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Otis Worldwide Corp. (OTIS)

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CORPORATE PARTICIPANTS

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

OTHER PARTICIPANTS

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Okay. Great. We're moving right along here with Otis and Cristina Méndez, CFO. Thank you so much for making it here. And I think you're going to give a little bit of intro, and then we'll jump right into the Q&A.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

Absolutely. Thank you, Stephen, thank you for having me. I appreciate the opportunity of talking with you today. Let me read the statement first. Please note that except or otherwise noted, I will speak to results from continuing operations, excluding restructuring and significant non-recurring items. Reconciliation can be found in our fourth quarter earnings presentation on our Investor website. We also remind listeners that today's discussion contains forward-looking statements. Otis' SEC filings provide details on important factors that could cause actual results to differ materially. So thank you, Stephen.

Let me start by saying that the Service is the foundation of our business, as we all know, and we are very pleased to see the Service business growing. It has grown mid single-digits since the spin with expanding margins of 50 basis points per annum. And we see this growth continuing, thanks to the growing opportunity we see in the market. And thanks to this resiliency, despite of the challenges we have faced in New Equipment in the last years, New Equipment has declined, especially in China. From the top line perspective, it has been a drag of approximately $400 million a year in 2024 and in 2025. Despite of that, we have delivered ongoing and steady EPS growth and that's thanks to the resiliency of our Service business.

And looking ahead, we are very excited about the opportunity we see. We see an opportunity in the addressable market, what we call the TAM, and that is thanks to the aging population of units. So, we have all of these units that were installed in the major Western construction cycles back 30 years ago and in the construction cycle that started in the 2000s. We are talking about 9 million units out of the 23 million units global installed base. These are in the prime age of modernization, that means 15, 20 years or older. And this population is growing high single-digit. And besides the portion of the market that is actually being served is significantly smaller. And that's why modernization revenues are growing double-digit. And we see this as an evergreen opportunity, because by the moment, we complete the cycle of modernization of all of these units, we will have new units that require modernization again.

In addition to that, repair, it's also growing, because of all of the units that have not been modernized, and repair is our highest margin activity in the P&L. So, we see this happening simultaneously, repair and modernization growing in the four regions in the globe. We are also executing a strategy that is based on value. We are addressing value growth instead of volume growth. And we are very excited about an opportunity in pricing. We have been very disciplined in passing inflation to customers, but the opportunity is to do micro pricing to be much more targeted and to [ph] segment it (00:03:23) and align the price with the willingness to pay and to the value that customers receive.

So because of all of this, we are excited about the growth opportunity in Service. We see the acceleration happening as early as in 2026, and as early as in Q1. Q1 is growing maintenance and repair sequentially from Q4, as we expected. And we are convinced that with our scale, with our industry-leading margins, and with our strong brand, we are very well positioned to capture this opportunity.

QUESTION AND ANSWER SECTION

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So I guess, the Service business obviously very strong in line with guidance. Maybe you could just talk about the – just broadly the other parts of the business, what you're seeing out there? And are you reaffirming the total company guidance?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. No, absolutely. And look, as you said, Service is super strong. We see an acceleration of repair. Repair in the quarter, in Q1 is trending [indiscernible] (00:04:20) approximately 10% growth exactly as expected. And we are also seeing an ongoing demand. Our repair orders continue growing high single-digit. So, we have good line of sight for the high single-digit repair growth we have guided for 2026. In order to do that, we are hiring mechanics. We hired last year 1,000 mechanics. In the two first months of the year, we have on-boarded 200, together with the 250, we on-boarded in Q4. So, we are in good pace and we are accelerating as much as we can because we need those mechanics to execute our growth plan.

In addition to that, I've talked about pricing. I'm super excited about the pricing opportunity, because here what we are doing is piloting pricing in maintenance and repair in high value market, we are very focused on the markets that move the needle and we are essentially adapting the price to the value we deliver to the customer, it's super [ph] segmentated (00:05:20), very analytical, thanks to an AI algorithm that we are rolling out in these particular markets. We see the results in the orders and this is flowing through in the P&L as we convert those orders.

With price, we expect this year to be 4% versus 3% in the past. So, 1 point incremental. That together with portfolio growth, that is expected to be around 3%, we will continue growing our maintenance business. And last but not least, you ask outside Service. New equipment is also performing very well. And New Equipment in particular, we are positive about the Americas. As you know, Americas has had strong quarters of orders in the last six quarters. Their backlog is growing. As Q1, that backlog will be growing low-teens and you have seen probably today the ABI numbers. They are also very promising. ABI is going up sequentially 49 plus, so it's still below 50, but getting their highest ABI number we have seen in the last 12 months. So, we remain very bullish about the New Equipment market in Americas growing mid single-digit.

Now, on the New Equipment and mod side, we are impacted by the geopolitical situation in the Middle East. We are present in the Middle East, but it's a small portion of our business. It's only a low single-digit percentage of our revenues. We are present in UAE, Saudi, Egypt, Qatar, Bahrain, Kuwait, and we also have distributors or indirect presence in Lebanon, Jordan, Israel, Cyprus, and Oman. But it's a small part of the business, but [indiscernible] (00:07:05) sites are closed. So, we see some delays in the recognition of revenues. And we also see some disruption in shipments from Asia to Europe and vice versa because of the shipments of units, components and parts. This is just temporary. We are rerouting the shipments all along Africa instead of following the Suez, and we also see increase of logistics cost and some FX headwinds. We guided FX for euro at 1.18 and we see today we are trading at 1.15.

Having said that, all of these impacts are temporary. The orders are in place, the units have been produced. It's just a matter of the situation stabilizing in the area and being back to normal. And we quantify this impact for the quarter in approximately $20 million for New Equipment and modernization each, which is a small portion of our quarterly revenues.

For New Equipment it represents 2% of our revenues, for modernization it's 1% of our revenues. At profit level, there is a flow-through because of the delay of shipments. And we also have a calendarization of investments. I said before, we are investing in mechanics. We are not taking the foot off the gas. We are accelerating investments because it's the right thing to do for the business, it's a key enabler for us to grow. Because of these mechanics that have on-boarded at the beginning and are productive and because of the investment in pricing in the AI algorithm and training the sales force, we see some calendarization of profit into the second half of the year. So currently, we are seeing EPS in Q1 around minus 3% to minus 5% down, but [indiscernible] (00:08:46) calendarization in the year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So, 3% to 5% down EPS, that's a year-over-year figure?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Correct.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. For the first quarter?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

For the first quarter.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And then anything kind of calendar wise in the second quarter, should we expect a nice steady ramp from there?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. So...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

How do you see that seasonality playing out?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So, second quarter, of course, will depend on how the situation evolves in the Middle East. But assuming we come back to normal, it's just a matter of time for the jobsites to be reopened there. And look, we are prioritizing the safety of our employees. We leave – the employees are not in the job sites. It will take some time for jobsite readiness. The rest of Europe, the shipments are in place. It's a matter of facing the logistics, the FX. And also some commodities are a headwind because of the conflict, particularly aluminium. But we are talking about the small numbers, it's only mid single-digit dollar impact.

So, I would say first half of the year would be minus 3% to minus 5%. So, Q2 in line with Q1 EPS growth. We already had a back-loaded profile in the year. And the reason for that is because New Equipment is gradually turning around into positive. We expect Americas to be positive in New Equipment sales, Q2, the latest Q3. We also have a tariff comparison that is easier in the second half of the year, and we also see the acceleration of Service that is in the second half, particularly because of the pricing benefits coming later in the year. So, that's [indiscernible] (00:10:15) as planned. With the conflict, there is some revenue and profit shifted to the right, but kind of essentially in line with the calendarization we had initially.

The good thing Steve is we are very encouraged by this strong performance of the core of the business that is maintenance and repair, the acceleration in Q1. And also we have a new organization in place. This was announced in January. We have now a Chief Operating Officer and a Chief Growth Officer, new roles that are focused on the one side on operational performance and on the other side on growth initiatives. And we believe this is the right organization for us to execute our plan in the year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So just thinking about the repair growth, you mentioned it was going to be up 10% in the first quarter. How are you thinking about it for the year, for the total year?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So for total year, we said around high single-digit growth. First quarter, probably a little bit stronger. It has also an easier compare with first quarter last year. It will slow down, but is still in the high single-digit level for the full year. And as I said before, our orders for the quarter are trending in that direction.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. And as far as the pricing on Service, I think just – can you just take a bit of a step back and you said there's going to be a point of price this year and that's incremental to what you've guided to? Or is that in line with guidance? Just feel better about it.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

That was already baked into the guide.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

We feel very good about it because we see the results of the first pilots in the first two months of the year, it's coming in orders, it's just making its way through the P&L as we compare those orders and we are also going to scale up to other branches and always focus on maintenance and repair and always focus on high value customers to get started.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. And then as far as mods are concerned, how are you feeling about orders there in the first quarter and the expectation there for the year as well on sales?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. So as I said before, mod for us is evergreen. We see mod growing at low-teens and we expect the first quarter to be kind of around that ballpark. And conversion is coming as we ramp up resources. We ended up last year with a backlog growing 30%. So, we are very positive about mod. The good thing of mod is we are industrializing our packages. That makes everything easier in the factory. We benefit from supply chain scale, material productivity and this is especially easier on the field, because it's the same installation method. As for New Equipment, we can shift mechanics from New Equipment to mod very easily and we also capture field efficiency. We said in the past, two years ago, that mod was going to overpass New Equipment margins. At that point, New Equipment was at 6%. With a mid-term target to get to 10%. We are very close to that 10% margin in mod and we will not stop there. We will continue capturing efficiencies. We think we can do more than that.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And on that on that front, there was a obviously a pretty big subsidy program in China. How are you guys thinking about that in 2026? And then what's the outlook for the sustainability of a program like that? Those programs are notorious for turning on and then shutting off. How do you guys think about that outlook?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. You are totally right. So, the problem in China has, first China is growing modernization in all the verticals, not only residential, this program is focused on residential, but we are also growing in commercial, in infra, and in offices. But on the residential side, the program has started in 2024. At that point, the government subsidized 80,000 units. Last year, it was 120,000 units. This year, in December 2025, the government announced the plan to subsidize 180,000 units. In February, the Ministry of Housing and Urban and Rural Development announced the first release of a batch of 61,500 as part of the 180,000 for the year. So, we see these very positive as an ongoing support of the government to continue promoting modernization in China.

And the difference this year that we welcome is that there is no fixed price. The subsidy will depend on the number of stops. The higher the number of stops, the higher the subsidy. And they have announced that for more than 19 stops, it's going to be RMB 200,000. This will help the mix and therefore the margin. And we are quantifying that with a more volume and this tiered approach, the program this year is going to be 15% to 40% bigger than last year. And we are going to take that opportunity and we are going to take our larger share of segment in this growing segment. And remember that China has a faster conversion rate. So, we'll get more orders. We can convert faster in the year. We are still evaluating and see what it means for us in the year. But this is a good opportunity.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And you said that up – you expect it to be up 40% for you guys?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

15% to 40% bigger...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

...than what it was last year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Okay. Got it. And is there any visibility on I mean, it seems like it's huge for you guys. Is there any visibility on 2027, and how they approach 2027? Because it's a lot of units.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

They're putting in the base.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So look, first...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Sorry. And how big is your China mod business today-ish, roughly?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

It's small. We don't disclose China mod, but it's small relative to New Equipment.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

But growing, well, last year China grew 80% mod sales.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

100% in Q4. So, it's really booming.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

Back to your question, we expect the program to continue and maybe winding down over time in the sense of probably not having a full subsidy, but a partial subsidy. But the good thing of this program is creating the demand and is creating the interest in the marketplace. It's now monopolizing all the residential modernization. As we – as it winds down, we are very prepared to continue generating this demand and growing over time. So, you don't see a hit when the product comes to an end.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right. Okay. And the talk about attrition rates. Maybe just talk about the – what's happened. This is kind of the maintenance side – the maintenance portfolio side. How is the attrition rate trending and what are the actions you're taking to kind of stabilize that?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. No. Attrition rate is one of the key focus areas at the moment, and we are pleased to see outside of China attrition rate stabilized in 2025 at a very good level by the way. We had a retention rate of 94.5%. That is a good rate. That is because we are putting much more focus on quality. We have realized that customers do not leave because of price or because of competitive pressure. They leave because they are not satisfied with the quality of the service. So, putting the right focus on quality and ensuring that all the branches are looking at the quality KPIs and assigning enough mechanics to follow those contractual commitments, it is fundamental to improve retention. We have started investing on that last year and that's linked to hiring mechanics.

And I mentioned that we have hired 450 in the last five months and we see good results. And going forward, we expect this to improve. Now, China is different. China is a very price sensitive market. The contracts are only annual. Therefore, every year you renegotiate. And in China, we are pivoting into a value driven strategy. We are not chasing units for the sake of units. Not all the units count the same. So, we are focusing on the right customer segments, on the right verticals, on the right years, not a surprise Tier 1, Tier 2 cities are much more profitable because they are more dense than Tier 5 and 6. So with this strategy, we may slow down the growth of volumes in China, but with an acceleration of dollars because we get more value from the customer base.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And I guess, do you have – do you need to tweak the head count there as well because of that, because you have kind of an infrastructure to serve a certain level of growth? Or do you just kind of stop building that infrastructure and leverage it to the extent?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So we are talking about service. The good thing is that we will be able to be more efficient. As you rightly say, we have less growth, but more dense, therefore is more productive. But that means we can free up resources to do more activities on repair and modernization. So, it's kind of freeing up resources for more growth.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

I see. Got it. And as far as that, the cost of those mechanics, how does that kind of filter into the P&L? Like what's the annual rough cost of one of those mechanics? And how does it – when do you see that like kind of breaking even?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

It depends on where you are in the world. It's not the same mechanic in China, than a mechanic in the US, of course. And for example US is under a union agreement, that is a multi-employer agreement. So, all the players in the industry follow the same rules. But I would say, yes, an average pattern at the beginning hiring a mechanic is cost because you need to train and they are not productive. They are billing revenues. After I would say three months to six months, depending on where you are in the world, they become productive and they are fully absorbed with revenue generation.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Got it. So, when we think about the portfolio growth rate here, I guess the 94.5% that you have outside of China, where was that before and cannot go back to where it was before. Are you pretty satisfied with the 94.5%?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

Well, [ph] we think it's a (00:19:57) good number. We have been a little bit higher in the past and we think a good target would be 96%. Going beyond that is complicated because you have natural attrition coming from aging and/or buildings that are changing, right. But 96% would be a good target.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And you're still thinking, so in this kind of construct, you're thinking portfolio growth in units. Is that 4 or 3? I think you said 3 plus a point of price or something?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

That's exactly what we are thinking. That is...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

...probably going to be around 3% with a different mix.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

Means China is slowing down and accelerating in other regions and with much more price and that will help long-term to reduce the headwinds and to also accelerate total maintenances growth.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Right. I think that makes a lot of sense. So, the Services business, if you kind of break that down, you said 50 bps of margin expansion is because of all these costs that are kind of loading in here this year. Is that 50 bps a little bit lower this year or are you pretty much on track for the first year?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

That's a good question. We are not focusing so much on margin expansion anymore. We are focusing on dollar growth, top line and bottom line. On the Service side, we still expect margin expansion because as we grow the portfolio, we increase density, we increase productivity. And also pricing has a higher flow through. All the pricing upsides are 100% flowing through the P&L. Having said that, in Service, we also have two headwinds from a margin rate perspective. One is modernization that is growing faster and has a lower margin rate. And the other one are all of these investments. They are headwinds from the rate. They are not headwinds from the dollar side.

So to your question, we expect margins to expand not to the extent of the 50 basis points we saw in the past, maybe 10, 20 basis points. But there is still room to continue expanding.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

And that would be the annual framework.

Cristina Méndez A
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

That will be the annual. Then you have calendarization and seasonal effects when you compare the different quarters.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

Right. And then and you would expect though, after these you hire these 1,000 service people, they kind of get up to speed. You can start to leverage them a little bit more in the rate...

Cristina Méndez A
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

Absolutely.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

...so that maybe next year can be all else equal.

Cristina Méndez A
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

Absolutely.

C. Stephen Tusa Q
Analyst, JPMorgan Securities LLC

That would be a little bit of a lift with everything else being pretty stable.

Cristina Méndez A
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

Absolutely. Having said that, as we continue growing, we continue on-boarding. And so, this is going to be a natural process.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. So, it doesn't sound like the 50 bps from a longer-term perspective in Services is really we should kind of build back up to that over time as opposed to going from up 10 to 20 to up 50 in an inflection.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Exactly. And look, at the end of the day, the question is Service will continue. We'd accelerate growth. From mid single-digit to mid single-digit plus.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Margin will not expand 50 basis points, will be 10 to 20, but total profit will continue growing in Service.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

On the New Equipment side, New Equipment has been a drag. I cited at the beginning both revenue and profit. This is coming to an end. We think the worst is behind us. We see China stabilizing. So, in the moment, New Equipment has stopped being a drag together with acceleration of Service growth. You can see the growth in EPS.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. How are you exposed? I guess just stepping back for a second to the Services side. How are you exposed to fuel prices on that front? I think you got a lot of guys driving around in trucks.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah, it's not a big amount. So, we have approximately 60 million to 70 million fuel cost per annum. If you assume a 10% increase, this is mid-to-high single-digit impact. And by the way, we have the ability to pass part of this to our customers.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

Not a big impact.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Not a big issue for you guys.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

No.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Got it. So, the – anything on the tariffs front that stands out for you guys this year?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

Well, tariffs I mean, the situation remains fluid, but based on what we know today, it should be a positive impact to our guide. The Supreme Court decision regarding IEEPA together with newly implemented Section 122. This could represent $5 million to $10 million upside to our guide. This is excluding any refunds from the previously paid IEEPA that is. But as I said before, it's very fluid. So, we continue to evaluate and we wait until we see the final scenario.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And just remind us again on kind of the non-fundamental stuff, the forex, what were you expecting and what would that be now?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

Yeah. That is at the moment, the headwind because we guided according to euro being 1.18. And we see it's 1.15 and 1.16. So that can be a headwind to the guide this year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Got it. Any magnitude there?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.
A

We see how it goes. And it also depends on how the conflict evolves in the next weeks.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. I'm not going to ask you about that, timing on that. So, on the New Equipment side, you're saying that China is stabilizing. Just talk a little bit more about the orders there and what you're seeing so far this year in China. What gives you confidence?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So, China market last year declined 13%, and we are expecting this year to decline approximately 8%, a little bit more at the beginning of the year, around 5% decline in the second half of the year. And of course, the situation is very volatile and it may get better. And if it gets better because of the lower conversion rates, we can move it into the P&L faster. Our expectation is that China is going to continue declining. At the same time, we are very much focused on Service, the growth, modernization and Service and to focus on New Equipment projects that gives us the conversion into Service.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. So, and then the other and how is pricing there? Are you seeing pricing stabilize at all on the New Equipment front?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

It is. I would say stabilize is this too much to say. But is price-cost neutral.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Okay. And then in the rest of the world you were pretty optimistic. You talked a little bit about the US, what are you guys seeing in Europe?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. Europe is growing low single-digit all across the board, leaving aside the situation in Middle East, that of course, may impact demand if it stays for long-term. And APAC is growing. APAC is growing in India, it's high single-digits. Southeast Asia is growing. Japan is slightly growing. And even Korea that has been declining. We see some signals of stabilization in Korea.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And as far as the margins here, just remind us that what you guys guided to and how you see that playing out for this year?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. So, we guided slightly below 4%. That would be the same level of margin rate we saw in Q4 is going to continue this year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. So, no change to that. Okay. Just one last one to kind of wrap up the guide. I know some of this stuff is temporary in the first half. How much of this impact in the first half can you make up in the second half? So, on an annual basis, are you kind of reaffirming the year or is the slow start kind of you gained some of that back, but you don't gain it all back in the [indiscernible] (00:27:00).

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Look I would say, it's too early to say, because again, I cannot predict how long the situation is going to last.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Having said that, all of the impact we are seeing is temporary. There is no impact on the demand. We see the orders continue. We see the – by the way, the orders we are now executing are in place. We have a backlog and we have the shipments. So, it's a matter of – for the rest of Europe, navigating the macro and for the Middle East is for the jobsites to be reopen. In the moment this happens, we can't recover everything. It's only a matter of the calendarization that we expect now. A more backloaded profile in the second half of the year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. You guys had a really strong performance in free cash flow in the fourth quarter. Maybe talk about the moving parts on cash flow as you move into this year, and then into – for the annual on cash conversion?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah. We are very pleased with the cash flow conversion. Last year, we ended up at 100% back to our normal levels. And that at the end is a result of New Equipment that is moderating the decline, plus modernization is growing, and modernization has the same working capital pattern as New Equipment, which is essentially we collect advances when we book the orders and we also collect before shipping the material to the field. As modernization grows, this is a tailwind in working capital, and we see the 100% conversion rate from 2025 continuing in 2026. New Equipment is also going to moderate. We expect in the guide New Equipment sales to be flat to low single-digit down versus minus 7% last year and mod continues growing at low-teens. So, from that perspective good line of sight to continue cash flow conversion at 100%.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And what are you – how are you thinking about capital allocation priorities? There are some assets out there that are being talked about.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Is there any M&A on the agenda?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So, we have a very consistent capital allocation strategy. We generate an incredible amount of cash and we have said to our shareholders that we will continue with a 40% payout of dividend subject to board approval, plus also share buyback to give the excess of cash to shareholders. From the M&A perspective, the bread and butter of our M&A and the most accretive deals are small ISPs that we can easily integrate into a brand, we synergize the [indiscernible] (00:29:24), we synergize the field routes, and we will continue doing that. We see more ISPs knocking on the door, because the industry gets more sophisticated technology-wise and under generational refresh, right. And they are calling us and we are taking opportunity when it comes up.

From a big M&A perspective, there are rumors in the market, I'm not going to comment on any rumor transaction. I can only say that whatever scenario happens, we will welcome the transparency on that asset and this will happen either in an IPO or in a consolidation scenario. If it is consolidation, it's going to be a very complex deal which will trigger destruction, and we are going to take advantage of that from our side. I don't want to comment on potential, very serious questions about whether this is in the best interests of customers or employees.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

And last but not least, we have competed in a very consolidated industry for more than 100 years. We know these players very well and we know how to win. So, we are essentially going to remain focus, to execute our winning strategy that is being customer-centric and continue leading the market with the best-in-class margins.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

What are you seeing from the ISPs as far as how competitive they're being on price?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

So, they are – they have a different value proposition. They are more local, they have proximity. And they are also less sophisticated. They cannot run the big modernization, they cannot run complex repair. So, they are kind of more bread and butter. With – I'm not so concerned about the competitive environment. As I said at the beginning, retention is typically very high, if you do the right things for the customer. So, that's not an issue. What we do see, and I said it before, is more ISPs trying to leave the market, because of technology sophistication and because of the generational refresh.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. So, really the competitive dynamics that you're seeing out there or at least the attrition rate you're seeing out there. I mean, in China, it's a bit of a pivot in strategy that you're undertaking. And then here in the US, it's really not a competitive issue. It's more of a – you guys needed more boots on the ground and better service effectively.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Absolutely. You got it right.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. That makes sense. Any questions out there? Everybody's shy. I mean we have one question the entire day. That's all right. I can keep going. On the other raw materials, metals or steel or anything like that. Anything to note?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

No. Look, last year commodities was a tailwind for us of approximately $10 million. This year, we anticipated it was going to be a headwind in the similar amount. Essentially, copper is trending up, but very small in the progress scheme of things. So, we are talking about $10 million and nothing to do with the commodity crisis we saw three years ago.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. Far from what we saw in COVID and...

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Absolutely nothing to do with that.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

...the inflation there. And anything else that you wanted to talk about that we didn't – that we really didn't touch on?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

No. Look...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

I think we covered a lot.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Again, we are very encouraged by the trends we see in the first quarter in the core of the business that is maintenance and repair. Leaving aside all the noise for the geopolitical conflict that in the broader scheme of things is small, as I said before $20 million-ish in New Equipment and in any modernization and it's just calenderization within the year. We continue investing. We see the good results of the investment in price and in mechanics and with a new organization in place, we are very confident on delivering what we said.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. And I guess this first quarter shallow start is really centered within the Middle East region and things going – they're having trouble going back and forth and some delays as opposed to anything to do with like underlying demand in China or anything like this?

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Exactly. Exactly. So, it's essentially the Middle East region, shipments to Europe impacted by the Middle East conflict...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

...plus the calendarization of investments.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah, the investments, right. Because you're starting off the year on a pretty strong foot.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

A

Yeah.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Okay. Anything else? Anybody. Any questions? Okay. I think that's all we have.

Cristina Méndez
Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

Thank you very much.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Thank you so much.

Cristina Méndez

Executive Vice President & Chief Financial Officer, Otis Worldwide Corp.

Thank you, Steve.