

Q2 2025 Earnings Call

Company Participants

- Cristina Mendez, Chief Financial Officer
- Judy Marks, Chief Executive Officer
- Robert Quartaro, Vice President-Investor Relations

Other Participants

- Chris Snyder, Analyst, Morgan Stanley
- Jeffrey T. Sprague, Analyst, Vertical Research
- Joseph O'Dea, Analyst, Wells Fargo
- Julian Mitchell, Analyst, Barclays
- Nicole DeBlase, Analyst, Deutsche Bank
- Nigel Coe, Analyst, Wolfe Research
- Rob Wertheimer, Analyst, Melius Research
- Steve Tusa, Analyst, JP Morgan

Presentation

Operator

Good morning, and welcome to Otis Second Quarter 2025 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 the call over to Rob Quartaro, Vice President of Investor Relations.

Robert Quartaro {[BIO 19222979 <GO>](#)}

Thank you, Tina. Welcome to Otis' Second Quarter 2025 Earnings Conference Call. On the call with me today are Judy Marks, Chair, CEO, and President; and Cristina Mendez, Executive Vice President and CFO.

Please note, except where otherwise noted, the 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'll turn it over to Judy.

Judy Marks {[BIO 5075554 <GO>](#)}

Thank you, Rob. Good morning, afternoon, and evening, everyone. Thank you for joining us. We hope everyone listening is safe and well. Starting with Q2 highlights on Slide 3. Otis delivered solid second quarter and first half results as the Service segment continued to drive strong performance with both a year-over-year and a sequential operating profit margin improvement. Organic service sales in the second quarter were up 4% with growth across all business lines and in all regions.

Our maintenance portfolio grew 4% again in the quarter, adding to our industry-leading \$2.4 million unit portfolio under Service. Modernization momentum continued as we accelerated orders to 22% and ended the quarter with the backlog up 16% at constant currency. New equipment orders decreased by 1% due to continued economic challenges in China, while orders in the rest of the world increased 11% versus the prior year.

We continue to make progress with UpLift, and we remain on track to achieve \$200 million in run-rate savings by year-end. Additionally, in response to continued weakness in China, we're executing additional actions to reduce costs as part of our China transformation. We now anticipate run-rate savings of approximately \$40 million by year-end.

Our 2025 in-year savings targets remain at \$70 million and \$20 million for UpLift and China transformation, respectively. Together, these initiatives are enabling us to deliver greater customer-centricity and to invest in growth.

In addition, we also now expect the impact of 2025 tariffs to be roughly half of our expectations in April to a range of \$25 million to \$35 million, reflecting more favorable reciprocal tariff rates and our mitigation efforts. We completed approximately \$300 million in share repurchases in the second quarter, taking year-to-date repurchases to approximately \$550 million. During the quarter, we closed on our previously announced acquisition of eight urban elevator locations in the US. This deal further expands our maintenance portfolio and enhances our ability to serve customers.

Adjusted EPS was \$1.97 in the first half of the year, growing 2% versus the same period last year due to solid margin expansion and continued tax planning efforts. In June, we published our Connect & Thrive Report that outlines our progress and commitments to four key areas: health and safety, governance and accountability, environment and impact, and people and communities. These areas are closely aligned with our strategic vision and the Otis Absolutes of Safety, Ethics and Quality that we live by every day.

During the quarter, we were honored to be recognized with several sustainability awards. USA Today, in collaboration with Statista, included Otis among America's climate leaders, and Forbes recognized Otis among 200 US companies included on the net zero leaders list for reduction of carbon emissions. Newsweek also recognized Otis among companies from 26 different countries for our environmental sustainability performance. And most recently, Time Magazine named Otis among the world's most sustainable companies for the second consecutive year.

Turning to our orders performance on Slide 4. Combined New Equipment and Modernization orders grew 4% in the quarter, driven by continued strength in modernization. Excluding China, orders grew 14% with notable strength in the Americas and Asia Pacific. Our combined backlog remained relatively flat year-over-year. However, excluding China, it increased 10%. Our total backlog, including maintenance and repair, is at historically high levels, positioning us well for future quarters.

New Equipment orders declined 1% in the quarter. However, excluding China, we saw robust 11% growth. For the fourth straight quarter, the Americas orders were up in the low teens. Asia Pacific also delivered strong results, with order growth exceeding 20% for the third consecutive quarter, led by Southeast Asia and India.

This strength was offset by continued softness in China, where orders declined by more than 20%. Note, however, that our China New Equipment orders were sequentially stable in the first half of 2025, and we anticipate year-over-year growth in the coming quarters. In EMEA, New

Equipment orders declined low-single digits as strength in the Middle East was offset by weaker demand in Europe.

At constant currency, our New Equipment backlog declined 3% year-over-year, but excluding China, it grew 8%. Modernization acceleration continued as orders grew 22%, leading to our quarter-end backlog up 16% at constant currency, with Americas, China, and Asia Pacific, each growing orders more than 20%. The modernization opportunity is compelling, driven by the aging of the 22 million unit installed base. We continue to expect these aging units to drive a multi-year growth cycle across our regions.

Our Service portfolio grew 4% in the quarter with contributions from all regions. China's strong growth trajectory continued as the region grew its portfolio low teens, Asia-Pacific grew mid-single digit, and EMEA and Americas grew low-single digits.

As our global teams continue to deliver, we're proud to share second-quarter customer highlights that reflect our success in winning strategic projects through innovation, execution and trusted collaborations. In the Americas, Otis will modernize 21 elevators at the OneAmerica Tower in Indianapolis, expanding our long-term relationship with this customer. Otis provided the original elevators for the buildings in the 1980s, modernized them in 2009, and is the current maintenance provider. Otis will upgrade controls, doors, signals and cab finishes on the elevators.

In Dubai, we continue to strengthen and grow our relationship with Damac Properties, one of the leading luxury real estate developers. Our latest agreement to supply and install 20 SkyRise elevators at Damac Bay 2 in Dubai Harbour brings our total orders with Damac to 88 elevators. This includes 72 SkyRise and 16 Gen2 systems across six high-rise projects in the city. These orders reflect the trust Damac places in our technology and service and they underscore our growing footprint in the Middle East.

In China, Otis recently entered into a contract for more than 400 escalators and connected elevators to support metro and infrastructure expansion projects in Hangzhou, Changchun and Tianjin. These orders reflect our ongoing role in supporting urban mobility across key cities. And in Ho Chi Minh City, Vietnam, Otis has been selected to install and maintain SkyRise and Gen3 elevator systems at The Kross, a 39-story premium mixed-use development in the city's central business district. These units will be supported by our Compass 360 and EMS Panorama 2.0 management system, delivering a modern integrated solution for enhanced passenger experience.

Turning to our second-quarter results on Slide 5. Otis delivered net sales of \$3.6 billion, flat on a year-over-year basis, with organic sales down 2%. Adjusted operating project -- profit margin was flat versus the prior year at 17%. Excluding a \$13 million foreign exchange tailwind, adjusted operating profit decreased 2%, with growth in Service offset by a decline in New Equipment.

Adjusted EPS declined 1%, or \$0.01, in the quarter, driven by a tough year-over-year comparison from an operational and tax standpoint. As I previously mentioned, EPS grew 2% in the first half of the year. Adjusted free cash flow was \$243 million in the quarter and \$429 million year-to-date.

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

Cristina Mendez {[BIO](#) [24091827](#) <GO>}

Thank you, Judy. Starting with Service on Slide 6. Service organic sales grew 4% with growth in all lines of business. Maintenance and repair organic sales grew 4%, driven by growth in our portfolio and positive price of 3% in maintenance, partially offset by mix and churn. Our repair business

accelerated in the second quarter as anticipated, growing 6% organically year-over-year compared to 1% in the first quarter. We are pleased with our progress, and with our backlog up 8% at quarter-end, we are well-positioned heading into the second half.

Modernization organic sales grew 5% with notable growth in China, which increased over 20%. While modernization organic sales growth was muted, this was primarily driven by timing of several large projects, which can vary from quarter to quarter. Our modernization backlog remains strong, up 16% at constant currency at quarter end, and we expect approximately 10% growth in modernization sales for the full year. Service operating profit of \$578 million increased \$26 million at constant currency with higher volume, favorable pricing, and productivity, including the benefits from UpLift, more than offsetting higher labor costs and mix and churn. Operating profit margins expanded 20 basis points to 24.9% in the quarter, making another record quarter in -service margins since spin.

Turning to New Equipment on Slide 7. New Equipment organic sales declined 11% in the quarter as the strength in EMEA was more than offset by declines in China, Americas, and Asia Pacific. EMEA sales grew 7%, primarily due to strength in the Middle East, which grew greater than 20%, while Europe was up low-single-digits. Asia Pacific declined low-single-digits with notable strength in Hong Kong and Taiwan, offset by weakness in Korea. Additionally, growth was negatively impacted by timing of project execution in India. However, the backlog in India remains strong.

Americas declined high-single-digits as we worked through last year [ph] backlog, but in addition, backlog execution has been slower due to market concerns around global trade policy. China remained weak, declining greater than 20%, as soft market conditions, a strict credit control on shipments, and a decline in backlog continued to impact our results.

New Equipment operating profit of \$68 million declined \$41 million at constant currency, driven by lower volumes and unfavorable price and mix. Operating profit margins declined 240 basis points to 5.3%, driven by the headwinds of lower volume and regional mix that were partially offset by productivity, including the benefits from UpLift and our China transformation.

I will now turn it back to Judy to discuss our 2025 outlook.

Judy Marks {[BIO 5075554 <GO>](#)}

Starting on Slide 8 with the market outlook. Before discussing our updated 2025 outlook, I'd like to briefly discuss our global market expectations, which are largely unchanged. We continue to expect a low-single-digit decline in the Americas. However, we are beginning to see trends improving sequentially. Our market outlook for EMEA is unchanged with low-single-digit growth.

Asia is now anticipated to decline high single-digits. This is driven by mid-single-digit growth in Asia Pacific, offset by a low teens decline in China. Our outlook for China is now slightly lower than our beginning-of-year expectation due to continued softness in the market. While year-over-year comparisons are easier in the second half, we now believe the market will be down approximately 10% for the remainder of the year. Taken together, we expect the global New Equipment market to decline mid-single-digits in 2025.

On the Service side, we continue to expect the global install base to grow mid-single-digits, driven by low-single-digit growth in Americas and EMEA, and mid-single-digit growth in Asia. This growing install base should further support growth in our maintenance portfolio and expand our service flywheel.

Turning to our financial outlook for 2025. We now expect net sales of \$14.5 billion to \$14.6 billion, a slight decline from our previous outlook driven primarily by a lower outlook for New Equipment sales. This is largely driven by the New Equipment market environment in China and the US. In China, market conditions have remained soft as liquidity challenges are causing a slowdown in execution of our backlog. In the US, continued uncertainty over global trade policies are causing project delays.

That said, we have driven low teens or greater order growth in the Americas for four consecutive quarters, and our backlog remains strong there, up 5% at the end of the quarter. This backlog positions us well as we head into 2026. And as you know, our resilient service business is relatively insulated from tariffs. This resilient business is our core earnings driver, representing approximately 90% of our total operating profit.

Looking ahead, we expect our service organic sales growth to continue to ramp up through the remainder of the year. Our outlook for adjusted operating profit is unchanged at \$2.4 billion to \$2.5 billion, up \$55 million to \$105 million on an actual currency basis, including the impact of incremental US tariffs imposed in 2025. This is in line with our prior outlook as reduced reciprocal tariff rates for China and favorable foreign exchange rates offset lower expectations for our New Equipment profit this year.

Service profitability should remain strong from growth in all three areas of the business: Maintenance, Repair, and Modernization. Our outlook for adjusted EPS is unchanged at \$4 to \$4.10 per share, representing an increase of 4% to 7% compared to 2024. We expect adjusted free cash flow to be between \$1.4 billion to \$1.5 billion for the year, which we expect to largely return to our shareholders through our dividend and \$800 million of share repurchases. Note, we are well on track to meet our share repurchase target, having bought back approximately \$550 million year-to-date through June.

I'll now pass it back to Cristina to review the 2025 outlook in more detail.

Cristina Mendez {[BIO 24091827 <GO>](#)}

Thank you, Judy. Moving to our organic sales outlook on Slide 9. We now expect organic sales growth of approximately 1% for the year. This is driven by continued strength in service with organic growth of approximately 5%, partially offset by a decline in New Equipment of approximately 7%. Within New Equipment, we have lowered our outlook for Americas to down high-single-digits and Asia to down low teens due to the macroeconomic concerns Judy previously noted.

Within Asia, we expect a strong growth in Asia Pacific, offset by a greater than 20% decline in China. We continue to expect EMEA to grow mid-single-digits for the year. Within Service, we continue to expect growth in all segments through the remainder of the year. Maintenance and Repair is expected to grow approximately 5%, driven by portfolio growth and pricing, partially offset by mix and churn. We saw solid acceleration in our repair revenue in the second quarter, and we expect continued acceleration through the second half. In Modernization, we are anticipating approximately 10% organic growth as we execute our strong backlog.

Turning to Slide 10 to provide an update on tariffs. While circumstances remain fluid, our anticipated tariff exposure has meaningfully declined from expectations in April. This is driven by more favorable reciprocal tariff rates, as well as our successful mitigation strategies. Given these changes, we now expect an approximately \$25 million to \$35 million negative impact to our 2025 earnings, net of our mitigation efforts. Note that this impact is primarily expected in the second half as the year-to-date impact has been minimal. As a reminder, our tariff exposure is primarily in

our backlog, as we have adjusted contract terms and pricing for the current environment. Therefore, after execution of the backlog, the impact of the new tariffs on our results should be offset by pricing and contract language.

Turning to our financial outlook on Slide 11. We currently expect adjusted operating profit to grow \$55 million to \$105 million on an actual currency basis, including the impacts of tariffs. This growth is driven by the strength of our Service segment, as well as cost savings from UpLift and our China transformation. Adjusted operating margin is expected to expand 30 basis points, driven by expanding service margins and mix, offset by declining New Equipment margins from tariffs, as well as the flow-through of last year's backlog and regional mix.

Adjusted free cash flow is now expected to be between \$1.4 billion to \$1.5 billion for the year. The decline from our previous forecast is primarily driven by our reduced outlook for New Equipment sales as well as the impact of the mix. As New Equipment sales are more favorable to working capital, we continue to anticipate approximately \$800 million of share repurchases for the year.

Moving to the 2025 EPS bridge on Slide 12. Our adjusted EPS outlook for the year remains \$4 to \$4.10 per share. This represents 4% to 7% growth compared to the prior year, driven by strong operational growth from our Service segment. The New Equipment segment remains a headwind due to soft economic conditions in China and the impact of global trade policy in the US. Favorable foreign exchange rates and a lower share count are expected to offset the impact of tariffs and a higher interest expense. And while conditions remain challenging for our New Equipment business in the near term, our US backlog is growing and China orders are expected to stabilize in the coming quarters.

And furthermore, the resiliency of our Service business continues to drive earnings on the back of mid-single digit top-line growth and continued margin expansion.

We are also continuing to execute our UpLift and China transformation initiatives, which will allow us to better serve our customers while driving \$240 million of run-rate cost savings by year-end. We have good line of sight to deliver our targeted savings, and as UpLift is approaching the end of the program in the second half of the year. We are making good progress with our China transformation, and as I previously mentioned, we are raising our cost savings target to \$40 million due to additional restructuring actions underway.

Looking at the third quarter, we expect New Equipment organic sales growth roughly in line with our full-year guidance with sequentially lower margins in the quarter. This margin pressure is due to lower volumes that will be more acute in the third quarter. This is due to the execution of cost-mitigating actions, such as the temporary furlough of some of our production facilities.

Service organic sales are expected to ramp to around 5% and we anticipate solid year-over-year margin expansion with positive contribution from UpLift as we execute the last wave of the program. Taken together, we expect the third quarter adjusted EPS growth of around 5%, followed by a strong fourth quarter, to deliver 6% full-year growth at the midpoint of our guide.

With that, I will kindly ask Tina to please open the line for questions. Thank you.

Questions And Answers

Operator

(Operator Instructions) We respectfully ask that you limit your questions to one with one follow-up. We will now pause for just a moment to compile the Q&A roster. And our first question comes from the line of Jeff Sprague with Virtual Research. Please go ahead.

Q - Jeffrey T. Sprague {BIO 1494958 <GO>}

Hey, Sprague here at Virtual. Good morning, everyone.

A - Judy Marks {BIO 5075554 <GO>}

Hi, Jeff.

Q - Jeffrey T. Sprague {BIO 1494958 <GO>}

Hi, how are you doing? Judy, I wonder if you could just maybe unpack Service growth a little bit more for us. And the spirit of my question is, I think we've got two quarters in a row here now where Service revenue growth organically is equal to portfolio growth, where historically revenues outperformed portfolio growth. So you mentioned churn and mix. I guess I'm particularly interested in churn. In this kind of economic period of uncertainty, are you seeing leakage and retention, or really what's going on underneath the surface there?

A - Judy Marks {BIO 5075554 <GO>}

Yeah. Thanks, Jeff, and good morning. Apologies about your name. So listen, the Service is continuing to perform. We're going to be -- maintenance and organic sales were up 4%. It was driven by 4% growth in the portfolio. We did have positive service pricing; like-for-like pricing increased 3 points in the quarter. That's a little lower than we had in previous years, but inflation is not as high in certain parts of the world. In the developed mature markets, the service pricing performance was really excellent. EMEA was up low single. Our Americas team drove mid-single digit pricing. So really pleased with that.

The main changes, the two elements I'd call your attention to this quarter versus last quarter; repair sales snapped back, they were 1% in first quarter. This quarter, they're 6%, and we anticipate incrementally that to increase in the third quarter and even more in the fourth quarter. Our repair backlog is up 8%. So we've got good backlog to work on as we look through the remainder of the year.

Mod revenue was down to 5%, and that was a combination of a lot of major projects that we had won. You saw our Mod orders are up 22%, really phenomenal performance. Three of our four regions up 20%. And the US-Canada team, our North America team, Mod orders were up over 50% this quarter. So they have continued to drive significant growth. Now we've got to convert it. It's a fair expectation, and we have the expectation that that will grow to 10% over the next two quarters for Mod revenue because our backlog is at 16%.

So it was a combination of major projects and some other items, but it's not a resourcing issue with us. So that's why we took the guide, the outlook down to 5% for year-end. We're 4% through the first half. You're going to see an incremental step-up as we go through third quarter, and then you'll see even more in fourth quarter.

I've got full confidence in the Service flywheel. We're seeing it everywhere. We're seeing the portfolio growth sustain itself at 4% now for almost -- for multiple years. And I think you're going to see that. I know you're going to see that come through in the next two quarters.

The operating profit shows that service impact. As Cristina mentioned, we had a record since spin 24.9% operating margin in Service, and that will continue to drive our growth in operating profit as we go through. And we've had operating profit now in Service, this is the 21st straight

quarter. So you're going to continue to see that. But we know it's a growth story on-top line. We own that, and you will see that as we go through the second half of the year.

Q - Jeffrey T. Sprague {BIO 1494958 <GO>}

Thanks for that. But just to be clear then, I mean, if units are up 4% and service prices up 3%. The fact that organic revenues are only up 4% is a function of New Equipment mix project-related stuff you're talking about, or is it retention?

A - Judy Marks {BIO 5075554 <GO>}

No, retention actually was slightly better in the second quarter than the first quarter. But it's a mix and churn effect because as the portfolio grows, the mix is it's growing more in the less mature markets, which have lower contribution, especially in China, where we're growing in the teens. So it's really a mix and churn effect there. And then, as you know, even with the units that, when we lose them and we don't retain them and replace them with a recapture, that does come at a lower margin and a lower price.

Q - Jeffrey T. Sprague {BIO 1494958 <GO>}

Right, right. Okay. Thanks. I'll leave it there. Good luck.

A - Judy Marks {BIO 5075554 <GO>}

Thanks.

Operator

Our next question comes from the line of Nigel Coe with Wolfe Research. Please go ahead.

Q - Nigel Coe {BIO 3818998 <GO>}

Thanks. Got my name right. That's encouraging. Good morning. Thanks for the question. Just on the retention, Judy, I know you said it improved slightly QoQ, and maybe you could maybe just put a finer point and quantify that. But I'm just curious really on, it sounds to me like you're pointing to New Equipment orders inflecting in the Americas. Just given the continued drag in multifamily, it's surprising to see this. I'm curious, what you're seeing in the pockets of growth in the Americas? And then maybe just touch on China as well. I think you said you expect year-over-year growth in the coming quarters. So just curious if that's just easier comps? Or are we seeing some benefit from the stimulus efforts in China?

A - Judy Marks {BIO 5075554 <GO>}

Yeah. So Nigel, we will provide all the retention data once a year. So you'll -- that part I won't elaborate on. In terms of the US, as I said, fourth strong quarter with teens growth. North America was up 15% in New Equipment orders. This quarter, we saw some contraction in Latin America, Brazil, Mexico, Chile, but North America is so much more of our business, as you know, in the Americas. Really strong performance in infrastructure. We saw resi was flat this quarter. So when we talk about multifamily, our orders were flat year-over-year. So I view that actually as positive versus the kind of pullback we had seen in multifamily over the past few quarters. And then commercial was down. And so, again, it was a strong infrastructure job, a lot of major projects, and a lot of volume business too. And I couldn't be really more pleased with our performance in North America, really strong four quarters in a row after almost six quarters where we had orders

contraction, which is the backlog we're living through in New Equipment in North America. So that's strong.

In China, listen, the New Equipment market, it does remain weak, down 15% first and second quarter, and we see it improving to 10% in the second half. The comps will help, but there was not a single vertical in the second quarter that grew, nor a single tier city that grew in the second quarter. Tier 1 did better than the others, but none of them grew. So the best verticals in China for the second quarter for us were infrastructure and industrial buildings, which are becoming more stable, but both commercial and office were down double-digit, and resi was down high teens to double-digit. So that market is still stressed. But again, now it's about sequential and looking at how we can perform quarter-over-quarter.

We focused in New Equipment in China, really on value, really two things; value in terms of -- because it's very competitive and the prices are very, very, very low. So we focus on value, and then we focus on our ability to retain it in our service portfolio. And where there was other opportunities for margin or for volume, where we weren't going to get any margin or get the service attachment rate, we walked away from those. So I think our team is being very disciplined to be in a much better place in terms of our backlog. And you know, you look at our New Equipment backlog for the company. So our New Equipment orders decreased 1%, but if you take out China, the other three regions were up 11%. If you look at our backlog for New Equipment, even though it declined 3%, if you take China out, we're up 8%. So I'm actually very encouraged for Rest of World ex-China, China stabilizes and Rest of World is growing now, almost our backlog is up high-single-digit at 8%.

Q - Nigel Coe {[BIO 3818998](#) <GO>}

Okay. That's great. Thanks, Judy. That's great color. And then my quick follow-on is, I think, for Cristina. So it seems like your 3Q and it points like a \$1 per share of earnings. I think the midpoint implies a step-up in earnings from 3Q to 4Q. That'd be quite unusual. So, just wondering how we should be phasing or thinking about the second half and thinking about that step-up in earnings in the fourth quarter?

A - Cristina Mendez {[BIO 24091827](#) <GO>}

Yeah. No, Nigel, thank you very much for the question. So let me give you some color on Q3 outlook, but also the calendarization between Q3 and Q4. So starting with Q3 on the New Equipment side, we expect revenues to be in line with the midpoint of the guide around minus 7%. With margin sequentially down, margin will be around 3% for New Equipment in the quarter. The reason being is, because we are anticipating the volumes drop in the second half and we are executing cost-mitigating actions. Among others, we will implement furlough in some production facilities. That will mean that the volume shortfall will be more acute in Q3 and will come back to regular level in Q4.

On the Service side, however, as Judy said, we are accelerating execution both on repair and modernization. They are going to be around 8% growth in the quarter, and we have very good line of sight to execute repair, because our ending backlog in Q2 was around 8%. So it's the execution of the backlog. And margin is going to go up sequentially too. We also have an easier compared to Q3 last year. So total operating profit will be around 2% up, and EPS will be around 5% up. That means that for the calendarization of EPS growth in the year will be \$0.03 first half, \$0.05 Q3, and around \$0.14 Q4. So it is kind of a back-loaded profile, and the growth in Q4 is based upon three areas.

One is on the New Equipment side, we expect a better stabilization in China in terms of shipments coming from better liquidity conditions in the market, but we also have an easier compare in China versus Q4 last year. So New Equipment contribution in Q4 will be back to normal levels around \$70 million in the quarter. And on the Service side, we expect an additional acceleration of repair and Mods will be around low-mid teens in the quarter. That implies for repair, a ramp-up in orders, but also ramp-up in execution, and we do have the resources. You may recall that last year we hired around 2,000 mechanics. Those mechanics are productive now, and we are also this year selectively hiring in those countries where we see further growth potential of the backlog.

And on the Mod side, it will be around 15%. This is based upon the acceleration of Mod in China on what we call the bond projects. These are the governmental subsidies. And you may recall that last year, we had a similar acceleration because the subsidies come to an end at the end of the year. So they need to be used. And this year, we are planning to do the same, with a bigger scale because the program this year is bigger. It's around 100,000 units versus 40,000 units last year. So the acceleration in Q4 is based upon New Equipment, Repair, and Mod.

Q - Nigel Coe {[BIO 3818998 <GO>](#)}

Great. Thanks, Cristina.

Operator

Our next question comes from the line of Nicole DeBlase with Deutsche Bank. Please go ahead.

Q - Nicole DeBlase {[BIO 16935492 <GO>](#)}

Yeah, thanks. Good morning.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Good morning. Welcome, Nicole.

Q - Nicole DeBlase {[BIO 16935492 <GO>](#)}

Thank you so much. Maybe we could just start with the China transformation savings. You guys were very clear about the -- what you're adding. But I guess what does that mean for carryover savings into 2026? Is there anything that we should be thinking about next year?

A - Cristina Mendez {[BIO 24091827 <GO>](#)}

Yeah. So the China transformation savings at the beginning of the year, we guided \$20 million in the year, \$30 million run rate. We are executing according to the plan. We had \$5 million in the first half of the year, and the remaining \$15 million will come in the second half. But because of the more acute decline of volumes, we are taking additional cost reduction actions. That's why we have increased the run rate from \$30 million to \$40 million. So this is going to be an incremental savings for 2026.

And when you step back and you look at our overall picture of New Equipment in the year, New Equipment sales are going to decline around \$400 million versus \$450 million last year. This is a very similar decline. In terms of contribution, last year the decline was \$44 million. This year, excluding tariffs, this is an extraordinary effect, we are going to decline \$60 million. There is an incremental decline of \$15 million, but we are facing new headwinds. One is the price, because price in the backlog in China became negative last year as we deteriorated prices, the market

deteriorated prices. This is a headwind of around \$100 million BPY this year, and the second one is commodities at last year was \$20 million positive, this year is flat. But we are only deteriorating incremental \$15 million. So this shows you all the cost actions we are taking in New Equipment that are the UpLift program, but also the transformation of China, and the usual productivity, material productivity action. So there is a lot of cost mitigation in the New Equipment side.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Yeah. Nicole, let me put this in kind of the business perspective versus just the financials. We made a major organizational transformation change in China as we started the year. We went from basically two separate, almost wholly operating companies with very different brands to being more laser-focused on New Equipment and Modernization together in China for good rationale and service. So we now offer both those brands in service, and we offer both those brands in New Equipment and Modernization. But now we have the ability to optimize, to have our agents and distributors, and our direct sales folks make us more customer-centric.

So we're going through this transition, and at the same time, obviously, market conditions are a headwind in New Equipment, especially. Service is growing nicely, Modernization is growing very nicely in China, over 20% mod growth in China, over mid-teens portfolio growth in service. So we are preparing, while we're taking this cost out, we're preparing for and implementing our new China approach to market, which will position us not just for the fourth quarter of this year to get to that stabilization point, but for '26 and beyond to go-to-market in a different way than we have in the past 20 years.

Q - Nicole DeBlase {[BIO 16935492 <GO>](#)}

Okay. Thank you. That was a very comprehensive answer. I appreciate that. And then just maybe a quick follow-up. The discussion around 3Q versus 4Q cadence was really helpful. Just one follow-up to that. What about the cadence of free cash flow? Does that look more akin to normal seasonality? Or will it look similar to the earnings profile? Thank you.

A - Cristina Mendez {[BIO 24091827 <GO>](#)}

Yeah. So cash flow in the second half of the year is going to be at the level of the second half in 2024. So we have a good line of sight to deliver as we delivered last year. Cash flow is weaker than what we expected but is primarily driven by the business mix. So we have seen New Equipment deteriorating further and Service remaining strong. And as you know, New Equipment is favorable in working capital because of the advanced payments, but also because of billing according to milestones. And for example, in the case of China, we don't ship unless we collect. On the other side, in Service, we bill after rendering the service. So this is a headwind in working capital, but it's a temporary one as we stabilize New Equipment and for the second half of the year, we have good line of sight to deliver the cash flow.

There is another component related to our UpLift transformation. We are transforming our processes while outsourcing our collections areas to a third party. The transition is progressing very smoothly. We are collecting with no disruption in the business, and we are positive that as we end up the transition towards the end of the year, the support of our new partner is going to help us accelerate and optimize collections even further.

Q - Nicole DeBlase {[BIO 16935492 <GO>](#)}

Thank you. I'll pass it on.

Operator

Our next question comes from the line of Steve Tusa with JP Morgan.

Q - Steve Tusa {BIO 4278663 <GO>}

Hi, good morning.

A - Judy Marks {BIO 5075554 <GO>}

Hey, Steve.

Q - Steve Tusa {BIO 4278663 <GO>}

Can you guys just talk about how you're set up into, like, just mechanically what the backlog would suggest for next year in China? And I'm sorry, did you say that the orders there are looking to improve sequentially now? I didn't quite catch that in the beginning on any.

A - Judy Marks {BIO 5075554 <GO>}

Yeah. The orders will improve sequentially in China. The backlog for -- is actually -- let me just take you through the whole world in terms of backlog and how they're doing. If you look at -- let's start in the Americas, Steve. Our backlog as we ended last year was minus 4%, which is obviously where we saw some of the challenges in the revenue this year on New Equipment in -- especially in North America, we're ending this quarter up 5% there. So that, plus the orders we anticipate through the rest of the year, position us really well going into '26.

Asia Pacific, really strong backlog, double-digit. So we're really pleased there and EMEA will be fine as we enter, especially based on the Middle East and Spain and some other locations. So it leaves us with China backlog. And that's why we've been talking a lot ex-China today. China was about 12% of our global revenue this year, 10% this quarter, 10% last quarter. So it's still now that smaller contribution. So we're watching it closely. We're rightsizing our costs to the best of our ability. But even with the Mod backlog will be up, the Service backlog will be up going into next year at China, but the New Equipment backlog will be down.

Q - Steve Tusa {BIO 4278663 <GO>}

Okay. So I mean, that just sounds like on a -- like, from a profile perspective, is China enough of a drag next year to completely offset what's happening in the other regions?

A - Judy Marks {BIO 5075554 <GO>}

Yeah, we're not going to guide for next year yet, Steve, but the other regions are really growing strongly.

Q - Steve Tusa {BIO 4278663 <GO>}

Okay. Great. Thanks a lot.

A - Judy Marks {BIO 5075554 <GO>}

Thanks.

Operator

Our next question comes from the line of Rob Wertheimer with Melius Research.

Q - Rob Wertheimer {[BIO 15171160 <GO>](#)}

Thanks, good morning.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Hey, Rob.

Q - Rob Wertheimer {[BIO 15171160 <GO>](#)}

I wanted to clarify -- hey -- demand in North America, I mean, you just referenced backlogs being strong. I think earlier in the call, you kind of talked about some project delays. You mentioned recovery multifamily. So I wonder if you could just square that circle. Thank you.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Sure. Well, and you may have seen the June ABI data that came out this morning, which was down a little from May, but inquiries being up, Dodge momentum is up in June. And so what we're seeing for the segment, we stayed at down low-single. But I would tell you, as we kind of came through the end of the second quarter, we are starting to see some nice positive opportunities when we look at proposal activity and pending awards as well in terms of North America. The uncertainty we talked about was for the current backlog we're executing at job sites.

So our backlog, as I said, was down as we came in this year, minus 4% in North America on New Equipment. We've been shipping from our Florence, South Carolina, facility. We've been ready to install, but some of the job sites have slowed down a little. And I can't -- it's not our labor or -- but there are just some general unease with the tariffs and what's been going on on the more macro project level. We're not seeing that slowdown in our orders by any means, with four consecutive orders in the teens in North America, up 15% in New Equipment orders that really this quarter.

So everything we're seeing locally which is we'll look at the data, but what we're hearing, again, is as the tariffs are getting more defined and settled. There's more excitement. We all are waiting for interest rates and whatever will happen from the Fed to happen, obviously, in the second half of this year. There are a lot of jobs where the math works with that next small interest rate decline. So we bid them. We're waiting to hear. Our team is prepared not just to win them but to perform. And I think we've seen just really strong performance there.

Q - Rob Wertheimer {[BIO 15171160 <GO>](#)}

Very helpful. Thank you.

Operator

Your next question comes from the line of Julian Mitchell with Barclays. Please go ahead.

Q - Julian Mitchell {[BIO 21229700 <GO>](#)}

Hi, good morning. Maybe just wanted to start with a broader question on free cash flow because, I guess, based on the updated dollar guide for this year, you've sort of got the same free cash flow, it looks like for -- in dollars for four years running now despite over that period sort of mid-single digit sales growth, mid-single digit plus net income dollar growth. So just trying to understand, not so much in Q2, but what's going on more broadly on free cash flow margins or

conversion? Is something changing in industry dynamics around payment terms or something competitively, anything you'd call out there?

A - Cristina Mendez {[BIO 24091827 <GO>](#)}

No, thank you for the question, Julian. And it's what I said before to Nicole. So it's a matter of the business mix that is changing. We -- and the working capital of New Equipment is more favorable than in Service. And in the last years, New Equipment has been declining because of the situation in China. In 2025, the situation is a little bit more acute because on top of China, we have the decline of US in sales, driven by the ending backlog last year that was negative, plus what Judy mentioned, the job sites are slightly delayed because of the uncertainty about tariffs. But this is just a temporary effect.

So Service is growing strongly. Service collects, but we collect later. It's a matter of time. So by when we stabilize New Equipment and we have line of sight because the US backlog is growing, it's growing 5% in Q2. So US will stabilize and China will bottom out. And we also mentioned that orders in China are expected to stabilize towards the end of the year. And on the other side, we will collect in Service. So we -- our business fundamentals remain unchanged. Our business models generate cash flow conversion of 100% plus because of our low capital intensity, because of our low R&D is just a matter of the temporary shift of the mix until we stabilize New Equipment.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Yes. Julian, there is no structural change in payment terms across the industry. Everything remains strong, and I just want to give a shout-out to our colleagues who do such a great in execution and then collect that cash that allows us to be able to share that cash with our shareholders. And you saw we're committed to the \$800 million in share repurchase and to our dividend. And I think we've been -- we're really good stewards of giving that capital back to our shareholders.

Q - Julian Mitchell {[BIO 21229700 <GO>](#)}

That's helpful. Thank you. And then just a shorter-term question on the operating margin dynamics. Just to understand, so in the first half of the year, the operating margin is up 20 bps or so, and including the Q3 guide, not much. And then you've got this step-up for the whole year guided of including tariffs sort of 30 bps or so. So that margin step-up is happening, I suppose despite a bigger tariff headwind later in the year. Maybe just help us understand sort of what's the puts and takes there around sort of the degree of tariff margin headwind in the back half of Q4, and what all those countervailing factors are to offset that?

A - Cristina Mendez {[BIO 24091827 <GO>](#)}

Yeah. And Julian, you are right. So the tariff impact is going to be in the second half of the year. We are guiding the midpoint of \$30 million. Year-to-date, we have had \$5 million, \$6 million in the P&L. So this is going to be a headwind that we have quantified in around 10 basis points, 20 basis points of margin. But on the other side, the business mix improves in the second half of the year because we are accelerating very strongly repair and modernization, again on the back of a strong quarter and backlog growth. And as you know, service margins are higher. So this is going to be a tailwind.

But in addition, we are finalizing the execution of our UpLift program. And we have very good line of sight, because most of the actions are now to be executed. They are progressing on plan. And also China, as I mentioned before, the \$20 million in year savings, we have captured \$5 million in

the first half. So the remaining comes in the second half. So essentially, it's a combination of business mix, productivity, and the flow through of the UpLift and China transformation savings.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Yeah. Let me just reinforce our confidence in the service business in the second half of the year. We have the backlog, we have the resources, as Cristina said, and now we execute. And you will see that make the difference and drive the guide, and put -- that will take care of the tariff impact, and it will get us again back to the outlook that now we've reconfirmed twice.

Q - Julian Mitchell {[BIO 21229700 <GO>](#)}

Great. Thank you.

Operator

Our next question comes from the line of Chris Snyder with Morgan Stanley. Please go ahead.

Q - Chris Snyder {[BIO 17451533 <GO>](#)}

Thank you. I wanted to follow up on the prior commentary around margins into the back half. So I guess, is service mix getting more favorable into the back half versus Q2? Because it seems like much of the UpLift in growth from the 4% back to, I guess, something like 6% is driven by mod, which I thought would have been more dilutive to service margins. Thank you. Any color on that?

A - Judy Marks {[BIO 5075554 <GO>](#)}

Yeah. I mean, the simple answer and the candid answer is, it's actually more driven by repair step-up, which again we have 8% backlog going into the third quarter. There will be additional repair orders added. The demand we're seeing there is strong everywhere in the world, all four regions, EMEA, Asia Pac, China, and the Americas. And that mod will pick up too, but the relative contribution both in sales and in profits will come from repair.

Q - Chris Snyder {[BIO 17451533 <GO>](#)}

Thank you. I appreciate that. And then maybe just on the Americas, obviously, orders have been pretty good, not converting at the rate expected. I guess, what do you think the market needs to see to start converting those orders? Is it visibility around tariffs? Is it interest rates? Any thoughts on that? Thank you.

A - Judy Marks {[BIO 5075554 <GO>](#)}

Yeah, no, it's a great question, Chris. We do convert well. The challenge -- the Americas, especially North America is our longest lead time from when we book an order to when we get to a job site. There's a combination of reasons from permitting to just general construction challenges in the US. So we've been running through 18 months ago of backlog, and now we've got four straight quarters of orders improvement, which you'll see in '26 really start stepping up the revenue for North America. So it's -- that part's not an issue.

What we're just seeing is a bit of uncertainty right now on current job sites from the backlog that we're literally not just delivering but installing. And it's just, you know, as each job takes another week or two longer than anticipated, we're not seeing it -- we're not seeing that impact on the margin side, on the labor side, because we can move our crews around, but we are seeing it on when we realize the revenue.

Q - Chris Snyder {BIO 17451533 <GO>}

Thank you. I appreciate that.

A - Judy Marks {BIO 5075554 <GO>}

You bet.

Operator

And our final question comes from the line of Joe O'Dea with Wells Fargo. Please go ahead.

Q - Joseph O'Dea

Hi, good morning. Can you just expand a little on where the furloughs are occurring, how long you expect those to be in place at this point?

A - Judy Marks {BIO 5075554 <GO>}

Yeah. So they're temporary. Let me be clear. I mean, measured in weeks. And you're mainly seeing them where we're seeing our New Equipment challenges in terms of revenue, North America and China.

Q - Joseph O'Dea

Got it. Makes sense. And then just in terms of order expectations as we get into the back half of the year, because first half of the year pretty stable with total orders down one organically. We do get comps that move around quite a bit. And so, just any color on how you're thinking about order activity in the back half of the year. If you could revisit, I think you gave a little bit on China, that in particular, but then also Americas and EMEA, how you're looking at order trends there?

A - Judy Marks {BIO 5075554 <GO>}

Yeah. Let me start with modernization, and then I'll turn kind of New Equipment over to Cristina, and we'll pair up on this one as partners. Listen, the modernization order strength will continue, and you will see that continue globally. And I think you'll actually see more strength coming out of EMEA relative to how they performed in the first half. They had a challenging second quarter, but it was due to a tough compare to a major modernization they won second quarter last year.

So we expect to be talking about EMEA mod orders becoming far more positive, but the other three are on good trajectories to continue at this rate. We've always believed that mod orders, because of the market demand we're seeing, China will be up far more than 20%, because you'll see this. We call it this bond mod, this government stimulus mod at 100,000 units available that they have to spend the money by year-end. You'll see that pick up well beyond 20% that we saw last quarter. And as I said, Americas had a phenomenal quarter with 50% plus in North America. I don't expect them to sustain that rate, but I do expect them to be in the teens plus for mod. And APAC has strong mod growth as well. They were 20% plus, and they should be at least teens plus.

Cristina, I'll let you talk to New Equipment.

A - Cristina Mendez {BIO 24091827 <GO>}

Yeah. So on the New Equipment side, we have talked about China. China has been sequentially stable in the first half of the year. We expect ramp-up in the second-half BPY back to flat to even slightly positive in orders. The reason for that is, of course, the easier compare, but also the fact that we have been working on the transformation initiatives of New Equipment in the first half of the year in consolidating the two brands, consolidating agents and distributors. So we are now in very good shape to start getting the results in terms of orders.

On the Americas side, Americas has had a super strong performance since the second half of last year, has been growing mid teens of above. For the second half of this year, we expect the growth to slow down a little bit, but it's just a matter of the compare, because they started growing very strongly last year. So we expect them to be sequentially stable, but the growth with a slow down.

And then on EMEA, EMEA is expected to be kind of low-mid-single digit up for the year. The reason for that is, we have a very strong growth in Middle East. There are certain markets in Europe that are more muted. I'm talking about Central Europe, Western Europe, or the North of Europe. But we are also taking selective investments in those markets where we see positive possibility to grow to [ph] a segment, but always with a prospect of converting into service afterwards.

Q - Joseph O'Dea

That's great color. Thank you.

Operator

I will now turn the call back to Judy for closing remarks.

A - Judy Marks {BIO 5075554 <GO>}

Thank you, Tina. While we face near-term challenges in our New Equipment business, we remain confident in our long-term outlook. The global install base continues to expand, while the population of aged units presents an attractive and growing opportunity for modernization. Together, these strong fundamentals should continue to drive our service flywheel. As we look ahead, we're confident our service-driven business will continue to deliver attractive long-term shareholder returns.

Thank you for joining us. Thanks to our Otis colleagues and thank you to our investors.

Operator

Thank you again for joining us today. This does conclude today's conference call. You may now disconnect.

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