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Otis Worldwide Corp. (OTIS)

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CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Good afternoon, everyone. My name is Brandon Knutson. I'm on the multi-industrials team here at Morgan Stanley. And I'm here with Judy Marks, CEO of Otis Elevators, and looking forward to our conversation. But before we get started, need to read some disclosures. So, for important disclosures, please see the Morgan Stanley Research Disclosure website at morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley representative.

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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QUESTION AND ANSWER SECTION

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Q

Great. Well, Judy, saw the announcement Monday. You announced your retirement. First off, congratulations on a great tenure at Otis. And when we look back at your career there, what are you most proud of from your time at Otis, and what are you most excited about for the next CEO to take over?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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Thanks, Brandon. I mean, this is an exciting time for Otis, and I couldn't be more proud, and I really need to thank our customers around the world, but most importantly, our 72,000 colleagues. When you think about us really spinning out of a conglomerate after over 43 years and still leading our industry, creating our service business model, and being able to accomplish that regardless of what headwinds were thrown our way, I couldn't be more proud of our team. I couldn't be more proud of the results, and I couldn't be more proud of the people we support, 2.5 billion people a day who use our product.

So, it goes beyond financial metrics, although we've had a great return for our shareholders. When you look at the capital, we've returned between dividends and share buybacks. It's been substantive, over \$8 billion. But most importantly, we've kept the world moving, and we've really committed to this high-quality service model that has tremendous growth ahead of it.

So what advice would I give is, I think the service flywheel and everything we're doing to lead this industry will continue. I believe our global reach will continue. We'll focus on scale, we'll focus on density, but most importantly, we'll focus on serving our customers and our communities. And we are entering this new chapter of top-line growth. For those of you who saw our second quarter, we had the highest service growth since Spin. Organically, it was 9%, 6% maintenance and repair, 24% modernization. Elevators around the world and escalators are aging, and so we're entering this period, which is what we've been investing in, of significant growth in the service business that hasn't been seen in decades.

So to the next CEO, and I'm not going anywhere right now, I'm committed, working hard, but will help the board in terms of assisting in the succession, both internal and external candidates. To the next CEO, you're entering a growth phase for an industry that's traditionally had low growth. We're entering it from a service perspective where Otis has the lead, and we'll continue to build on that with our incredible 45,000 field mechanics and our amazing 2.5 million unit service portfolio.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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Great. Well, the portfolio has historically been viewed as a predictable service compound or even a very strong service business. What needs to happen operationally over the next 12 to 18 months for Otis to get back to the combination of service growth, but also service margin expansion?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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So we've been on a trajectory of investment. It goes back a few years when we first recognized the modernization market was going to be a high-growth opportunity. When we talk modernization or refurbishment, we look at the 22 million units in the world, elevators and escalators that are in use, and 9 million of those are in this modernization window. They're over 20 years old. They're ready for refurbishment, technology upgrades, and primarily full replacements or partials, but mainly full replacements. That creates a demand signal that we needed to be prepared for. We needed to industrialize how we were approaching modernization from in our factories, where we were actually creating modernization packages to sell and to manufacture at scale. We needed to change our installation methods so we would get productivity in the field, and then we needed the ability to deliver those synchronously across the globe.

So the modernization business is really what was growing, what also -- and we invested in that. We knew we needed more field professionals. Our mechanics are a craft skill. You're hearing a lot about trades these days, but elevator mechanics are a craft skill unto themselves. Our mechanics commit to this career. They don't become welders. They're not electricians. They are elevator constructors and mechanics, and incredible professionals. But we knew with the pending growth, we needed to invest in them. So if you go back to 2024, 2025, even this year, we've added to our field workforce to prepare for this growth.

And while all that has been happening, our repair business, because as units age, if people don't make this discretionary modernization decision, as units age, they break more. So this break-fix repair business for us, [indiscernible] (00:23:39) was a mid-single digit growth kind of business, is now a double-digit business. We grew 12% in the second quarter, and we see that double-digit continuing, not just through the rest of this year, but ongoing.

So as we look out, top-line service growth is now a mid to high single for the medium term, with repair growing double digit and modernization growing mid-teens. So it's an exciting time to be in the service business. It's over 90% of our of our profits. And for us, this investment needs to pay back in margin expansion. We've made the investments this year, and we expect some of them are one time, and we will continue to find this margin method of growing margins. But volume alone will create profit. And we're seeing the top-line volume, that will flow through. We're seeing pricing initiatives, that will flow through 100%. But then this leverage we want on the rest of the service margins, we would tell you is going to come through the service operating model, which I think we're going to talk about later.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. We'll definitely get to that. And as you mentioned, the service organic grew 9% in Q2, a big acceleration, highest level since spin. So great growth there. But you talked about the growth investments as well, which are partially meant to help the retention, which declined a little bit over the last 12 months, and it's taking a little bit of time to recover. What are you seeing today in retention, particularly in the Americas? And what milestones should investors watch for to know that the service quality investments are working?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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Retention to us is when a customer renews. So we go through a maintenance period. Our first maintenance period starts after the warranty, and then on average, in most parts of the world, about four years later, we re-sign the customer, we . We retain them. Some of that's due to auto renewal, but a lot of that's due to continued service quality. As we exited 2024, we saw that our world class retention rates, which have been over 95% since been in ex-China, had started coming down. And it did create an area for us to focus on. And so we stepped back and

said, even though they are world-class, we're convinced they are the best in our industry, we said, what do we need to do to increase that retention back to where we know we were at 95%?

And so, what we did is we looked across the globe, because it's not a unique geography, it's not every one of our operating territories in one geography, but we had variability in these retention rates by operating territory. We have 1,400 branches or operating territories. And so we looked, and we started in North America, and we said, where are we below that median of 94.5%? Which branches? And we did root cause to understand what was going on there. And what we found was we had this lower quartile performing branches where, while they were performing, they weren't at the level of quality that we expected of our Otis branches.

So in late 2025, we invested. We invested in more mechanics. We continued that through 2026 so that we would have the ability to address the service quality at the branches. When you talk about retention, most people naturally say someone's leaving you for price. That's not the case in this industry. And then they ask me, well, are they leaving you for an independent service provider? That's not the case either. Sometimes they go to an OEM, sometimes they go to a service provider. Very rarely is it price. It's all about things you control and service quality and performance.

So we've added these mechanics to make sure that our service quality improves because there's a direct correlation between service quality and retention rates, even though there's a lag. So we have four elements we measure in North America on service quality. We meet code. Let me start there. Let me make sure everyone understands the code. We meet everything on maintenance. In the US, there's no mandatory visits required. But in our Otis Maintenance Management System, we require that you do a scheduled visit twice a year. So the first thing we measure is, have you been there within the last six months to see the customer to do the scheduled maintenance?

The second thing we measure is, of the checklist we gave you to do during that visit, did you do every one of those tasks?

The third thing we measure is even though there aren't scheduled mandatory visits, for any of you who live in the US, you go in an elevator and you see there's an inspection certificate. Did you pass the test to prepare for the inspection? And then the fourth thing we measure is, are there any units that are down? And that mix creates a service quality index that we measure at every one of our 1,400 branches, but specific to the US, it's that mix.

What we shared at second quarter earnings was by making this investment, by adding mechanics, by doing more visits, by literally complying everywhere with our Otis Maintenance Management System, we were able to raise our service quality index 7 points. I can tell you, as of September, we're still at that positive 7 points in the places where we invested. Now we need to see the retention rate and that correlation.

There's no direct timeline for when that happens, but we do anticipate that happening. But again, world-class retention, we ended last year at 94.5%. Any quarter you measure it, you're going to have some variability, but we do see line of sight to getting back to 95% probably in 2027.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Great. And 95% is a high level of retention, definitely.

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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That's the best in the industry.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Right. And investors always want some more upside. So is there any -- is that fair to think of that as a ceiling or what can you do to possibly take it up to a little bit above that?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

I think there's always room for improvement. Any time you focus anywhere on your lowest quartile, and you have the ability to move that to median or above, you're always going to get some extra benefit from that, plus your top performers. So I want everyone to understand, we have -- I visited many of our operating territories of 98% retention rates. So this is an average across the globe, ex-China. There's room for more, but there is a ceiling. You will never get to 100%. I don't think you'll even get to 98%. But can 95% go up over time? I think it can. And I think as we benchmark with Software-as-a-Service, subscription services, there aren't people that can get much higher because there's always natural churn.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Makes sense. One of the more interesting developments this year has been the decision to temper some AI-driven micro pricing a little bit in the maintenance portfolio to protect the retention that we're talking about. What have you learned about price elasticity in your installed base?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

Pricing is an interesting element and an important element. As I share with any colleague who'll listen to me, as costs go up, you have two levers, price and productivity. And costs will go up, whether it's annual wage increases, whether it's commodities, all of those things, and you need to offset it with price and productivity. Let's talk service pricing. So in repair pricing, when we have a unit that breaks, we generate a repair proposal, that's reactive repair. We generate a proposal, present it to the customer, and that's the first time they see it. Micro-pricing in repair allows us to understand how much elasticity we have, how much value the customer will get at this, where it's happening to them, what its impact is to their enterprise. And we've seen strong micro-pricing and repair. It's already in our backlog, and our AI algorithm looks at all of these metrics. What will the market bear? What has this repair been sold for in another city? Because the parts are the same cost, the labor is the same cost. What did your peer salesperson get for this? What does this mean for your commission if you can get the repair at this price?

So repair micro-pricing is doing outstanding. It's in our backlog. That's why you're going to see the 70 bps of repair margin improvement to the service margin in the second half of the year is coming from repair volume and repair micro-pricing. In maintenance, we get annual price increases. Everyone, when we use this word temper, there was this misunderstanding that our prices don't increase. We have contractual and commercial way mechanisms to be able to get annual price increases. They're tied to different inflationary reasons, depending where you are in the world. Some are backward-looking or 2025, that then you can apply in 2026. But others are real-time, and they're all different indices, as you can imagine. That happens anyway.

But the micro-pricing, we've trained all of our maintenance salespeople on it. They see what's possible. What we've tempered is how much more they think they can get versus the theoretical, what we believe is possible,

tempering that with if that's going to push your customer over the line to cancel us and not be part of retention, then we're going to allow the local team to have some judgment, at least this year, because we want to balance retention and price. We're still getting price on maintenance, but we want to have that ability. It's not happening everywhere. We're seeing great maintenance pricing with micro-pricing in a lot of our operating territories. But in some, it's really more customer-specific, and we just don't want to push them too far.

But we are getting price. We're getting price in terms of the annual price increase. We're getting price in terms of surcharges because of fuel and logistics challenges in the Middle East. And we're preparing and getting price now for what we see potentially as other input costs next year in terms of material productivity.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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And what can you do to make the gap between the micro-pricing you can get on the repair versus the maintenance side smaller and maybe even parity?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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Well, I want to make -- I'm not worried about the gap. I want to make them both grow. So let's start there because, the repair pricing, it is market pricing, and that's what we want to reinforce over and over again. And you'll see that, as I said, in the second half of the year. The maintenance pricing, again, we focus on a few things. We focus on what's achievable, what's possible, and then besides just the AI micro-pricing tool, we use AI tools to help our sales reps do value selling. We actually have an interactive AI tool that will actually mock negotiate with them before they go see the customer, so they understand what value propositions they need to propose for Otis service.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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Great. I want to touch on the Otis service operating model a little bit. You introduced this operating model [ph] aimed at (00:35:08) standardizing field and sales processes across the organization. What is structurally changing at the operating territory level versus how Otis has historically run the business?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

A

So we're 173-year-old business as of last week. And you can imagine we have very proven, reliable processes. We're in the life safety business. It's important that we operate safely, but it's also important that customers count on us. All of you in the room and everyone listening you count on us for a safe, reliable ride every time, you don't think twice, and that's 2.5 billion people every day.

We've been on a journey in terms of transformation. We started at Spin with needing to set up the company to be an independent public company. We focused on where we needed to enhance processes. We focused on the technologies we needed. We focused on go-to-market. We focused on innovation and product. And we worked through all of that the first few years after Spin, and you saw those results, and we're very proud of those results. And most importantly, we focused on service portfolio growth because we believe the strength and the size of our service portfolio is the foundation for service contracts, for maintenance and repair on top of that, and then eventually modernization.

And we took a company where between 2010 and 2019, the service portfolio kind of oscillated between 1.9 million to 2 million units. And we focused on portfolio growth in the early days, the first few years, and we grew at 25%, and we now have 2.5 million units, largest service portfolio anywhere in the world.

Then we said, that's great, but now how do we continue to drive growth top-line and margin expansion bottom line? And a few years ago we said, well, as we look at these 1,400 operating territories, first and foremost, let's take out and centralize the local activities that are not customer-facing, that are more transactional. We call that UpLift. Do you recall? We did a major restructuring on that.

So we've removed all of that, handed it, working with a partner, we've centralized all of that. The next step in this transition, and it's not a restructuring, let me be clear, it's the service operating model. We have some of our operating territories that are operating incredibly well. They have best practices to share, but we haven't changed the basic core of how we work end-to-end process from the sale to the field installation to the field service, especially. So this is all in service. So from the time the warranty starts till we provide maintenance, repair, and then eventually mod, we haven't changed how we do that in a very long time.

So we're going to change the processes and we're also going to apply technology, because this is happening at a very unique inflection point where agentic AI and generative AI and 1.1 million of our units being connected on Otis ONE and giving us data every day is giving us the ability to make our field more productive, to improve our quality, and also to raise the level of how we work. So it's not a restructuring program, but it's a build after we did UpLift so that we can be customer-centric, and we can get leverage on service margin. This is all about.

Now where do we get the next leverage on service margin? We can continue to add units, that'll help. We can drive volume on the top line. But now we need to get that leverage in terms of productivity, in terms of how we deliver and how we work. And you're going to be hearing more about this service operating model. We're going to do in a very focused way, Brandon. Now, we are going to start in our high-value countries because not every unit contributes the same way. A unit in an emerging part of Asia is very different contribution than any unit in a mature part of Europe or the Americas. So we're going to start this in the US. We're then going to move the service operating model to a few key high-value countries. You can imagine Germany, France, Spain, in Europe, and then we'll proliferate it from there.

But the yield, it's all about leverage for us on service margin, and we think beyond volume growth, this is that second piece that pulls it all together.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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As you mentioned, you have some territories that are operating very well, combining strong growth, retention, and productivity. What separates those best-performing territories from the rest of the network, and how much margin opportunity is there from simply closing that performance gap?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

A

They're significant. I won't put a quantitative number on it, but there's significant opportunity by raising the lower quartile and getting to where our, and we have some world-class leaders in these operating territories. Retention rates in the high 90s, customer satisfaction, incredible, far greater margin contribution and service margin. What separates them is the ability to do workload planning, to do resource allocation, to be able to be responsive to customers, and to do all of that simultaneously based on the processes they've put in place these best practices.

And we have some that are outstanding. And the challenge is how do we institutionalize that? And these people are, they're doing great jobs. We only have 1,400 P&Ls that all add up, and they're not all operating at the same level. But when we can get this deployed, especially in these high-value countries, you're going to see the difference on the bottom line.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Q

That's great. I want to drill down a little further on service margins. The biggest question coming out of Q2 was with the margin story of strong organic growth, as you mentioned, but margins declined 170 basis points as mod mix, labor costs, and investments weighed on the results there. How should investors separate what was temporary executional costs from structural costs that are required to support a faster service growth level?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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So we had about \$50 million in 2026. [indiscernible] (00:41:15) about \$50 million of that, it's not investment costs, but was for the decision we made to be able to do much faster backlog conversion, and that drove a lot of the repair and modernization top-line volume. We needed to -- you can't allow backlogs to grow too significantly, especially in repair, because the customer's got an elevator down. So we needed to apply higher skills at times in certain countries. We needed to bring subcontractors in for us to be able to convert the backlog. Our mod backlog as we entered the year was at 30%. It's now at 26% with this 24% revenue we had. We needed that ability, and we thought for customer relationships, for backlog conversion, that's temporal. We know that that's temporal in terms of what we need to do.

Simultaneously, obviously, hiring these mechanics and the skill needed to do repair and modernization is a higher skill discipline than just to do maintenance. Traditionally, we had the luxury of bring everyone in, they start with maintenance, and then you continue to grow them and groom them. With our backlogs as high as they are in repair and mod, we needed to use higher skilled labor than we had anticipated. So that \$50 million, that was all fairly temporal in the second half.

In terms of modernization, though, and mix, it is a lower margin offering for us than maintenance and repair, but it is worth it. So if you look at right now, we have about a 75/25 split in revenue, maintenance and repair being about 75%, modernization being about 25%. The modernization markets, our target medium term was to get to about 10%. We're on that trajectory, and then we'll improve from there. But, you know, our service margins, we're going to end the year at -- the second half will be about little over 24%. You can imagine that maintenance and repair is much higher margin.

The reason we're so excited about modernization is twofold. One is actually the expansive opportunity. But in terms of how it can contribute is we have the volume we're going to get from it. And with that volume, we're going to get the flow through of profit dollars. So the EBIT is going to come. It'll be margin dilutive, but the EBIT is going to come. But just as important is a tremendous number of the modernizations we do are units that are not in this 2.5 million unit Otis service portfolio. So as we finish those modernizations, as we're in a live building with the customer, they're having us do their work, our conversion on those into our service portfolio helps us grow the service portfolio even more. And it overcomes even China conversions, which have slowed down because new equipment slowed down.

So to us, modernization is an evergreen opportunity. Again, 9 million units over 20 years old. Last year, we anticipate it's not really well-kept records in our industry like new equipment. We anticipate a little over 300,000 units got modernized. More than that entered the modernization window last year. So the opportunity is growing.

It's going to continue for years to come. And so the modernization business, again, as we grow scale, it will get even more profitable, but the profit dollars will come and the ability for them to add to our portfolio is like a double benefit.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Q

Before we get to modernization, I just want to ask one more on margin. So the \$50 million that you said is temporal for the second half of the year. What specifically do you need to see improve in order for that \$50 million to truly be temporal and unwind in the next year?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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So we've already hired the mechanics. They're on their journey in terms of their apprenticeships, in terms of their learning curve. So in terms of the need to bring in additional surge subcontractor support and the need for us to keep moving labor around, whether we're moving China mechanics to Japan or mechanics from Peru to Spain, we've been using our workforce dynamics and subcontractors to be able to help fulfill this while our mechanics have been getting trained. We're comfortable our mechanics are at the right place in the learning curve, we hired them in 2024, 2025 or now in 2026, that will take care of that situation.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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Great. So now shifting to modernization. As you mentioned, the sales were really strong, grew 24% in Q2, backlog up 26%. But you're going to moderate growth to the mid-teens, you're saying. What is -- how sustainable is this level of demand in the 20s? And what would it take for you in terms of investment or whatever else you would need to do to support a higher level of growth in the mid-teens you're guiding to for the back half?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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We're ready for in terms of an investment perspective. We've got the modernization packages standardized around the globe. They're coming across our new equipment lines in terms of manufacturing, so we're getting the scale in terms of supply chain, in terms of material productivity, and we're seeing the early days of the installation productivity repetitiveness that'll get us that efficiency in terms of how we quoted versus what our final results was.

I don't think we stay at 24% for every quarter, but I think it'll modulate in the 26% up backlog. There's a combination of volume mod, so think about an apartment building, a school, something of that nature versus major projects mod. Think about the Empire State Building when we did that mod, Willis Tower, large office complexes or airports where you can't stop the flow of people, but you can take down one elevator at a time to do a modernization.

I was last year at the Beijing Metro, and for that escalator mod, we were allowed to operate from about midnight till 4:00 every day, and then we had to leave. So major projects have a little different revenue recognition flow. It looks a lot more like new equipment, but the volume mod we see happening easily at this mid-teens, and then major projects is kind of the piece on top that's a little harder to predict in terms of revenue recognition.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Q

Got it. I want to shift to the new equipment for a second. We saw down only 1% in Q2, one of the better results, I mean, in the last couple of years with backlog growing as well. Is the new equipment market turning a corner? And where are you seeing the most strength and weakness on a regional basis?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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This quarter we were -- that minus 1% from second quarter will be positive. First time we can say that since 2023. Any of you who know us know that that's due to the significant decline in China new equipment that's been happening now for about five years, a little over 45% decline in the market segment. And we've done everything, whether it's our China transformation or any, and pivoting more to China service and modernization to handle that and to really reflect in our business a different level of business we have now in China that used to be predominantly urbanization new equipment.

What we're seeing happening right now in the third quarter, what's overtaking that overhang from China, and we're just delighted to see it, is how our team in North America has done. We've had eight straight quarters of new equipment growth in the US and Canada, and it's been significant new equipment growth. There's a good 18-month lead time, so if you go eight quarters, we're now starting see that not just flow through our factory in Florence, get installed, but we're seeing it flow through at much higher volumes to where it's overtaking China.

Asia-Pacific and Europe still look strong. China, new equipment is now 18% of the group revenue. It was 33% in 2020. So -- and our business has grown. So you think about, we've overcome the China overhang. We're going to inflect positive in third quarter. That's going to continue through the rest of this year and next year. And once China just stabilizes and we don't have the compare, you all will see how well the other three regions have been performing year after year to keep our business growing.

I mean, our top line, we're going to be up to about \$15.1 billion to \$15.4 billion in revenue this year. And that's still with China down in its fifth consecutive year on new equipment. So I think the team's done a great job compensating, and once China stabilizes, we don't expect new equipment to ever grow there again. That would be a nice surprise. Once it stabilizes, you'll see the strength of Asia-Pacific, of EMEA, and of the Americas, and how well they've been doing on new equipment. Still a lot of construction going on in this world.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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And as you mentioned, China has been weak, but recent comments have suggested that it's sequentially improving at the very least and performing as expected. What are you seeing on the ground today in China? What gives you confidence that the market is approaching a more stable level?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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I have the privilege of having just gotten back from China two weeks ago, and met with government officials all the way up through Premier Li to understand economics, party secretaries, governors, to understand where China is heading, where the priorities are in the 15th Five-Year Plan. And what does that mean to our market and what does that mean to Otis? And just as importantly, time on the ground with the team. We understand our markets. So, our team has performed incredibly well under challenges. We knew we needed to take cost out of new equipment, and we did that through our China transformation last year.

But we ended second quarter with 48% of China revenue being in service. First quarter was 52%. So all of a sudden, what used to be such a predominant new equipment business, we've converted to be a service business, and China looks a lot more mature, where we're seeing growth in China on the service side, we're still growing our service portfolio. We spun with about 220,000 units in China in 2020. We're now over 0.5 million. Team has done a great job growing that, which then drives repair. But the biggest CAGR growth is happening in modernization in China.

China units tend to modernize at the 15-year mark versus the 20 because of so much usage they get. And in 2024, the Chinese government added a stimulus. Originally it was for white goods, but we got elevators included. For older residential elevators, the government pays to modernize their buildings. In 2024, it was 80,000 units. In 2025, it was 120,000 units. This year, it's 180,000 units. In the second quarter, our modernization orders in China alone doubled, smaller base, but doubled, as we're winning more than our fair share of this modernization stimulus. What I heard while I was in China is it's going to continue into 2027, and we believe beyond, potentially beyond just residential to take care of the citizens of China. Other buildings will be included in the stimulus. This year, we got it added that it wasn't just one price point, it's three price points depending on the rise, how many floors there are, because there's more material. So the Chinese government's committed to this in the 15th Five-Year Plan, and our Otis team has been performing wonderfully.

So China looks more like a mature market to us. It obviously had a hit on our new equipment margin becoming lower because China had the highest new equipment margins, followed by the Americas. But we've been able to make that up.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

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And as investors start to think about looking beyond 2026, I'm not asking you to provide guidance, but what should we think of as the major puts and takes that we should be thinking about as we bridge into 2027 in terms of service volume, margin recovery, new equipment in China?

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

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We are excited. Listen, the business model is intact. This is a stable business that has been preparing for higher growth than we've seen in a long time. That's what the investments have been all about. Those investments need to pay off. Pricing needs to happen. We need to see the service quality continue where it is and continue to improve and that translate directly into retention rate. And we need to execute with excellence. The service operating model will help us do that. We are the leader. We've got a great portfolio. We've got the best people in the industry. And what you'll see on the margin side is some of these temporal issues and investments we made this year not repeating. There is some seasonality, so I'm not going to get into first half versus second half in 2027. We'll share that with you when we guide.

But we're going to leave the year strong in terms of service margins. You'll see incremental improvements, third quarter and fourth quarter. That's all in our backlog now, so we just need to perform. And when you see that strength and we share with you where we're going in 2027, I think you guys are going to see the returns of a high quality business and a business I've been very proud to lead and will continue to lead into the year.

Brandon Knutson

Analyst, Morgan Stanley & Co. LLC

Great. Well, that's all the time we have. Thank you so much, Judy, and appreciate the conversation.

Judith F. Marks

Chair, President & Chief Executive Officer, Otis Worldwide Corp.

Thanks, Brandon.

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