helped there has been good growth in deliveries in Asia Pacific. So that's – and we have a lot of new units coming into services. So, I believe that we have – our ambition continues to drive good growth there, so nothing has changed on that side. But remember of course the bigger the base gets, of course we need to have even more growth the following year to get to the same percentage number. That is just simple maths. But the key point is our ambition level continues to be high and compounded at a good rate.

Andre Kukhnin: Okay, got it. Thank you. And just to double check on the increased level of investment that you highlighted at the Capital Markets Day – the 20 plus 20 basis points – of which base is that, given that you are already ramping it up as you highlighted and there's already 20bps improving and increase in R&D sales year to date in 2016?

Henrik Ehrnrooth: Probably if you look at this on a rolling basis from now on, it is not [inaudible] you know each quarter that much, but that's kind of the trend. And, you know, it can fluctuate from quarter to quarter, but we can see that this year it's increased quite a lot. We're going to see increase next year as well. So, if you look at a rolling basis from now on for the next year or so.

Andre Kukhnin: Got it. Thanks very much.

Henrik Ehrnrooth: Thank you.

Moderator: We will now take our next question from Michael Calgaras[?] of Bank of America. Please go ahead.

Michael Calgaras[?]: Yeah, hi. Good afternoon. Question, I just want to put the you know, your comment on lower growth margin into context. I think in the past you were referencing you know on your pricing pressure. You were able to offset that by you know your cost competitiveness. Basically, supplier and raw materials, each of them being maybe you know one third, one third, one third. I mean, going forward I guess, raw materials I mean the rumour[?] probably disappeared, do you think that you know the pressure you can put on your suppliers in a government where raw materials are you know stabilising are going to be – I mean, are you still able to do that?

Henrik Ehrnrooth: I would say, as you've seen from how we developed, we have been able to work very successfully together with our suppliers. [Inaudible] with them, making sure that we can have sustainable business with them and therefore develop the solution and look at how we do things and what materials and what designs we use and so forth. That will definitely continue. However, as I said earlier, added benefit to that.

The main improvement has been through the actions we've taken. So that's important. And that's – will be continued. But the added benefit to that has been in raw materials that have been declining now for you know for a few years, and providing a good tailwind. Now, if we look at steel prices, they're up actually quite significantly. And therefore that's going to turn from tailwind to headwind. And you know the work with our suppliers that continues but this is something that – as external factors are more difficult to impact.

Michael Calgaras: Okay, so, basically if we assume, you know, pricing is going down maybe 5%, maybe those couple of percentages that you can't pass through and that is basically the difference in margin in your orders at the moment.

Henrik Ehrnrooth: You know, I would say that when we talk about orders to save margin, remember, that is the estimate of what we have today. And the real margin is what we deliver eventually to our customers when everything is delivered and we have done everything and – so we have to see. But, at the moment, it looks like we are slightly down. I wouldn't quantify it now.

Michael Calgaras: Okay, thank you. Then maybe just a follow-up and taking a bit of a longer term perspective on pricing in China. If, you know, I guess you've had other countries which went through that phase of being not very mature. So nice margins on the year end, and you know maturing, getting a bigger services space with the OE margin probably mostly going down a little bit. How should we think about pricing in China medium term and not just talking about the next few quarters? But is it a market that basically you're going to see 5% or so pricing pressure for the next 10-15 years, or should we think of it differently?

Henrik Ehrnrooth: Again, I can't make comments on pricing going forward. That we have to see. What is good is that the services business has continued to grow at a good rate. And, if you look a few years forward, it's clear that the bigger share of the pie of profitability for the industry as a whole, and I believe for us as well, will come from services [inaudible]. So, clearly, you have a gradual shift. But, how that will happen, we have to see.

Michael Calgaras: And last one, Henrik, on you know the investment in the R&D and IT, so we get a 20bps increase for those[?], then how should we think on an absolute level as you roll out the kind of initiatives that are supported by those investments? Are these investments going on? Do we need to do more investments as you go into more countries? Or is it kind of like one-off investments? You do these, you go back to previous level of R&D, IT, or they stay stable? How should we think of it beyond 2017 maybe?

Henrik Ehrnrooth: It's clear that we have – there's a lot of new technology happening in the market and all this helps us to serve our customers even better and provide better value to them. So I think that this is a trend that when technology is moving fast and shifting quite a lot. So I think we are in a certain period of time – we are now in a structurally higher investment environment. However, as I mentioned also in the Capital Markets Day, the results we have from some of the increased investments we've done, for example in the services side, are very encouraging. So, we believe that there is a payback, but of course you know investments come first; and then the payback comes later. But I believe that as technology continues to move, that there's probably structurally slightly higher level we need to see over the coming years. But again, we are very excited at what this can provide us in terms of providing value to our customers and also improving productivity in our business.

Michael Calgaras: I think, I mean, everyone will agree saying that you know your capital allocation – I mean is already very good. So basically, I mean, the way you think about these extra investments at the moment is basically this will allow you to remain above 5% you know for maintenance and services growth for another – many years after the [inaudible] cycle in China, comes to, basically [inaudible], have you thought about that?

Henrik Ehrnrooth: Clearly, we are making this investment to continue our good growth, whatever that growth rate is. But yes – why we are doing this is to differentiate from the market overall. We want to provide the best value to our customers. And we do that – we see great growth opportunities in this industry. We see a lot of good growth opportunity in services. Remember, it's a very fragmented market and with good, organic growth in particularly in the Asian part of the world. So, that's what we're investing in, because we see there's good opportunities there.

Michael Calgaras: Understood. Thanks very much.

Henrik Ehrnrooth: Thank you.

Moderator: We will now take our next question from Glen Liddy of JP Morgan. Please go ahead.

Glen Liddy: Good afternoon. If you looked at the revenue for Europe or the US in terms of an OE cost relative to the aftermarket value over a period of ten years, how does that compare in Europe, the US, and China?

Henrik Ehrnrooth: You know, in US, products are more expensive in Europe because you have a higher labour cost there; and there tend to be larger and bigger equipment. But also service prices are higher. So, I try to look at what is the relative new equipment to service price. I don’t think that there’s going to be probably massive differences between the regions. So, you know, in China, yes, equipment are cheaper, partly because labour cost, partly because volumes and so forth. But also service prices are higher so I can look at what is the relative- the new equipment, the service price, I don’t think there’s going to be a massive difference between the two- between the regions. So, in China our equipment is cheaper partly because labour costs [inaudible] volumes so, but also services are much cheaper than the rest of the world. So it’s a racial difference, I can’t really- I don’t think there’s going to be a huge difference.

Speaker: And is the Chinese aftermarket profitability improving yet or are you still investing a lot so it’s not improving in its profitability?

Henrik Ehrnrooth: Well what I would say about the Chinese service business is it has a good profitability.

Speaker: Okay. And regulatory change in China, have you got a view on when that might happen to trigger a big wave of aftermarket opportunity?

Henrik Ehrnrooth: Yeah we’ve had some regulations over the past year mainly related to installation and mainly related to bigger repairs. They have no significantly changed market, now you have in some areas you have some specific service regulations. We have to see how that changes, but if we look over the years we can see that we [inaudible] little bit bigger share of the service market. It’s not a huge shift but it’s going and remember Will Johnson[?] showed that in his capital market presentation mainly that trend will continue and more demands of our services- equipment will start aging. Also the larger EMs[?] can show the value from utilizing new technology. I believe that you will start to see a gradual consolidation of the industry.

Speaker: And finally on China, I mean, direct sales rather than hire a third party, is that resulting in different pricing environment? Are you in more control of your prices if you're doing it direct rather than through a third party?

Henrik Ehrnrooth: It's a little bit different model, so you have different models in China but there is not a significant difference.

Speaker: Okay. Thanks very much.

Henrik Ehrnrooth: Thank you.

Moderator: We will now take our next question from Tommy Reilu[?] of SEP. Please go ahead.

Speaker: Hello, can you hear me?

Henrik Ehrnrooth: Now we can hear you, yeah.

Speaker: Yes. Okay good, I apologize. Can you just also on China give a comment on the [inaudible] growth for the third quarter.

Henrik Ehrnrooth: So we continue to grow at a good rate. Year-to-date we are at 25% in the third quarter we're about 20% growth in China. So we continue to compile a good rate in China.

Speaker: Thank you.

Moderator: We will now take our next question from Ben Masslin[?] of Morgan Stanley. Please go ahead.

Speaker: Yes thank you, just a couple of follow-ups please. Henry[?], there's obviously a lot of focus on the line and the report that says that the relative margin of orders is slightly lower. We've not seen that before really so I just wonder what you meant by that? Do you mean that the margin is lower on a kind of like-for-like basis for this similar equipment or is it lower because the mix is different, you know maybe there's more new equipment in U.S. and Europe, less in China. Or is it a mix of that? As you say people are trading down in China, I'm just trying to understand is it a kind of- is it a commentary around a like-for-like basis or is it a mix of that that's making the margin come down? Thank you.

Henrik Ehrnrooth: So, this margin is particularly related to China there on a like-to like basis. Their margins are slightly lower and as you know they are- that's our highest margin, new equipment business and that is what has the impact.

Speaker: Got it, thank you. And then just following up on China, can you give it a sense maybe of what the kind of book-to-bill ratio is on your equipment on China or how your backlog is looking? Just so we can perhaps- you if revenue in China is down 10% already how much more of a decline will we have to process as we go into 2017? Any help with that would be appreciated, thank you.

Henrik Ehrnrooth: [Inaudible] our book-to-bill but it was [inaudible] for China. Now approximately in the third quarter I believe correctly it was 0.9, that's what I remember. It's around that. So you guys remember then also that third quarter is also seasonally something where you have more deliveries and less orders so I think that's not that unusual.

Speaker: Yeah, yeah. Okay. Got it. So, but then in terms of looking into next year you would still see- even if orders flatten out from here which I guess is what your guidance is implying for the market there's still a sales decline to process.

Henrik Ehrnrooth: Yeah I mean orders received decline at the beginning of the year. And the first half of the year [inaudible] monetary value declines and you know that the lead time is six to nine months usually so that is what you can draw your conclusions from.

Speaker: Thank you. And then just going back to your point, you know raw material costs and how they can change going forward. So you know your margin is an estimate of what you deliver now; it may change. If you were to take an elevator order in China now, ho0w much of the component cost is fixed at the point of order and how much is kind of variable that you will lock in at a point closer to delivery? Thank you.

Henrik Ehrnrooth: So because the volumes are so high you don't do them individually elevator by elevator but as you know what we try to do is that we try to lock in our prices on a periodic basis to smooth out any development. This year we have successfully been locking in our prices at favourable levels and we will see when those roll over what the impacts are but you wouldn't do it individually because you have so much equipment in the order book so you do it more rolling. But we know that locking in prices and hedging[?] you can [inaudible] a certain period of time but of course after a while it does- underlying comes through.

Speaker: Okay thank you.

Moderator: We will now take our next question from James Moore of Redburn. Please go ahead.

Speaker: Oh yes thanks. Henrik I’ve just got a couple of follow-ups on the non-Chinese business. So service pricing or maintenance pricing, I wondered if you could comment on pricing there in the U.S. and Europe and how that’s changing?

Henrik Ehrnrooth: I wouldn’t say any significant changes. As you know we talked about for a while is that the South European markets in particular- that’s where the most significant price competition has been. And given the fact that new equipment volumes have been in low for many years there that means that there’s not that much new equipment flowing into the market. That has made them quite competitive so not a big difference there. North American markets continue to be priced competitive but perhaps not quite as significant as we saw about a year back or so.

Speaker: That’s helpful, thanks. And just on the U.S. market I wonder if I could ask about the volume demand [inaudible]. You’ve had a good run for the last few years and I’m just thinking about the MRL share of the market, which has gone up a lot from 4% to 60-70 over time. I think it was asked, the capital market share, but could you just say what you thin- and how fast it keeps going up. Does it stay here or do we get a 95%, is it going to take a long time or could it keep running at the same sort of pace? And embedded in that question is also, I see that stocks for multi-family buildings- which I guess is where you have lifts- have come down quite a lot and your orders keep going up. I wonder whether you see some volume clouds on the horizon because of those multi-family start-ups.

Henrik Ehrnrooth: We have to remember that- let’s start with this question about machine [inaudible] elevator versus hydraulic [inaudible]. So it continues to shift more towards machinery and less- at what pace I can’t say but that’s definitely the trend. Because also if you look at buildings in the U.S. they are probably starting to gradually get a little bit higher and we can see that the average floors have gone up a little bit over the past years. So a hydraulic elevator usually is used in very low-rise buildings. So we think that this trend is going in our favour and you know a machine[?] elevator just provides better value over the life cycle for the owners and users.

Now how do we look at- we haven't given guidance for next year but you have to remember that U.S. markets- in particular the North America markets- there's quite a big commercial component. It's not as residential-driven as Europe, residential has been one of the growing segments and so far we've seen pretty good momentum there as well. But maybe you have had some slow down in some area but as said continued good momentum overall in the market that we addressed with machine[?].

Speaker: That's very helpful. Could I just trouble you[?] for- a rough mix of commercial versus residential U.S.?

Henrik Ehrnrooth: What would it be- it's not an exact number but you know commercial probably would still be more than half of the market. Whereas in Europe residential is clearly the largest.

Speaker: That's very helpful. Thank you very much.

Henrik Ehrnrooth: Thank you.

Moderator: Our final question comes from Martin [inaudible] of [inaudible]. Please go ahead.

Speaker: Yes, thanks for taking my follow up question. Just looking at your comparable base in the Q4- the Q4 in 2015 saw some pretty strong growth if I remember correctly. I think close to 11%. That looks like a tough [inaudible] going forward so I'm a little bit surprised that you're still looking or considering 5% is doable as you put it in your revenue guide going forward. Is there anything that we should be aware of in particular with regards to [inaudible] growth going into Q4 or how should we think about the dynamics going into the final three months of the year? Thank you very much.

Henrik Ehrnrooth: Nothing specific there. I would say a little light-heartedly that we have a tough comp[?] every quarter because we have now been growing our profits for 20 years in a row. So I don't think we've had a quarter where we'd have an easy comparison for it so I don't think that's anything new for us but nothing specific in Q4. We expect to have a good development towards the end of this year.

Speaker: Okay thanks.

Henrik Ehrnrooth: Thank you.

Moderator: I guess it is now time to close the event. Thank you Henrik.

Henrik Ehrnrooth: Thank you.

Moderator: And thank you all for your good questions. I wish you all a good rest of the week. Thanks.

Henrik Ehrnrooth: Thank you.