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Otis Worldwide Corp. (OTIS)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Otis' Fourth Quarter 2023 earnings conference call. This call is being carried live on the internet and recorded for replay. Presentation materials are available for download from Otis' website at www.otis.com. I'll now turn it over to Michael Rednor, Vice President of Investor Relations. Michael, you may begin.

Michael Rednor

Senior Director-Investor Relations, Otis Worldwide Corp.

Thank you, Krista. Welcome to Otis' Fourth Quarter 2023 earnings conference call. On the call with me today are Judy Marks, Chair, CEO, and President, and Anurag Maheshwari, Executive Vice President and CFO. Please note, except where otherwise noted, that company will speak to results from continuing operations, excluding restructuring and significant non-recurring items. A reconciliation of these measures can be found in the appendix of the webcast. We also remind listeners that the presentation contains forward-looking statements which are subject to risks and uncertainties. Otis' SEC filings, including our Form 10-K and quarterly reports on Form 10-Q, provide details on important factors that could cause actual results to differ materially.

Now I'd like to turn the call over to Judy.

Judith F. Marks

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

Thank you, Mike, and thank you, everyone, for joining us. We hope everyone listening is safe and well. We delivered a strong fourth quarter to cap off strong full-year performance. We enter 2024 with confidence in our Service-driven business model, remaining focused on our strategic pillars, including deliver modernization value, which we added as our fifth strategic imperative last year, while driving operational excellence. We achieved these results with the hard work of our colleagues around the globe. So, I want to thank each of you for your hard work, commitment to our customers, and demonstration of our Otis absolutes. Starting on slide 3, we achieved full

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year organic sales growth in all regions, with total Otis organic sales growth of 5.6%, driven by Service, which grew 7.7%. We grew our industry-leading maintenance portfolio by a record high of 4.2% for the year, and it now stands at about 2.3 million units, a new milestone for our company.

We delivered strong low teens adjusted EPS growth for the year, including mid-teens growth in the fourth quarter. Modernization orders were up 16.8% for the year, including low teens growth in the fourth quarter. Our modernization backlog is up 15%. New Equipment orders in Q4 increased 2.9%, and our New Equipment backlog increased 2% for 2023. In 2023, we achieved approximately 50 basis points of New Equipment share gain. Heading into 2024, as our backlogs have continued to grow, we have good visibility on our New Equipment sales despite the uncertain macro environment, and we expect strong sales growth in our modernization business. We generated approximately $1.5 billion in adjusted free cash flow, allowing us to return approximately $1.35 billion of cash to shareholders through dividends and share repurchases.

Additionally, earlier in 2023, we began executing initiatives related to our customer-centric UpLift program, focused on gaining scale across our global organization to unlock synergies, standardizing our processes to generate efficiencies, and optimizing our supplier and indirect spend. Our streamlining and transformation efforts are on track to achieve $150 million of run-rate savings in mid-2025, as we previously indicated. To summarize, 2023 was characterized by solid organic sales growth, adjusted operating profit margin expansion, and nearly 12% EPS growth, outperforming our medium-term guidance. We are well-positioned as we enter 2024, as we focus on executing our growing New Equipment and modernization backlogs, with greater than 4% maintenance unit growth supporting sales growth in our maintenance and repair business.

We also made meaningful progress toward our 13 ESG goals in 2023, emphasizing the alignment of our absolutes of safety, ethics and quality with our business strategy. Importantly in early November, we announced our commitment to setting near-term science-based greenhouse gas reduction targets, which have been formally submitted to the science-based targets initiative for evaluation. Turning to our orders performance on slide 4. New Equipment orders returned to growth in the quarter, up 2.9% with quarter-over-quarter acceleration in all regions. Orders were down 3.9% for the year as mid-teens growth in Asia Pacific and low single-digit growth in EMEA were offset by declines in China and the Americas. Overall, globally, New Equipment units were down approximately 8% to roughly 850,000 units in 2023.

Despite these macro challenges, we were able to achieve about 50 basis points of New Equipment share gain on top of the nearly 3-point increase between 2020 and 2022, and we were able to grow our New Equipment backlog which was up 2%. We continue to innovate to better serve our customers and drive growth across our business. For example, we continue to roll out our digitally connected elevator platforms, launching the Gen3 Core in North America and expanding the deployment of Gen360 to China. In addition, we launched the Gen3 Mod Plus, a package of upgrades to support our modernization business in the Americas, which also includes connectivity to our Otis ONE IoT platform. R&D and strategic investments remained relatively stable at about 1.4% as a percent of sales for the year, reflecting our ability to invest and innovate efficiently.

We strengthened our number one position globally, accelerating our portfolio growth to over 4% for a second year in a row. We demonstrated the power of geographic diversification within our business with double-digit portfolio growth in China, mid-single-digit growth in Asia Pacific, and low single-digit growth in the Americas and EMEA. Globally, our recaptures offset our cancellations for the second consecutive year, leading to conversions as the portfolio growth driver, in line with our strategy. China conversion rate continues to improve, currently standing at about 51%, an approximately 4% improvement versus 2022. Additional details on our portfolio growth in 2023 can be found in the appendix as accelerating our portfolio growth is an essential component of our long-term strategy and top-line growth algorithm.

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At year-end 2023, we have 900,000 connected units, of which 500,000 use our Otis ONE IoT solution. Our Service sales force performed well throughout the year with like-for-like maintenance pricing of 4 points helping to mitigate labor cost headwinds within the business. Our fifth strategic pillar of delivering modernization value is performing. Modernization orders were up 16.8% driven by double-digit growth in Asia, particularly in Korea, as the strength in our mod package offerings continues to drive results. Additionally, the Americas and EMEA drove strong fourth quarter modernization major project bookings. Our modernization backlog is up 15% versus prior year, giving us good line of sight for strong growth in 2024. We continue to win many exciting projects based on our innovation, ability to deliver, and the trust our customers have in us. As we build, service, and modernize our customers' elevators and escalators, we build loyalty and value with increasing recurring revenue streams.

For New Equipment, in China, Otis is building on decades of close cooperation with the nation's metro providers to help expand urban transport and city development. We will provide 237 escalators and elevators for Line 15 of the Chongqing Metro in West China while incorporating Otis ONE on these units. Otis has a long history with Chongqing Metro which carries more than 4 million passengers daily across rugged terrain on a network that is famous for its ingenious design and engineering. In San Francisco, Otis was awarded a comprehensive modernization of all 16 elevator units at 560 Mission Street. The project includes the installation of custom cab interiors and our Compass 360 destination dispatch system.

In addition, Otis has been awarded the maintenance contract for the 31-story commercial office building, extending our relationship with Commonwealth partners and contributing to our service recaptures in the quarter. In Hong Kong, we are honored to have been selected for a modernization project at Tin Yiu Estate. This project for the Hong Kong Housing Authority, a long-standing customer, includes the modernization of 18 elevators which will all be maintained by Otis upon completion. The new units will use gearless machines with energy-efficient drives to meet the project's environmentally-conscious requirements. In Dubai, Otis will modernize 42 elevators and 8 escalators at the Burj Khalifa. We take pride in being the original equipment manufacturer and maintenance provider of the world's tallest building since its opening. Emaar Properties has trusted us with the upgrade of their controllers and drives and providing the latest technology for this iconic building.

In addition, the contract extends our service agreement for another 10 years. And last, also in EMEA, for nearly 130 years, visitors have taken Otis elevators to the top of the Eiffel Tower where we're delivering a multi-year modernization of this iconic tower's two duolifts. Turning to fourth quarter results on slide 5. For the fourth quarter, reported sales of $3.6 billion were up 5.3%. Organic sales grew for the 13th consecutive quarter and were up 3.8% with high single-digit growth in Service while New Equipment was roughly flat in the face of macro challenges, notably in China. Adjusted operating profit, excluding a $9 million foreign exchange tailwind, increased $52 million with profit growth in both segments. Adjusted EPS grew 16% or $0.12 in the quarter. We ended the year with fourth quarter adjusted free cash flow of $573 million, allowing us to finish the year strong at approximately $1.5 billion.

With that, I'll turn it over to Anurag to walk through our 2023 results in more detail.

Anurag Maheshwari

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

Thank you, Judy. Starting with segment sales performance on slide 6. Otis fourth quarter New Equipment sales were $1.5 billion, with organic sales roughly flat, driven by high single-digit growth in Asia Pacific, offsetting mid-single-digit declines in China. Americas and EMEA were up low single digits and roughly flat, respectively. For Service, we delivered another strong quarter of organic sales growth at 6.8%, with strong performance across all lines of business and regions. Maintenance and repair sales were up 6.8%, and March sales were up 7%,

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including the third consecutive quarter of double-digit growth in Asia. For the full year, New Equipment sales were $5.8 billion, and organic sales grew 2.6%, with solid growth in all regions outside of China. New Equipment pricing was up low single digits globally, with Asia Pacific up low single digits, the Americas up mid-single digits, and EMEA up high single digits.

Although the pricing environment in China remains challenging, we remain price cost neutral in the region from our continued focus on price discipline and material productivity. Service sales were $8.4 billion, with 7.7% organic growth, and all lines of business showing high single-digit growth, including another year of outstanding performance in repair, marking a three-year CAGR in the lower teens. Service sales were $8.4 billion with 7.7% organic growth, and all lines of business showing high single-digit growth, including another year of outstanding performance in repair, marking a three-year CAGR in the low teens. Maintenance pricing, excluding the impact of mix and churn, came in about, as expected, up roughly 4 points for the year. Turning to segment operating profit performance on slide 7. Starting with New Equipment, we delivered our best margin expansion for the year in the fourth quarter, up 120 basis points.

Adjusted operating profit, excluding $3 million of forex headwind, was up $20 million, as strong productivity, pricing, and commodity tailwinds were partially offset by unfavorable regional and product mix, alongside higher SG&A expense. Turning to Service, fourth quarter adjusted operating profit, excluding $13 million of forex tailwind, was up $33 million, as higher volumes, favorable maintenance pricing, and productivity were partially offset by annual wage increases and higher material costs. For the past 16 consecutive quarters, we have delivered consistent Service margin expansion, and for the second consecutive year, we expanded margin by 50 basis points, exiting the year at a 24% rate. For the full year, overall operating profit was up $166 million at constant currency and margin expanded 30 basis points.

Despite the weakness in China, we were able to achieve $26 million of New Equipment profit growth at constant currency as pricing, productivity, and growth in all other regions more than offset unfavorable mix. This performance was better than anticipated and put us at the midpoint of our initial full year guidance for operating profit growth at constant currency as we overcame the weaker macro backdrop experienced during the year. Service operating profit increased $178 million at constant currency, supported by strong volume, pricing, and productivity. Since then, we have increased Service margins by 240 basis points. Slide 8 lays out the full year 2023 adjusted EPS bridge. Adjusted EPS in the year grew $0.37, driven by $0.29 of solid operational performance. Accretion from the Zardoya transaction, share repurchases of $800 million, and optimization of our tax rate by 40 basis points drove an additional $0.12, which more than offset $0.04 of foreign exchange headwinds.

Additionally, we closed out 2023 with notable adjusted free cash flow of $573 million in the quarter, up more than 30% versus the prior year, driven by higher net income and favorable working capital. In addition to the growth in down payments from increased New Equipment orders in the quarter, the team continued to manage working capital well. As a result, we achieved our annual guidance, generating approximately $1.5 billion of adjusted free cash flow. If we were to look back to the beginning of 2023, we initially guided that we would achieve low to mid-single-digit sales growth, 20 to 30 basis points of operating profit margin expansion, and approximately 8% EPS growth. Due to our operational performance, continued penetration of repair sales on a growing maintenance base, robust pricing and productivity, we were able to outperform all these metrics despite an uncertain macro environment and grew adjusted EPS by approximately 12%, all while returning approximately $1.35 billion to the shareholders.

With a strong end to the year on New Equipment orders and solid modernization order activity throughout 2023, we further expanded both our New Equipment and mod backlog, which will support us in 2024 and beyond.

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I'll now turn it back to Judy to discuss our 2024 outlook.

Judith F. Marks

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

Starting on slide 9 with the market outlook. In the Americas market in 2023, the market was down low teens as double-digit decline in North America was partially offset by low single-digit growth in Latin America. In EMEA, Western and Central Europe were the primary drivers, leading to a market that was down high single digits. In Asia, the market was down mid-single digits with a solid year in Asia Pacific up low single digits, but the performance masked by the downturn in China, which we estimate was down just north of 10%. In 2024, the global New Equipment market is expected to be down low to mid-single digits in units, with markets in the Americas and EMEA down low single digits, and markets in Asia down low to mid-single digits driven by China.

While New Equipment market dynamics remain fluid, the long-term fundamentals of the industry are well supported by the Service-driven growth model. In 2024, the global install base is expected to grow at a similar rate to that of 2023, at around mid-single digits, and reach approximately 22.5 million units. In the Americas and EMEA, we expect low single-digit growth, and in Asia, we're expecting mid-single-digit growth driven by China. Overall, we expect Service to be the growth driver for the industry, and we expect the same for our business. With this as the industry backdrop, for Otis, we expect net sales of $14.5 billion to $14.8 billion, growing 3% to 5% organically or 2% to 4% at actual currency. Adjusted operating profit is expected to be between $2.4 billion and $2.45 billion, up $125 million to $175 million at actual currency, or $150 million to $190 million, excluding foreign exchange headwinds.

We expect adjusted EPS in the range of $3.80 to $3.90, up 7% to 10%, or nearly $0.25 at the midpoint versus the prior year. Finally, we expect adjusted free cash flow of approximately $1.6 billion. With our commitment to a disciplined capital allocation strategy, we expect to repurchase approximately $800 million in shares in 2024, as we look to grow our dividend payout and pursue our typical $50 million to $100 million of bolt-on M&A.

With that, let me hand it back to Anurag to outline the 2024 segment outlook in more detail.

Anurag Maheshwari

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

Starting on slide 10 for the New Equipment outlook, we have good line of sight for New Equipment sales due to a backlog coverage, which extends out to over a year of sales. This, in combination with the share gain initiatives and incremental pricing actions we have taken over the past few years, position us relatively well for 2024. As a result, we anticipate New Equipment organic sales to be flattish with Americas and EMEA up low single digits and Asia Pacific up mid-single digits with mid-single-digit declines in China. We expect New Equipment profit margin to be flat to up 10 basis points with roughly steady volume and tailwinds from pricing, productivity, commodities, and the benefits from UpLift, offset by unfavorable regional and project mix alongside higher SG&A expense. Driving strong material and installation productivity and faster backlog conversion will remain a priority with the goal to again outperform our targets.

Turning to slide 11 for the Service outlook. Starting with sales, we expect another solid year in Service and anticipate organic sales growth of 6% to 7%. Maintenance and repair organic sales are expected to be up 5.5% to 6.5% driven by the significant additions to our maintenance portfolio and approximately 1 point of net pricing after adjusting for mix and churn. Mid-single-digit repair growth will also contribute through both our traditional and digital channels, although at a more moderate pace than what we saw in 2023. For modernization, we anticipate

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organic sales growth of about 8% as we execute on a solid backlog which, similar to New Equipment, extends out over a year and ended the year up in the mid-teens. Our strategy of standardizing products and driving more supply chain and factory optimization will enable us to accelerate sales growth above the 7% achieved in 2023. This also has the added benefit of helping to drive modernization margin expansion.

Turning to Service profit, we expect roughly 50 basis points of margin expansion. Continued strong volume, price productivity, and UpLift are expected to more than offset annual wage inflation and higher SG&A, similar to 2023. Now turning to slide 12. We began executing project UpLift initiatives in the second half of 2023 as we leverage enterprise scale, optimize our indirect and supply chain spend, and improve and standardize our processes. We are on track to achieve targeted savings of $150 million with $80 million of run rate savings anticipated by year-end 2024 and $150 million in run rate savings by mid-2025. Out of the $150 million in total savings to be realized, nearly half will come from leveraging enterprise scale, roughly 25% from indirect and supply chain optimization, and the rest from process improvements and standardization.

We continue to analyze and execute on the opportunities and estimate 70% of the savings will be in the Service segment, with the remaining split between New Equipment and corporate. Moving to the 2024 EPS bridge on slide 13. Our guidance for adjusted EPS is $3.80 to $3.90 driven by approximately $0.30 of operating profit growth at the midpoint, reflecting organic sales growth of 3% to 5%, with approximately 50 basis points of margin expansion. Below the line, we expect to offset $0.03 to $0.04 of forex and increased interest expense headwinds with continued optimization of our tax rate and a benefit of approximately $800 million in share repurchases supported by $1.6 billion in adjusted free cash flow. Looking at the EPS cadence for the year, we expect the $0.30 of EPS growth to be fairly level-loaded between the first and the second half, while in the first half we expect the first quarter EPS growth to be a couple cents lighter than the second quarter.

A little bit more color on the first quarter metrics, starting with orders. We face a difficult compare versus the first quarter of last year where we grew more than 7%, so we expect New Equipment orders to be down roughly 10% while portfolio and modernization orders growth should remain strong. As for sales and profit, sales growth will be roughly 3% and total company operating profit margins should expand over 50 basis points to 16%-plus, both led by Service. Below the line, headwinds from higher interest costs and a tax rate roughly in line with the prior year due to timing will be offset by lower share count. All in, this should lead to $0.06 to $0.07 of EPS growth driven primarily by operational performance. Overall, our outlook reflects another year of performance led by consistent Service business. We remain focused on continuing to mitigate macro challenges and further driving shareholder value.

With that, I will request Krista to please open the line for questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Nigel Coe from Wolfe Research. Please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning and thanks for the early question. So, a solid outlook for 2024. I think you mentioned, Anurag, 1% price for New Equipment. I know we had some weakness in China. Just wondering if there's any sort of significant SKUs across the geographies that you called out there. Maybe, again, excuse me if I missed it, but what would you expect the Service pricing this year?

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

A

Okay. Thanks for the question. Let me clarify. The 1% that I spoke in my prepared comments was on maintenance pricing, so what we'll see is we'll see adjusted for mix and churn. So, we'll see about 3% on a like-to-like basis and adjust for that. On the New Equipment side, clearly, we've seen good price increases in 2023 in America, EMEA, and AP. Some of that will continue over in 2024 New Equipment, but China does have price pressure as we saw in 2023, but it's a deflationary economy, so we expect it to be price cost neutral.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. But no evidence of pricing deflation outside of China?

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

No, Nigel, none at all.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay, great. And then just on the UpLift savings, obviously, we're starting to see those coming through in 2024. Where did these land mainly this year? I mean, what would you say, more New Equipment or services? And I'm just curious if we're seeing any kind of upward trajectory on the modernization margins. I know that's an initiative that you're focused on. Just wondering if we're going to see some of that coming through in 2024.

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Yeah, Nigel, let me talk to the UpLift in 2023. We pretty much saw it across the board. Again, early days, but pretty pleased with the savings we've seen, and more importantly, the trajectory of where we're going with the process work, with the organizational model, and really changing how we work to be more customer-focused. Anurag, I'll let you touch on mod margins.

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

A

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Yeah. On the mod margins, as we said a few months ago that we expect it to be at par with New Equipment in a few months and then it started going up. And we see that trajectory pretty good. We'll give a little bit more color on the Investor Day in a couple weeks, but that is on the right trend. And for the UpLift savings, I think the cadence, what I outlined in the prepared comments, 70% in Service and the rest between New Equipment and corporate, that should be for this year as well. So, we're going to exit the year at $80 million [indiscernible] (00:28:49) $40 million with similar cadence across that. Yeah.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thanks for that.

Operator: Your next question comes from the line of Gautam Khanna from TD Cowen. Please go ahead.

Gautam Khanna
Analyst, TD Cowen

Q

Hey. Good morning, guys.

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Good morning.

Gautam Khanna
Analyst, TD Cowen

Q

I was wondering if you could quantify the net savings from UpLift and how we should think about that this year and next.

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

A

Yeah. So the – thanks, Gautam, for the question. The $40 million is net savings, which is flowing through to the P&L for UpLift, right? So, if you look at in 2024, we are going to grow our operating profit at constant currency by approximately $170 million. About $140 million of that is price cost. The price is what Nigel asked me earlier, a little bit from the Service side, from the New Equipment side, we're still seeing commodity tailwinds, albeit a little bit lighter than 2023, but that's obviously positive. And then UpLift is contributing $40 million to that. Right? So, if you add all of that together, we're getting a price cost of about $140 million, and the rest is coming from volume net of mix. So, the $40 million of UpLift is 100% net flow through to the P&L.

Gautam Khanna
Analyst, TD Cowen

Q

Got it. And then to your earlier comment on China and the New Equipment market, it doesn't sound like you're talking about price erosion due to competition per se, but rather – is there some other reason for – is it just lower costs across all the competitors or – if you could just expand on what's going on in China New Equipment pricing.

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Sure. So really, it's a very competitive market. We'll start there. And the market remains weak. We've called it north of 10% in terms of what we saw this year. And we're going to be very focused on continued productivity

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savings. But in a deflationary environment, we're seeing the costs come down too and that's really what's helping. The commodity costs are coming down. And it gives us this price cost neutral ability. Now, listen, every day in China, we're – on New Equipment, we're balancing the quality of the orders, the volume we're taking in, and what that's contributing to our backlog margin. And we are in a market that's down 10% in this quarter. Sally and the team did a great job. We were down 5% in terms of orders. And so, we did gain share. And we've gained share now consistently for several years.

So, we're managing that carefully. But I will tell you, our China business, when you look at it as a whole, our China business contributed significantly this year and their profit for the year was up year-over-year when you look all in because what we've done is we've really executed our strategy well on New Equipment with key accounts, with our sales coverage. But just as importantly, Gautam, we've focused on pivoting more and growing our Service business. Our Service sales have grown mid-teens CAGRs, and we service now accounts for 25% of our China sales, which is up from mid-teens a few years ago. And we had 20% growth in both units and value in Service in this last quarter and that's the trend we've been on. So, it's about balance in New Equipment, but it's a growing service and mod story.

Gautam Khanna
Analyst, TD Cowen

Q

Appreciate it.

Operator: [Operator Instructions] Your next question comes from the line of Julian Mitchell from Barclays. Please go ahead.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi, good morning. I just wanted to clarify perhaps on the New Equipment outlook. You've got the slide 9, I think the market down in every region and globally for the year. How are you thinking about the backlog trending sort of as we move through the year, because I guess last year you had the backlog up in New Equipment even with the orders down? So you had a sort of a book-to-bill, I guess, over one times in 2023 in New Equipment. So, just trying to understand in 2024, how we're thinking about the sort of backlog progression there and the implied book-to-bill. Thank you.

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Yeah. So the backlog itself, Julian, is – obviously we're going in with 2%. We really couldn't be more pleased with how, especially Americas and EMEA, really drove strong New Equipment orders in the fourth quarter. Americas was up 6%, EMEA was up 11%. So everyone's going in with backlog strength, with the exception of China backlog is down mid-single digits as we go into 2024. But it's that strong backlog that's giving us that line of sight in the majority of our regions that gives us the confidence that we can – between that and New Equipment share gain of 50 basis points that we're going to sustain, that gives us the confidence.

Anurag, I'll let you take him through kind of how the year transpires.

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

A

Yeah. Thanks, Judy. Yeah. So, as you said, Julian, our book-to-bill was more than one time in 2023. We expect that to be similar in 2024 because our orders are quite higher than our New Equipment revenue. So, as we go

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through the course of the year, we do expect to finish – even if we perform in line with our market outlook and don't even increase share, we should end the year at a backlog flattish to be slightly higher. Clearly, the coms are tough for us in the first quarter in terms of New Equipment orders, but then they get easier for us in the second and third quarter. So, you will see a little bit of gyration quarter by quarter, but we are confident that given this market outlook, if it stays the way, we should end the year with a flattish or slightly higher backlog.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's helpful. Thank you. And then maybe just one for Judy on particularly sort of North America and EMEA, how you're seeing that market right now in terms of sort of verticals and how customers are behaving in New Equipment. Are you seeing a particular weakness in office versus multifamily? Are you seeing projects being delayed or if sort of existing projects are going ahead on plan and it's the new projects that maybe it's just taking longer for customers to sign off? Any sort of color on that on North America and Europe, please?

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Sure, Julian. Let me start with North America. And as I said, our team's out there and it goes back to these long-term customer relationships that really enable the orders book to be up and the backlog to be up. But for context, the New Equipment market segment in units in North America finished last year the lowest since the GFC and yet, we still – we gained share, we delivered, and we increased pricing, so our team is performing very well there. When we look at the segments themselves, none of the segments are strong in North America. Multifamily is the weakest due to several years of outpaced growth. If I had to rank order them, infrastructure is the best, and we've had really good success with major projects; we're going to continue to grow there. But all of the segments, none of them are strong in North America.

And so, this is going to be a year where the benefit to Otis and why we're going to be successful is we invested in the low-rise market. We introduced our Gen3 Core product, and 80% of the North American market is two to six stories. And that market we're still seeing active bids, we've seen a great pipeline for Gen3 Core, and that gives us the encouragement between the backlog and the orders we're seeing to know that we can – it's a mid-single-digit backlog in North America and that gives us a good 12, 18-plus months line of sight for next year's revenue. In Europe, South Europe remains strong led by Spain. We're seeing sustained activity. Central and Northern Europe is weak. And again there, infrastructure tends to lead. Residential is a little better in Europe than it is in North America by far. But, again, what we see on the ground, whether it's the German economy or any of the other locations, looks to us like 2024 looks like 2023 in terms of the segments in Europe.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's very helpful. Thank you.

Operator: Your next question comes from the line of Miguel Borrega from BNP Paribas Exane. Please go ahead.

Miguel Borrega
Analyst, Exane BNP Paribas

Q

Hi. Good morning, everyone. Thanks for taking my questions. The first one just on China, the market, the competitive environment in China. Obviously, as you said, the market remains weak. But do you sense increased

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pricing pressure over the last quarter or so? One of your peers reported strong market share gains in Q4, so just wanted to get your views on anything incremental to what we've seen so far.

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Sure. Well, listen, Miguel, performance can vary in any given quarter based on compares, but I like to take a step back. And overall, for 2023, we believe we gained share in China with the market down north of 10% and us coming in, again, down about 5% and actually even low single digits when you look for the year, but let me try and give you some additional color here. First, we did perform better in the first half of the year versus the second half, but we always manage volume and share versus profitability, and we manage those dials appropriately while maintaining momentum on our share growth. Our order value declined mid-single digits, and we've spoken all year about the deflation that's impacted the market, but we've been able to offset the price decline with better productivity. And when you look at our strategy in China, we've added the agents and distributors.

It's given us the geographic and vertical coverage and we've continued to innovate and invest in our products. We've brought multiple products to the market in China. We've upgraded our escalator offering, our [ph] OH8000 (00:39:53). And we brought Gen360 to the market in China over the past year, and that will yield for us and give us an advantage this year because of the technology, because of, again, our reach in terms of our sales channel. Overall, we've increased our bookings in China by nearly 20% since pre-spin while the market over that same multiyear period is down 10% to 15%, so our strategy is working. Our team is out there every day focused. Our backlog, while it's down mid-single digits, the quality of our backlog, the profitability of our backlog we're not sacrificing for volume.

Miguel Borrega
Analyst, Exane BNP Paribas

Q

That's great. Thank you very much. And then my second question, if you can talk a little bit about modernization. You mentioned backlog is up 15%. What is driving that growth exactly? And how should we think about it from here, 2024 and 2025? And then on the margin of modernization, you mentioned that's par with New Equipment. I think one of your peers stated that margins are even higher than maintenance. Where do you think the difference lies? And would you see those margins in modernization growing ahead of the other segments for you in the next few years? Thank you.

Judith F. Marks
Chair, Chief Executive Officer & President, Otis Worldwide Corp.

A

Yeah. So I'll comment a little on – let me talk about the market and a little bit on the margins because the margins vary by region in terms of modernization margins. But the mod market is up nicely in all regions. And the majority of that is just driven by the refurbishment required due to the aging equipment that's out based on construction cycles from 20 plus years ago. We're just in a natural growth cycle now where you're going to see year-over-year additional mod. Really pleased with the backlog up. This was our sixth consecutive quarter of orders up over 10%. Asia Pacific really was the standout again with Korea. But we have a great mod product in China. And our China orders, albeit on a small base because it's a little bit of a younger install base, is growing significantly double digit. And Americas and EMEA, as I said in my prepared comments, really had a strong major project contribution in mod orders in the fourth quarter, and we expect that to continue.

Again, in terms of margins, as Anurag shared, we will surpass New Equipment margins shortly, but when you look in different geographies, there are different mod margins. The market is a combination, again, of aging and safety regulations and demand creation. And, I'm really proud of our team because when a part goes obsolete, our team

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is out there, our sales team's out there, our mechanics are out there. They're ensuring our customers know what they need to keep their elevators not just current but to prepare them for the future. I'm really encouraged by modernization. We've organized around it. We've set up this as a fifth strategic imperative. We have mod kits because we are going to industrialize how we do mod, so it'll look more like New Equipment coming out of a factory, and that's what's going to drive the margin expansion.

Anurag Maheshwari

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

A

Yeah. Just to add to that, Miguel, I mean, I can't speak about the others, but for us, we're clearly seeing the trajectory of mod margins pick up, and there's no reason why it should be much higher than New Equipment. And as we standardize our products, optimize the supply chain, do better on the go-to-market strategy, we see that inching up. And as I said, we'll talk more about it in the next couple of weeks, but clearly, the margins should outpace New Equipment margins.

Miguel Borrega

Analyst, Exane BNP Paribas

Q

That's great color. Thank you very much.

Operator: We have no further questions in our queue at this time. I will now turn the call back over to Judy Marks for closing remarks.

Judith F. Marks

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

Thank you, Krista. 2023 proved to be another strong year for Otis as we focused on our strategic imperatives to drive value for all stakeholders. We head into 2024 supported by the strength of our service-driven, customer-centric business model and remain excited to share our 2024 successes with all of you. We look forward to you joining us at our Investor Day at the New York Stock Exchange on February 15. Please stay safe and well. Thank you.

Operator: This concludes today's conference call. Thank you for your participation, and you may now disconnect.

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