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Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Natalia Valtasaari

Head-Investor Relations, Kone Oyj

Good afternoon and welcome to KONE's second quarter earnings call. My name is Natalia Valtasaari, I'm KONE's Head of Investors, and I'm very pleased to be joined here today by our CEO, Henrik Ehrnrooth; and our CFO, Ilkka Hara. As usual, Henrik will take you through the business and financial highlights to start with. Ilkka will then go through the financials in a bit more detail, and Henrik will end the presentation by running through the guidance, both from a business perspective and a market perspective. We'll move to Q&A then. And I would ask you all to please limit yourselves to one question, one follow-up during the Q&A session to ensure that as many people as possible have the opportunity to ask their questions.

So with that Henrik, please.

Henrik Georg Fredrik Ehrnrooth

President & Chief Executive Officer, Kone Oyj

Thank you, Natalia, and a very warm welcome to everyone. Great to have you here today. And I'm also very happy that we have a lot of good news to share with you today. If I start with the highlight, really, one of the key highlights for the quarter was the very broad based growth we had in sales. We grew our sales strongly in all businesses and all geographic regions. That was really great. And also we had a strong profitability improvement that I'm very happy about.

We had another quarter yet again of excellent performance in services, both maintenance and modernization. Both of them had really, I would say, phenomenally strong sales growth in this quarter. And that is something I'm really, really happy about. New equipment orders, clearly, they are lower now as a result of challenging markets in both Europe, North America, as well as in China; although also some very positive opportunities in Asia.

During the quarter we implemented our new operating model. I am very happy of the strong performance that we had during time of organizational change. We are now really set up for better competitiveness speed through even better local accountability in our organization. The objectives that we set for ourselves there on competitiveness, improving speed and decision-making closer to customers, as well as profitability through cost savings, we are on track to achieve all of those.

So, those are the highlights, and let's start then with the key figures of Q2. As I mentioned already, really highlight was about very strong sales growth and a great improvement in our profitability. Our orders received a bit shy of €2.3 billion, a decline of 8.1% in comparable currencies. It's clear that our new equipment business did decline. At the same time, we had continued good development in modernization, and also I would highlight the great development we had in Asia-Pacific outside of China.

What is great is that our order book continues to be at a very solid level, over €9 billion. A year ago, it hit an all-time high of €10 billion. We are now in comparable currencies, €2.9 billion below that. So, good level. So actually we have had a positive book to bill if we look at last 12 months. Sales is €2.8 billion and 11% up and 16% up in comparable currencies. As I mentioned here, really, the highlights where the phenomenal strong growth in modernization of almost 25% and 9.8% in our maintenance business, which is really, really strong.

Operating income improved by about 50% to €283 million. And our adjusted EBIT improved by 59% to €332 million, and a margin from 8.2% to 11.7%. So we are really on track with our objective of improving our margins and that is, of course, positive. And our cash flow, €306 million compared to €167 million a year ago. But as we always say, six months is a short – sorry three months is a short period of time. Now, we have full six months behind us, so we have a little bit more perspective on our performance.

And if we look at the first six months of the year, very much similar trends to what we saw for the second quarter. So, orders received, €4.5 billion, down 6.6%. Sales, strong growth, to almost €5.4 billion, which is 11% growth. And also adjusted EBIT grown from €406 million to €574 million and adjusted EBIT margin up from 8.1% to 10.6%. So, 2.5 percentage points. So, very good margin improvement.

Also, if we look at a six-month basis, cash flow, a good €762 million. So really good cash conversion also for the first six months. And earnings per share from €0.51 to €0.79. So, I would say, our numbers I think are strong for the first six months of the year.

As I mentioned already, we have in the past six months implemented what we call our new operating model that has required a fair bit of organizational and position changes. I'm very happy that, during that change, we have had a strong performance that really talks volumes about the motivation, the spirit, and the forward-looking nature of KONE's employees. So, a huge thanks to everyone for a very, very good job done.

In the quarter, we performed our annual customer loyalty survey; and, this year, we had a slight negative development. Here, what impacted was really lockdown related challenges in China, as well as supply chain challenges overall last year. What I'm very happy about, though, is that our Net Promoter Score in our services, especially modernization, continued the positive development that we have had over many years. In fact, actually, if I look at most of our countries, we had a positive development overall.

And we are now back at the level we were in 2021, which was a clearly a good level. And I think when I look at the background and the reasons for the slight decline now, I am confident that we can recover based on the [ph] feedback (00:07:11) we have got and what we are seeing in our customer work right now.

Key feedback again was really about KONE reliable partner as a company, the great quality of our products and our services, and the responsiveness we have as a company. So all of those are positive, but it's clear that we're not happy that it came down somewhat this year. And our clear focus on improving our customer loyalty again.

So, those are some of the highlights of KONE's second quarter. Let's then talk about markets where we clearly see two different situations. New equipment markets are clearly impacting by economic environment in China, as well as Europe and North America. And we have seen a weakening of the new equipment markets in the second quarter.

North America markets in Q2 declined significantly from, I would say, a high base. What is positive with North America, though, is if you look at the Architectural Billing Index, which is an important leading indicator. We can see that it is at 51. So, a 50 indicates stable market; and of course, then above that means there's positive more billing and so forth. So, we are seeing actually slightly positive development in that area, which is good.

Europe, Middle East, and Africa, also significant decline, very much the trends that we talked about in connection with our Q1 result, which is the further we go in Northern Europe, the Nordic countries are perhaps where we have seen the most significant weakness, as well as Germany; whereas a little bit further south, such as France and perhaps also UK, we see a somewhat better situation. Middle East and Africa overall declined; although if I look at the Gulf countries, there, we continue to see good demand.

China markets declined clearly as a result of weak consumer sentiment. This is clearly a bit weaker than what we expected in connection with Q1 results, but I'll come back to China and talk about that a little bit more in detail. Rest of Asia-Pacific, particularly India and Southeast Asia, we have very strong markets where demand is also growing. Southeast Asia has been growing and developing very positively, as has India. So, that's where the best growth opportunities are right now in new equipment business.

Now, what we have to remember is that more than 50% of our business today are in growing markets. That means our services markets, which continue to develop positively across the board in all countries. Modernization business is – modernization markets overall are at a good level, and they continue to grow slightly both in North America and Europe, Middle East, and Africa. China modernization markets are back to a good growth trend after slightly weaker markets last year. Clearly, we had a COVID impact, but they are clearly back to a good growth trend, as our markets in rest of Asia-Pacific.

In maintenance, we have continued to see similar trends as before in measure of units, slight growth in North America, Europe, Middle East, and Africa, and clear growth in rest of Asia-Pacific and in China. But I would say that if we look at the service markets in monetary value, we actually have more growth than we have seen in the past years because of better pricing in the markets overall. So, again, I believe that we are in an excellent industry because in this economic environment as well, more than 50% of the markets where we operate are clearly growing.

Let's now talk a little bit more in detail about China. I know that interest and that is, of course, for us also very important, so we focus a lot on it. And if I give a little bit of perspective how we've seen China develop during this year. Beginning of the year and in connection with the Q1 result, we said that we expected the market to start recovering towards the end of the first half of the year.

That situation seemed to be very much intact in Q1 because of good development we had seen in February, in March, continue into April. However, then when May came, we saw that growth really petered out overall in the economy and that also impacted property markets and consumer sentiments. And we see that savings rates in China have continued to go up. So, it's really a question of consumer sentiment at the moment why markets have been somewhat weaker and then we had expected.

What has held true what we expected beginning of the year was that there would be a strong focus on completions; and completions, in fact, would be at a good level. And this has clearly happened. When we look at the new equipment markets for the rest of the year, it is clear that policy actions are very important to how the markets develop end of the year.

If you look at China what we also have had as very high focus in China is to drive growth in services, both maintenance and modernization. We've seen those markets develop well and we see good growth for us as well. We had extremely strong growth in our modernization sales now in the quarter. So again, that is where the growth is in China and we're putting a lot of emphasis on this.

And we can clearly see the challenge in markets if we look at the statistics; real estate investments, particularly new starts. At the same time, we can see a positive situation in completions. And we believe this completion story will continue going forward as well. So, that perhaps hopefully gives a little bit more context and views on how we think about China.

But now I'll ask Ilkka to again dive a bit deeper into our financial performance for Q2.

Ilkka Hara

Chief Financial Officer, Kone Oyj

Thank you, Henrik. And also, warm welcome on my behalf to this second quarter result announcement webcast. And as Henrik already said, we have some good developments and performance in the second quarter, so let's dig deeper into the numbers. First, orders received. For the second quarter, they were €2.275 billion; and on a result basis, that's a decline of 12.8%; and on a comparable basis, a decline of 8.1%.

We saw orders received growing in Europe, Middle East, Africa; whereas Americas and APAC declined, especially driven by the market backdrop in China that Henrik already covered. When we look at the pricing, we saw positive development in pricing outside of China. In China, the market continues to be competitive, and both price as well as mix contributed slightly negatively in our orders received. At the same time in China, component costs continue to come down, which is then mitigating the impact to margins.

Overall therefore, we continue to see our margin of orders received improve year-on-year and continue on a stable level compared to the good level that we were in first quarter. And as highlighted already by Henrik, especially good development in orders received was in the modernization that continues to grow well in this environment.

Then to sales, which was €2.836 billion for the quarter. On a reported basis, 11% growth; on a comparable basis, over 16% growth. So very strong development in sales. And what I'm especially pleased about is how all areas as well as all businesses contributed to this positive growth in our sales. In new equipment, the growth was 18.5%. As Henrik already highlighted, maintenance grew very strongly at 9.8%; and maybe again the highlight of the quarter, as was the case also in the first quarter, is the very strong sales development in modernization, growing at 24.8%.

We see both in the new equipment as well as in modernization that after a more difficult period from a supply chain perspective, now both customers and ourselves, we are able to also get a positive order book development and get back to a more normal level, with the support in the sales in those businesses.

Then from an area perspective, we saw EMEA growing at 13%; Americas, at 12.6%; and in APAC, strong growth at 21.6%. As already noted, APAC of course, the comparison point for China due to COVID lockdowns is part of the explanation, but we did see strong performance also in Asia-Pacific, especially in India, Southeast Asia from this perspective.

Then to our adjusted EBIT and profitability. For the quarter, €332 million at 11.7%. we are now seeing the profitability improving. That's been one of the focus areas for us. I'm very happy to see that now materializing continuously in this quarter. We also saw a strong, broad based contribution from all of the businesses contributing to this outcome. If I look at the key drivers for this growth, of course contributes positively with a sales growth we had, but profitability also is a key part of the development.

Pricing of the orders continues to improve. So, the orders that we booked previously were the pricing is improving is now materializing in deliveries. We still see lower material cost contributing positively in this quarter and continue to see a better environment from that perspective. Also with a strong growth we get and had a stronger fixed cost absorption. But I will also highlight that I'm very pleased about our fixed cost control, which has contributed also to this profitability improvement.

At the same time, it's good to note that inflation continues to be on a high level and that's something that is negatively then impacting our profitability in the quarter, but very good development from a profitability perspective.

Then to cash flow, which for the first half it was €762 million, clear improvement from last year and particularly we continue to have – first quarter was very strong and a good development also in the second quarter. And our net working capital for the first half improved from €904 million to €949 million. Always seasonality plays a role. So the maintenance, invoicing cycle is contributing positively. And as already noted earlier in the year, we had a timing of our accounts payable contributed negatively. In the second quarter, it was more stable. But, overall, good first half from a cash flow perspective.

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

Henrik Georg Fredrik Ehrnrooth

President & Chief Executive Officer, Kone Oyj

Thank you, Ilkka. So, let's wrap up with market outlook. New equipment markets, we now expect China to decline by approximately 10% to 15% this year. Previously, we expected that we'd be slightly under 10%. And it's clear that policy actions by the central government will be very important to the market recovery. Rest of Asia-Pacific continues to grow. We see a good situation there. Again, India, Southeast Asia, very good demand there. We expect Europe, Middle East, and Africa to decline clearly; and North America to decline significantly from a good level or actually a high level.

What is positive and again, where more than 50% of our business is that both modernization and maintenance markets are growing. Modernization, we expect to continue to grow in all regions with clear growth throughout Asia-Pacific, including China. And our maintenance markets continue to develop positively in number of units. And actually, as we've seen, trend growth in monetary value is little bit higher than what's been in the prior years. And the biggest growth opportunities are in Asia-Pacific, China, and outside where we have good positions overall. So, that's where definitely we have good opportunities.

Then our business outlook, we have now specified our outlook as we have six months behind us. We now expect our sales to grow between 3% and 6% in comparable currencies. As you probably remember, we said previously that it would grow somewhat above the previous year. So this is really a specification of that somewhat. So, very much in line, but now just a clear tighter range. And the same thing we've done with adjusted EBIT. We're giving now a specific range. We expect the margin to be in the range of 11% to 12%, which means that we will continue to see a recovery throughout this year and previously we said it will start to recover.

Now, as I'm sure all of you have noticed, is that the renminbi and the dollar has weakened compared to the euro. So, from a translation perspective, we will have about €50 million negative impact from foreign exchange for the full year. For the first six months, we had only about €6 million. So, most of the impact will come in the second half.

Now, we have a bunch of things that are supporting our good performance, such as the continued positive outlook in services, both maintenance and modernization. As we've seen, markets are positive and we have had a really good performance here. We have a very solid order book, and we have continuously improving margins in our order book. So that is also providing good support for our profitability.

And we see easing commodity headwinds which are clearly impacting in particular in China. But then the more challenging situation is of course the declining market for new equipment in China and also softer markets for new equipment in Europe and North America, as well as wage inflation. Overall, I would say that given the backdrop we have, we have a good situation to continue to improve our margins.

So in summary, I would say great development in sales and in profitability. Really on track with the objectives we [indiscernible] (00:23:26); and actually, in sales, even better. The new operating model that we have implemented, strength is our customer focus and competitiveness. Decision-making, closer to the customer, provides us speed. And as you can see, we are very well-positioned to capture growth in services markets everywhere and also selected new equipment markets that provides good opportunities going forward.

So with that, happy to take all of your questions.

QUESTION AND ANSWER SECTION

Operator: The first question comes from Daniela Costa from Goldman Sachs. Please go ahead.

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you. Good afternoon. Thanks for taking my questions. I have three, please. First one, just wanted to check, what scenario do we need to see in the second half so that you have enough of an order book to support growth in original equipment in 2024; or do you already think you have that? Would be interesting to hear your thoughts.

Second thing, if you can update us regarding how much in terms of raw material tailwinds do we still have yet to come in the second half and beyond that? And then, thirdly, just given you've weakened the market outlook in Europe and North America as well, do you see some risk of backlog cancellations there; or are you seeing any evidence of, like, project delays? If you can talk a little bit about what led you to this quite a large change. Thank you.

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

A

Okay.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Maybe I'll start.

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

A

Yeah.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

I guess, so first of all, of course, at this point of the year, we're not guiding yet for 2024. And so from a order book point of view, we actually have – I guess you asked for new equipment business, but overall order book is on a very good level. So it's over €9 billion, which is just shy of our all-time high overall. In modernization, our order book coverage actually is very good, but of course that is a part of the order book that rotates faster. But I would say that overall book to bill continues to be on a very good level, clearly over 1 on that one.

In new equipment, we naturally at this point of the year still need to book orders for supporting our expectations for next year. But I would say that we are in a spot where we continue to follow how the markets develop. And I've said, we've now seen a few quarters of decline in our orders received in new equipment business. But let's see how the market develops there.

Then, to raw materials, which was another question. So overall, we expect raw materials for this year to be a tailwind – raw materials or input costs, as I like to say it – of a tailwind of about a bit more than €100 million. It's clearly up from what we said earlier. We've seen more positive development than we expected. And I would say that a bit more than half of that is still yet to be expected in second half. So, clearly, something that if we're on this level, there would be still some tailwind left for 2024, of course, assuming all things being similar in that equation.

Then I think the last question was on cancellations. So, we have not seen cancellations being different than in the past. So very much similar. So even though the markets have been more challenging to many of the developers, I think they've been taking the projects that have been – where the orders have been booked for forward. And as I said earlier on the revenue part, actually in some cases we now see those project going forward faster than we've seen in 2022.

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

I will just – one further context provide to this, Daniela, because as you know, we have put a lot of emphasis on growing our services business, both maintenance and modernization, and that has worked very well. I'm actually very proud of the 9.8% in maintenance business. I know all of you have followed our business for a long time and know that this is a incredibly strong number for a maintenance business. And modernization now, good orders received growth first half of the year in double digits; and now, very, very strong sales growth.

And then what we said is that in new equipment business, we have focused a lot on pricing. So, the growth we can really drive from our highest margin businesses and that's working very, very well. New equipment, we have said that, there, our focus was a lot to improve margins. And we have a great situation there because the orders that we're booking today are clearly at the higher margin than what we are delivering.

So, we are in a good situation that over 50% of the markets we operate are growing, and that's where we are driving growth. In new equipment so far we have focused a lot on improving margins, and that provides further tailwind going forward. And I think that approach has worked and that's the approach we have had so far.

Operator: We will move now to our next question from Klas Bergelind from Citi. Please go ahead.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.
Q

Thank you. Hi, Henrik and Ilkka. It's Klas from Citi. My first one is on the second half margin implied by your guide. It looks like 100 bps improvement year-over-year at the midpoint. And that's good, but I had expected a little bit more considering how price cost is moving. Sales will come down a bit in the second half, but it seems like, say, Ilkka, €100 million on the cost side guided and growth in services is still strong. That's mix positive.

We knew that equipment would slow quite a lot in the second half, but implies quite a negative mix impact in my model. So, here's my question, really. How much of this is driven by China coming out of the backlog relative to also Americas and EMEA coming down as you have very strong backlog conversion there also at the start of the year? Thank you.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

I guess, first, there's still quite a few different outcomes for the second half if you think about the range of the sales guidance and then the margin range. So, that's number one. And we've also said that one of the key priorities for us is to improve margins. And we continue to, with the guidance, say that we are improving margins also in second half. So, that's good.

We saw our margin development being quite good in second quarter if you look at especially fixed cost absorption with strong growth in orders -strong growth in sales contributed positively. And of course, like you said, there are a number of things that are positively – as positive tailwinds for second half as well. But then, for example, inflation now labor cost inflation, for example, we see more impacting second quarter. We see more of that impacting second half than we saw in first half; just given the cycle how salary increases are going.

So maybe those are a few other moving parts. Business mix, yes, it plays a role and we did get a very good mix development. But of course the order book rotation, which was fast in the first half is also then negatively impacting the profitability where the profitability is lower.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Do you see a higher cost inflation on the wage side now compared to when we spoke last time, Ilkka, for the full year and therefore for the second half of this year?

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Not that different than what we talked about in conjunction the first quarter results. But normally it always takes a bit of time to negotiate agreements and also merit grants and so forth. So, you see part of that impact in second quarter, but then it's more fully impacting second half. But I would say that cycle is more normal annual cycle. This is not that different year.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you. My second one is on the new order margin. It's up year-over-year, but it's flat quarter-on-quarter. Was that in line with your expectation, or have you expected to increase the margin more versus the first quarter? And the reason why I asked is, it seems, Henrik, you're taking the commercial decision again not to participate in China as much as the market. You're down 20%; and market, down 10%; pricing is still weak. So would you say that the margin backdrop in China has worsened a bit from here?

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

A

So, if we look at our margins of orders received, it's right that China pricing has been very tough in the market overall. We have focused on keeping that reasonably stable, but, yeah, margins are slightly down in China; whereas, rest of the world, they are up. So, very good development still outside of China. And then overall it's about stable quarter-over-quarter. Still year-over-year, positive; and as I said also that we clearly – the margins that we are booking on an overall basis today are clearly higher than what we are delivering. So, that gives a further good upside going forward.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yeah. And maybe to add to Henrik comment, is that in the rest of the world, I think the pricing developed quite well; and at the same time, also as you saw in the numbers as well, I think we had, from a volume perspective, also good development. So I think we got both volume and price in outside of China.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Very quick final one on the new equipment guide in Americas. I thought this was going to come a bit later given the commercial resi backlog that you had. Quite solid exposure to multifamily there, which is pretty stable. Just curious, Henrik, why you saw this shift. If you can talk a little bit more in the second quarter in new equipment in North America.

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

A

We also have to remember that backdrop last year the market was very strong and both markets were strong and we had very strong growth. Now actually, if you look at the Architectural Billing Index, actually multifamily, that is down; many other segments are up. It is clear that as we have seen in many other cases, that particularly US market does react quite quickly to the economic cycles.

And there are many different situations in the countries. We can see the West Coast, which is very tech related, there, we can see that declining significantly. Whereas, there continues to be opportunity is seen in many of the southern states where a lot of people and companies are moving right now. So it varies, but United States, as usual, being a market that goes quickly down, quickly recovers, little bit faster movements than we usually see in Europe.

Just how I think about it is that, I would say, almost everywhere, we have a situation particularly on the residential side in Europe where there is order demand. We all know that Nordic countries, Germany, France, UK, all of these countries have a shortage of apartments. However, consumer confidence and consumers' ability to pay is lower.

And I think consumers are still worried about high interest rates and can they go even higher. So, given that the demand is there in many countries, once we get to through a cycle where people see that at least interest rates have peaked or could even come slightly down, I would think that we can see a recovery in the market. But of course, we're not quite there, particularly in Europe. That is something we have to see. But it's been widely publicized. For example, Germany, there's a huge shortage of apartments, but currently the confidence of consumers to pay and take loans is too low to get the market going.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you.

Operator: Ladies and gentlemen, as a reminder, kindly limit their questions to one question and one follow-up in order to allow other participants to contribute in today's event. Our next question is from Jeff Sprague from Vertical Research. Please go ahead.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Good day, everyone. Thanks for taking my question. I was wondering if we could just delve a little bit more into modernization and maintenance. And the nature of my question is really around service attachment, what's going on with connected services and the like. And so, I wonder if you could just kind of unpack a little bit to what degree the strength is rising attachment or recapture, versus maybe rising revenue per unit on contract because of the additional services? Any way you could unpack that either in aggregate or via some key geographies, would be very interesting.

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

A

Sure. Sure. So, on maintenance, as usual in maintenance, there's not a silver bullet, but you need to get many things to work right. And if we look at the revenue side, why have we achieved now in Q2 a 9.8% growth and 9.5% for the first half, which is we haven't seen growth numbers in normal times like that before; it really comes from many different aspects.

First of all, our service based, the number of units is growing a bit faster than usual. So we hit, 1.6 million units in the second quarter, which was great. So it's number of units is growing faster. So that means that we have had a good development in retention rates in many countries that is really helping, and conversions continue to be good. So that is providing the unit growth, which of course the first very important aspect.

Then clearly on pricing, we have done very well. So a significant part of the growth also comes from pricing. So, that is also an important contributor. Then, connected services have continued to develop well and, as you know, we have quite a different strategy on connected services from most of our competitors is that we sell this as a commercial service. So, it does contribute to our top line and profitability, which is important. And then also we can see a good development in repairs. And repairs, as you know, depends on market. 25% to a third of the revenue is in maintenance.

Now, if I look at that, you can say, okay, are we going to continue to have as good repairs? But repairs is very much pricing driven, not necessarily unit driven. So, that we think therefore can continue. So, again, it's more or less, all of the cylinders that need to work in maintenance have been contributing towards that, and that's how we maintenance business need to be. You seldom have a silver bullet that moves quickly. It's a huge base you work with and therefore many things need to work right.

And we've worked for many, many years on our offering. It's really 2016 that we started to really introduce differentiated offerings and constantly renewed that and update it. That's worked very well. Put a lot of focus here in how we serve our customers, [ph] what kind of (00:39:47) digital services, and it's really paying off. But I would again say it's a business that does not turn on a dime. That requires long-term consistent development. So, hopefully that helps with a long answer.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Maybe to add color. So, Henrik was talking about the cylinders firing, so all of them were aligned and contributed in the same direction, but then also they interlink. So for example, when we have 24/7 connected units, we are able to do a better job, better outcomes for our customers, better availability, and then the retention for those is actually higher. So, all of this is also something when you're executing well with all of the items, then actually also boost one another. So, that's been very positive to see actually.

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

A

I must say that in this business, I think our teams have been doing a really stellar job.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Can you give – just as a quick follow-up, – some indication of kind of the growth and average revenue per service contract or however you measure it? What kind of revenue per user uptick you're seeing with connected services maybe versus the baseline a year or two ago?

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

A

I think, first of all, Ilkka can answer that. He probably has better grasp on it. But I would say, first of all I think what we talked about many times and was actually 2018 was a watershed year for us; because up until 2018, the average revenue per contract and that's of course not all of the revenue was in maintenance but had been going down slightly year-over-year.

And that clearly happened because we were growing fast in Asia where average contract revenue is lower than in Europe or North America. Now in 2018, we turned that because of our offering, because of pricing, because of value added services, and now we've been able to improve it year-over-year because you have a mix effect. When you have more Asia, it takes it down. But then with good actions, 24/7, pricing, retention, all of that, we've been able to get the whole portfolio value up. And we talk about a couple of percentage per unit per year or now actually even a little bit more, but that already helps. Just as a backdrop to this.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

And today, if I look at what we sell, it's a combination of the digital and physical service as a combination. That's what we offer to our customers. So your question, how much is the uptick on price is maybe not a straightforward answer, but approximately our aim is to get 20% to 30% uptick on revenue per customer when we connect them to digital services; and, of course, market by market, there's some variance on that one. But, clearly, it is more something where we want to get additional revenue, see that as an opportunity and something that is adding value to our customers, and that's why we're also commencing a fee for it.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thank you very much.

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

A

Thank you.

Operator: Calderon from Morgan Stanley. Please go ahead.

Aurelio Calderon Tejedor
Analyst, Morgan Stanley & Co. International Plc

Q

Hi. Good afternoon, Henrik and Ilkka. Thanks very much for taking my questions. My first question is actually a follow-up on the previous question, and it's trying to understand that very strong 9.8% growth in maintenance. You talk about pricing. Just want to make sure that is – have you taken pricing on top of the normal wage inflation clauses [indiscernible] (00:43:26) in some European contracts? Just trying to understand how the margin dynamic is evolving in those maintenance contract.

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

A

So, in Europe, you have in a pretty large part, but not all contracts, you usually have some kind of price escalation mechanism really that's linked to a CPI or inflation or something like that. In many cases, we've been able to do even slightly more than that. But still the majority of cases, these are commercial discussions. So, yes, we've been able to increase prices that exceed a bit what labor cost have increased. I don't know if...

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yeah. And if I think about it from a numbers perspective, out of the 9.8%, a bit more than 5% is units and the rest is price and value; and value to me is, for example, 24/7 connected service. So give you an idea. As Henrik said, so there's a mix of contracts that you cannot escalate. Some, you can. So that's just to give you overall figures. And of course, the inflation is not everywhere in the world. But that's the type of development and drivers for the growth out of the 9.8%.

Aurelio Calderon Tejedor
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Thanks very much. That's very helpful. And my last question is actually a follow-up on Klas' previous question on China. I think it's been well flagged that you've been growing less than the market or you've been declining more than the market. Is that a conscious decision to make sure that you get good project; or has there been any underlying market share shift, probably more towards locals; or you've not seen anything, it's just a conscious decision to take orders at good margins and good payment terms?

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

A

I would say, of course, margin and payment terms, absolutely critical in China. We've been working on those. [indiscernible] (00:45:12) perspective that if you remember last year, our focus everywhere was twofold, very much that growing our services business [indiscernible] (00:45:26) growth in new equipment, it was about margin. The same thing in China. So, we really focused on margin over market share. And we can see, I think that, that's delivering results right now.

Now, we can see the impact of that in China as well. Perhaps our development compared to the market, we wouldn't have wanted to be quite as what it is, even if we have been slightly below market, wouldn't have been an issue; now, we're a little bit too much. So, clearly, it is something we are focusing on. When I look forward, I'm confident that we can keep our market position in China. These are quarterly impacts.

And we have to remember, if you look at the first half of the year last year, we actually had very strong order intake in China. So, we had a very high comp, but it is where it is. If I look at the full year, I'm still confident on retaining our strong market position in China.

Aurelio Calderon Tejedor
Analyst, Morgan Stanley & Co. International Plc Q

That's great. Thank you.

Operator: We have a question from Andrew Wilson from JPMorgan. Please go ahead.

Andrew Wilson
Analyst, JPMorgan Securities Plc Q

Hi. Good afternoon, everyone. Thanks for taking my question. I wanted to ask you around the comment that you make, Henrik, around policy being obviously important for the second half, which is clear I guess. I wonder if you could just help with being a bit more specific in terms of exactly what you think is important there.

Is it policy from a broader stimulus perspective, which would seem to help the consumer confidence problem, or is it more specific to the property market? I ask because we've seen a lot of the news flow around property-specific stimulus or easing or removal of restrictions. And, sort of, as you allude to, as yet, we haven't really seen that make enough of a difference. So, I don't know if you can just help us sort of think about what we need to be looking for and thinking about.

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

Yeah. Very good question. I think it's a bit of both that, yes, we've seen certain cities lose restrictions. I still think we need to see developers having better access to financing. [indiscernible] (00:47:36) somewhat better, but that is still an important thing because they will not start projects and people need to be confident that they are in a solid financial footing, which I think is improving.

And I still think very important is the whole consumer confidence. And we can see that savings rates are going up in China. We know that there is underlying demand. So, I think that's going to be critical overall consumer confidence [indiscernible] (00:47:59) for the whole economy and that will go for the property sector as well. So, what those specific measures will be, I don't have a specific view on that, but it's really about the confidence overall.

Ilkka Hara
Chief Financial Officer, Kone Oyj A

And maybe to add to Henrik's comment on this liquidity, which has been a targeted to the developers to complete projects, and that we do see happening if you look at the completion numbers. But then the new starts and new projects is both financing as well as confidence, which is maybe the next focus.

Andrew Wilson
Analyst, JPMorgan Securities Plc Q

Thank you. And maybe a follow-up and I guess it's a follow-up to a couple of the margin questions and some of the observations that Klas made with regards to second half. I guess, looking further forward and appreciating that you're not going to comment too much on this, but if you could help us at least frame the debate a little bit.

It would seem to me that with the margins and the orders you're taking at the moment being ahead of the margins in the income statement with the mix potentially shifting, given maintenance and modernization strength, given the operational improvements you're making and the savings you've guided to on that, plus a little bit more tailwind from raw mats, it would seem to me that even with the current obviously relatively Chinese new equipment market, the 2024 margin has decent potential to be decently ahead of the 2023 number.

Now, even if you're not going to say yes or no to that, can you at least help me if there's anything that I'm missing in terms of thinking about that margin bridge?

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Well, maybe I'll start. And, yes, you're right. So, there's a number of things which are a tailwind for us. Of course, I already talked about [indiscernible] (00:49:35) also some headwinds, for example, inflation and so forth. But we've already said earlier that one of the key priorities for us is to drive our profitability up and improve profitability. And I don't see that, that goal is changing for 2024. And we continue to be focused. I'm very happy to see that we continue to have, for example, orders, margins, on a good level, supporting that.

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

A

Yeah.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Thank you very much.

Operator: Our next question is from Miguel Borrega from BNP Paribas. Please go ahead.

Miguel Borrega
Analyst, Exane BNP Paribas

Q

Hi. Hello, everyone. So, my first question is on the pricing of new equipment, which you said was up in the US and also in Europe, but not in China. At the same time, you have a negative outlook for Europe and the US. So, to what extent can you keep raising your prices; or will you see price increases now effectively plateauing? That's my first question.

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

A

Sure. So, we have talked about the margins of our orders received, which have gone up because of good pricing. Now, when we look forward, we probably – we have a better outlook now for component costs, raw materials, and all of that. So that's, of course, also helping. So, even if we cannot increase prices from here, we still have a good situation that the cost side of the equation should be better.

But it's clear that when markets are weakening, competition are likely to be tougher. I would say that in this market, the way we have achieved what we have achieved on prices I think is a great achievement. So we're starting from a really good position and we always have – margin is always a combination of price and cost, and now price has gone very well and outlook for cost is perhaps a bit better.

Ilkka Hara
Chief Financial Officer, Kone Oyj
A

Maybe to give a more color on the cost side of equation, which is very much aligned with what Henrik already said. So, majority of the €100 million improvement is coming in from China. But we are also starting to see that there is a slight tailwind in Europe and North America as well. And at the same time I think looking forward, a focus on product cost improvements, which is a part of priorities in the R&D, are actually yielding quite good results. So I think that's also supporting the margins going forward and that's been progressing quite well.

Miguel Borrega
Analyst, Exane BNP Paribas
Q

That's very good. Thank you very much. And then my second question, on the price increases that are already locked in the backlog, can you give us a sense what percentage of the backlog includes the higher margin? Or, in other words, how much is left to wash out from the legacy lower margin orders?

Ilkka Hara
Chief Financial Officer, Kone Oyj
A

I think the way I would say it, order book margins is a complex topic. Also, you need to look at when you deliver which orders and sometimes it's – and often it's actually related to customers as well in the new equipment business. But if you look at our commentary on how we've been able to improve our orders received margins over the last quarters, and then you start to look at the order book growth base. And so in China, it's probably less than nine months right now; and in Europe, a bit more than one year; and in North America, clearly more than one year, so closer to two years.

So you start to get an idea how much tailwind are we getting from the order book. And I definitely won't – personally don't think about a bad margin orders. We just have orders. And then if they have some work to be done to improve the margins, that's a challenge we need to take. So I don't differentiate between the two.

Operator: We have a question from Rizk Maidi from Jefferies. Please go ahead. We have another question from James Moore from Redburn. Please go ahead.

James Moore
Analyst, Redburn (Europe) Ltd.
Q

Yeah. Hi, everyone. I hope that you can hear me. Good afternoon. My first question is on order pricing. I wonder if you could quantify what year-on-year order price or price mix the China new equipment is in the second quarter? It's obviously down, but are we talking, I don't know, 1% to 3%, or 4% to 6%? I'm just trying to just scale it. That's the first question, really.

Ilkka Hara
Chief Financial Officer, Kone Oyj
A

I guess I've said the same thing earlier, that we haven't been giving more detailed commentary around the magnitude of the margin changes and they're quite nuanced. So that's – pricing and mix clearly were negative, but margins don't move around as much as the pricing and mix moves. So also there's a product cost and as well as the overall raw material environment that then mitigates part of the impact.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

So the question was on the pricing for orders, not the margin. I was just wondering [indiscernible] (00:55:37)...

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Sorry, sorry.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

No Problem.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

I misheard you. So I said already earlier. So, both pricing as well as mix contributed slightly negatively. So, it's a low single-digit number.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

Okay. That's great. And just a bigger picture question, if I could. I mean, if you take the China new equipment margin over the last 15 years, when did it peak? I just want to get a scale for the trough that I guess you saw recently, and kind of some idea as to how much above that we are now. I think you said recently that the China new equipment margin's above the group average. But I was just trying to understand what the shape was [indiscernible] (00:56:29).

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

A

I think we've been pretty clear that the margins, they peaked about in 2015, 2016 when they were at a excellent level. And from that then they came down 2017, 2018, 2019, started a bit to recover 2020, 2021. And now they've come down from there again. So, it's been a little bit of a wave effect, but it's clear that they were, yeah, for us in particular in 2015, 2016, they were significantly above the level where they are today. We still have good margins in China, but not the more-than-excellent that we used to have in those times. And compared to...

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yeah. So, I've commented in the previous quarters on this one. So if I look at – exclude normal seasonality, so China's margins overall are quite stable now, but we've seen improvement in other areas. So, as a result, then, China is slightly negatively contributing compared to the group average. But it's because of the improvement in profitability in the other areas rather than the decrease in profitability in China.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

Yeah, that makes a lot of sense. And just the last one, if I could. How does that compare to, say, new equipment margins in the US and Europe? Is it still at a significant premium? And what I'm thinking about here is the Chinese elevator market remains a very competitive market. And I wondered if, given that, it seems to me we're in a really tough Chinese property market for some time, there's still a degree of long-term risk of going down from a low double-digit number to a mid-single digit number.

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

A

First of all, yes, new equipment margins in China are better than, for example, North America for at least us, and somewhat better than Europe as well. There are some other Asian countries where the margins are higher. If you look at the players and I've said this before as well and perhaps it's come down, but if you look at the various players in China, they are not that many that actually make decent margins today. There are many that are breakeven or even below.

So, from that market perspective, yes, it's very competitive. But we continue to command a higher margin than the market on average, or we're clearly in the highest group of margins in China. So, that's just an important perspective to put. Also, if I look at it, is that while margins are good, for example, maintenance in China, they are not quite as good as the rest of the world. And we usually see a correlation that where you have really high service margins, you tend to have a little bit lower new equipment margins. In some places like the Nordic region, you then have more – there's not huge difference between the two. So, it varies and therefore, if you look at the overall margin of China, it is not today that it would be so much higher than others. And I think that's what's different from perhaps the past.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

And hey, maybe, James, just to make sure that I didn't mishear you. So when you asked about the impact of price, I said slightly negative impact from price and mix. That's a change of price and mix, not the margin. So, sorry if that – maybe we can follow up it separately, but you might have drawn the wrong conclusion.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

No, I think I thought it was a low single digit year-on-year down for price and a low single-digit year-on-year down for mix in orders for China.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yes.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

If that's okay.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yes, exactly.

James Moore
Analyst, Redburn (Europe) Ltd.

Q

Thanks. Thanks for your help.

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

A

Thank you.

Operator: Our next question is from John Kim from DB. Please go ahead.

John Kim
Analyst, Deutsche Bank AG

Q

Hi, everyone. I was wondering if you could speak a little bit about the competitive intensity in China. Can you give us a sense of how it's progressing through the quarter? And a slightly different question [indiscernible] (01:00:44).

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

A

Competition has been intense as it's been for a long period of time in China. And some players are doing better, some are not doing as well because there are a lot of players. What we can see is that the market is consolidating towards the bigger players, and they are – increasing number of the really small players are going out of business. So, that's helping a bit. If you look at the market where the biggest demand is a more affordable end of the spectrum, more affordable housing, and that is related to Ilkka's comment about mix.

So, is competition tougher now than it was before? I don't know. It's always been very tough in China. And that's why it's important to be competitive in China. We continue to be very competitive there. That's important for global competitiveness as well. So, I don't know if that answers your question.

John Kim
Analyst, Deutsche Bank AG

Q

Okay, fair enough. As a quick follow-up, one of the things I'm curious about is whether you see any kind of policy or financing for the developers. I think a while back when we spoke about this, the market may have been expecting consolidation or policies towards the actual developer base rather than the consumer. Any color and context on that?

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

A

Of course, the big thing was last November when they came out with the 16 Point Plan, which was to help developers restructure their balance sheets and make the market more healthier. And that, as Ilkka said I think very clearly and well, is that it has been now really targeted towards completing projects, not so much for new orders yet.

And I still think that the main thing holding back to the market is consumer confidence. And I said that it can be seen almost across the Chinese economy if you look at consumption and other sectors as well. And you can see that savings rates continue to be very high and actually go up. So, probably the biggest help, back to earlier question as well, to Andrew's question about what is it going take, is it more developer financing? Yes, we need a bit of that, but also we need improvement in consumer confidence. And exactly what actions would be required, I'm not an expert in answering that.

John Kim
Analyst, Deutsche Bank AG

Q

Okay. Thank you.

Operator: Our next question is from Ben Heelan from Bank of America. Please go ahead.

Benjamin Heelan
Analyst, BofA Securities, Inc.

Q

Yes, good afternoon. Thank you for squeezing me in. I had two. Firstly, I wanted to ask about your views around visibility into Q3. You've obviously made some fairly large changes in terms of your views around the new equipment market in the second quarter. How confident are you, you have visibility that those [indiscernible] (01:03:52) conditions are in EMEA and in North America into Q3? I'm just thinking what is the risk that that gets incrementally worse.

And then secondly, coming back to the 2024 margin and volume pressure, I know you're not going to comment on 2024 specifically, but you have kind of talked about quite negative trends in terms of the new equipment market. From a cost perspective, can you talk about your ability to manage volume pressure, if that is what you start to see? Thank you.

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

A

I think I'll ask Ilkka to answer both because he has been leading our South European Mediterranean business as his other job for the past six months, so.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yes. So I guess your question was how do we see the market developing and what gives us confidence on the market outlook? So, of course, we talk a lot to our customers. And part of the equation is about analytics, but also it's about getting the latest input from our customers. And I think what is particularly what's visible in our South European business, but I think it's a case in Europe as well is we continue to see opportunities being created in our CRM.

We see salespeople following being active on discussing those. And then the question is that how do you get the decisions and that means that when do you take the project forward? And it comes back to Henrik's comment earlier that when the price requested is too high, then you don't get the cost and the price meeting, and that's where then the decisions will be made when there's less volatility in the variable. So for example, interest rates being more stable.

So I think we have a relatively good understanding based on the customers when we comment market outlook. But it's been also a few years where there's been a lot of volatility, of course, in the market. So that's the comment on the outlook on the market.

Then, second question was on margin development in this environment. And think particularly for the new equipment business, I think there's less volume. So, first, I think we talked a lot about the positive side, [indiscernible] (01:06:10) developing orders, margin developing, a backlog which is we're still delivering orders at the lower margin that we're booking them. So, there's a positive backdrop in that environment for the margins.

Of course then from a volume perspective, we need to manage against what we plan to deliver. And the good thing for us is that we are manufacturing many other components that make an elevator together with our suppliers. So, we have quite a flexible manufacturing footprint and has been, if you look at the past, how we've been able to deal with that. And similarly, our installation capacity is quite flexible.

Benjamin Heelan
Analyst, BofA Securities, Inc.

Q

Okay, very clear. Thank you.

Operator: Our next question is from Gui Peigneux from UBS. Please go ahead.

Guillermo Peigneux-Lojo
Analyst, UBS AG (London Branch)

Q

Hi. Guillermo from UBS. I wanted to ask a question regarding the slides that you put [indiscernible] (01:07:11) versus the market. If I go back in time, in 2022, the first half of 2022, you managed to grow 5% versus the market. Then actually in Q3 you collapsed versus the market. Your demand actually falls by 30%. And ever since, the decline in rates have been closer to 25%, 20%.

I wonder whether going into Q3 2023 you're going to face significantly easier comps for you when it comes to order intake and therefore potentially you could even – if you were to achieve some market share gains or [indiscernible] (01:08:00) growth is possible from that YoY comparison from on a year ago. Thank you.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Maybe, Henrik, you take the comparison points [indiscernible] (01:08:12).

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

A

Yeah. Yeah.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

So yes, you're right. So, if you think about what happened last year in Q2 due to the COVID situation, we had to – we took good orders in, but then of course, we could not have our factory open for the full quarter or two months out of the quarter, which then impacted our capability to deliver on capability to also attract orders in third quarter. So yes, the comparison point is impacted by that development and that you do need to take into account, as we said, for second quarter also from a sales perspective.

Maybe you want to comment on your outlook for the rest of the year.

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

A

Outlook for the rest of the year. As you know, Guillaume, we don't give any outlook for orders received. What I said earlier is that based on what I see, I'm confident that we can keep our strong market position in China for the full year, but let's see. We still have almost six months to go and clearly a lot to be done in that market.

Guillermo Peigneux-Lojo
Analyst, UBS AG (London Branch)

Q

Maybe I can follow up a little bit on that one. If you were to look at units at the moment, orders in terms of units in China in Q2, if you compare that to Q3 last year, would you now be higher on Q3 last year in unit terms?

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Maybe we can follow up. If you think about how markets have decreased over the last four quarters, so you need to take that into account.

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

A

Probably not.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yeah.

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

A

Let's see, if we come to that. If you look at our orders historically, we have usually been quite first half heavy in orders in China.

Guillermo Peigneux-Lojo
Analyst, UBS AG (London Branch)

Q

Understood. Okay. Thank you.

Operator: Our next question is from Rizk Maidi from Jefferies. Please go ahead.

Rizk Maidi
Analyst, Jefferies International Ltd.

Q

Yes, hello. Can you hear me?

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

A

Yeah.

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yeah.

Rizk Maidi
Analyst, Jefferies International Ltd.

Q

Yeah, perfect. Yeah, I just have basically one on – is on the China outlook. Henrik, you've got it for 10% to 15% drop for the full year. I know this is not exact science, but it's just your best estimate. That's roughly the decline that we've had in H1. And I'm just wondering how do you square this with your sort of earlier comment in previous quarters that the completions should actually boost the new elevator demand, and there's roughly sort of one year worth of elevator demand in those sort of completions that continue to grow? Just perhaps how do we square both basically, the fact that you're not seeing an improvement sequentially in the second half in the Chinese markets versus the completions still up 20% year-to-date?

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

A

Yeah. So I think the completions clearly, much of that – not all – much of that has been in the backlog already. So, that's why we see a little bit speed up or the rotation of the order book is a positive thing. So, we delivered more in the order book. There's some to be ordered. How much is that I think it will still flow into next year. I don't know [indiscernible] (01:11:27).

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

Yeah. And I guess what has changed, really, we were talking about how to see the recovery in the markets towards the end of first half. That is maybe the one which is delayed by the consumer confidence. And therefore, we are seeing a slightly lower estimate for the overall market. So I think that's the key change to have completions actually continue to develop as we expect.

Rizk Maidi
Analyst, Jefferies International Ltd.

Q

Okay. Understood. The second one that I had is one of your main sort of supplier or one of your suppliers, especially on the [indiscernible] (01:12:04) is facing financial distress. I'm just wondering whether you've seen any sort of disruption from this in your supply chain? And secondly, obviously, have the whole supply chain constraints during COVID and now this impact on one of your supplier. Is this prompted you to consider more of in-sourcing part of your value chain, or are you still happy with the outsourced business model?

Ilkka Hara
Chief Financial Officer, Kone Oyj

A

So, I actually said already in the presentation that we've actually seen our supply chains normalizing and that's been able to actually supported our order book rotation quite nicely and I don't comment individual suppliers, but I think it's a comment that covers all of them. So, a positive development from that perspective. Then secondly, yes, of course, in this environment, we've also had to reconsider our supply chain footprint. Think about both geopolitics and as well as resilience in this environment a bit differently. And if you look at, for example, CapEx, it's a bit higher because of the investments we're making to support resilient supply chain as we see fit for our business.

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

A

But it's clear that, that's been a huge focus for us is to make supply chain resilient, as Ilkka said. And the outlook we have now, of course, we follow all of our big suppliers very closely, have close dialog with them. And we think we have a good situation, continue to have good deliveries for this year.

Rizk Maidi
Analyst, Jefferies International Ltd.

Q

Perfect. Thank you.

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

A

Thanks.

Operator: There are no further questions. So, I'll hand you back to Ms. Natalia to conclude today's conference.

Natalia Valtasaari
Head-Investor Relations, Kone Oyj

Thank you. Thank you, everyone, for listening in. Thank you for the very active dialog. Lots of very different questions, which is always nice. If you do have any follow-ups, please reach out to me or the team. We're always here for you. And I guess, with that, I'd like to wish you all a great rest of the summer.

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

Thank you all.

Ilkka Hara
Chief Financial Officer, Kone Oyj

Thank you.