**KONE Q3 2019: Interim Report for January-September 2019**

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Sanna Kaje: Good afternoon, and welcome to KONE's Q3 Results Presentation. My name is Sanna Kaje, and I'm the Head of Investor Relations.

As always, I have here with me today our President and CEO, Henrik Ehrnrooth, and CFO, Ilkka Hara. Henrik will first go through the Q3 highlights. Ilkka will give a bit more colour on the numbers, and Henrik will then discuss how we see the outlook. After the presentation, we have time for your questions. Henrik, the floor is yours.

Henrik Ehrnrooth: Thank you, Sanna, and warm welcome on my behalf to our Q3 webcast. And I'm very pleased to present a good result to you today. We have some good news to share here.

If I start with the highlights for the third quarter, I would say the highlights are really that we continue to grow faster on markets on a broad basis and the margins of our orders received continued to improve. Also, we had a solid growth in our service business, our adjusted EBIT margin improved and we had a very strong cash flow. So, overall, a very solid quarter and that I'm very happy about.

But as a usual, start with our key figures. As I mentioned already, it's all about solid growth, improving margins and cash flow. Orders received at €2 billion; good growth, 6.8% growth in comparable currencies. That is a very strong achievement in the market environment that we have at the moment. We have a strong order book at €8.4 billion and it's growing at 4.2% in comparable currencies over last year.

 

Sales, $2.55 billion, and growth of 9.4%, again very, very strong. Our EBIT operating income improved from €258 million to €314 million and the adjusted EBIT, which excludes the cost from the Accelerate programme increased from €274 million to €322 million and the margin improved from 12% to 12.6%; also good growth and good profitable growth in the quarter.

Cash flow at an all-time high of €463 billion, that is very strong, and also our earnings per share improved from $0.42 to $0.48.

But as we always say one quarter is a short period of time. And now we have three quarters behind us, so we get a little bit longer perspective of our performance. And also if you look at the first nine months, we can see a very similar trend – solid growth in all businesses and strong cash conversion.

Orders received for the first nine months of the year, €6.4 billion and growth of 7.6% in comparable currencies; again, that I'm very pleased with. Sales also growing strongly, €7.3 billion of sales and 8.3% growth in comparable currencies. Also, operating income grew from €750 million to €836 million, and the adjusted EBIT from €792 million to €870 million.

Our adjusted EBIT margin is still just slightly down year-on-year because of decline beginning of the year, but now we had a solid improvement in Q3. A clear objective from here is to be on an improving path. Cash conversion very strong for the first nine months at €1.16 billion compared to €818 million last year and our EPS grew from €1.19 to €1.26.

As usual, I'd like to express my thanks to all of KONE's employees for a fantastic job done in the third quarter. We know that the activity – the development activity level of KONE is very high. We are executing our strategy. We're bringing new service and solutions to our customers. We're driving Accelerate programme. But despite all of this, our people have kept their focus on our customers, being out there proactively helping our customers resolve their pressing problems. And that we can see from the growth that we are driving and from a fact that we continuously now have been growing faster in our markets.  That is a good achievement and I'm very happy about and very thankful for the great job our employees are doing.

Some more highlights of the Q3 is, first of all, the continued faster market growth in all businesses. It's been broad-based growth.  And if we look at our orders received, we have now two quarters in a row been able to slightly improve our margins in our orders received.  All of this tells us that our competitiveness is strong and it's broad-based.  We're growing in all businesses.  We have been growing in all geographic areas; that, I think, speaks volumes.

Also, in the summer, we had again – we did again our customer loyalty survey.  Results from that continue to be good.  Our net promoter score was now stable but on a good level.  What our customers saying about us, they continue to say that KONE is a reliable and good partner.  They appreciate our service mindset, our products and our services.  However, as always, we have a number of areas where we can improve, such as customer communication, such as proactiveness, and we still have a lot that can be done.  And those are things that we continue to work on so that we can continuously improve.

In Q3, our execution overall was very solid.  We had very strong deliveries to our customers in all businesses, and that I'm very happy about, particularly if we think about the resource shortages that this whole industry is facing at the moment.  In that environment, we have been able to keep our promises, deliver to our customers and deliver to our customers in a good way.

Also, strong cash conversion tells a lot about how we've be running the business, always very important metric to us.  You can see that the actions we have taken to improve our profitability are starting to show results.  Those, of course, have to do with pricing, with efficiency and productivity.

One of the actions we have been taking, apart from just executing our strategy, has been the Accelerate programme. We can start to see visible benefits from it. And just to recap, why did we start this programme? We have three objectives: improve customer centricity, speed, and efficiency.

Customer centricity is a big word. So, what does it in practice mean for us? What we want to do is that we want to help our front-line organisations, the ones who are constantly in customer contact, in focusing in more on customer interactions and spending more time there to serve our customers even better. Therefore, we wanted to take away tasks from them to help them focus on this and also drive the transformation that we need to drive as KONE.

We also want to be faster in bringing new services and solutions to our markets and clearly, we want to improve our efficiency. And we have a good momentum currently in the Accelerate programme. If I just take a few examples, in customer solutions engineering, we have brought new processes, new ways of working on new tools as well. This is helping our front-line organisations to serve our customers faster, better, and being more proactive with better tools.

We're also shortening the lead times of our deliveries to many of our customers. In many markets, that is important. And we have shortened those a lot that so we have actually gained a lot of speed in the business. So, we can see tangible benefits of what we're doing here.

Our HR organisation, which was one of the first ones we transformed, we have now built an organisation where we can much better meet the needs that we have in the coming years. For example, I believe that every company has a big need in the coming years to retrain a lot of people, to reskill a lot of people. We are doing that actively. And we have now built up an organisation that can support such retraining even better than we've done in the past.

I think as everyone remembered, we have every year, increased the amount we invest in developing our people, and now we're having a better platform how to do it. We have also been able to improve how we recruit and bring people on board to KONE. We are faster in recruitment with better quality. Our sourcing in our front lines, which is the local part, we have also improved that. So, many things have improved.

But for example, in customer service and admin and finance, we still have a lot to be done. But that was always the plan that we don't do everything at the same time; we do things sequentially. So, we are going in the right direction and that I'm happy about.

So, those are a few highlights of Q3 and bring a little bit more insight in the Accelerate programme, what we are really doing there.

And next, let's talk about what's happening in our markets. The global new equipment markets were stable in the third quarter. North America, stable on a high level. Europe, Middle East and Africa, clear variance in the region. Central/North Europe, pretty stable. South Europe growing, and Middle East declining. So, clearly a mixed situation overall. Asia Pacific, overall stable. In China, market grew slightly. I'll come, as usual, a little bit closer to China soon. But rest of Asia Pacific is declining due to decline in many Southeast Asian markets. Some decline in Australia and also decline in India.

What is happening in India? We've been always talking about that as a very promising growth market. Situation in India at the moment is that liquidity is very constrained and we can see that that's causing a lot of issues for many of the large developers. Again, as many of the other big reforms in India, we think it's going to take a few months, probably six months or so for this to work itself through the system and – because we can still see that the underlying demand from consumers continues to be strong. But at the moment that market is also declining.

Service market, continued positive development, not much new. Maintenance, all markets are growing at least slightly. Good growth in Asia Pacific. Modernisation market, actually now pretty good growth in Europe, Middle East and Africa and good growth in Asia Pacific, and also North America growing slightly. So, overall, solid and good growth opportunities in services.

But as usual, let's dive a little bit deeper into what is happening in China. Overall, we can say that the main theme in China is that the government is balancing between supporting the economy, but at the same time, restricting the residential market. If you look at our market overall, you can see that the market grew slightly if you measure in units and pricing was pretty stable as it's been throughout this year.

Government, when I talked about this support in economic activity, where we can see that mainly is through the infrastructure market. We can see high activity in building metro lines, railway lines, airports, and so forth. So, there we can see high activity and stimulus activity.

On the other hand, when we look at the residential market, we still see restrictions in the top 100 cities and it's interesting that when they have even slightly eased those restrictions, we immediately see a very strong growth. So, when people ask me that how much do I see stimulus in China. I would say, let's keep in mind that we still have, principally, restrictions in place, and those have it, in some cases, slightly bit eased, but not significantly. Overall construction activities is on high level.

If you look at some of the key indicators, you can see that real estate investments have grown at about 10% year-to-date. Also, residential sales volume and new starts are growing and new home prices in top 70 cities have also increased quite nicely year-over-year. It is, of course, against this backdrop why we continue to see many of the restrictions. If you then think about our customer base, developers, we can continue to see a consolidation amongst the top developers. But today, the top 100 developers already represent over 50% of the market. Clearly, that has many implications.

For KONE, we have created an opportunity out of that, how we're able to serve the market position we have with the top developers. But it's clear at the same time that they have a strong purchasing power. But also they usually have slightly higher conversion rates to service as they have a brand to protect. So, we think overall, we have created an opportunity out of that and continue to see opportunities there.

So, that is about the market and a little bit about our development. Now, I'm happy to hand over to Ilkka to talk about our financial development.

Ilkka Hara: Thank you, Henrik, and also welcome on my behalf to this third quarter results announcement webcast. Let's start going through our financials a bit more in detail and I'll start with orders received.

Our orders received reached over €2 billion in the third quarter, and that represents a 9.6% growth on a reported basis. And we saw growth in all regions and on a comparable basis, that's 6.8% growth. As Henrik already highlighted, our margin of orders received improved slightly now also in third quarter.

And if we look at the large Chinese market, we actually saw a good growth in our orders received. In both monetary value as well as in unit, we saw over 10% growth in our orders received. Mix had a slight negative impact in China, while pricing was relatively stable.

Then to sales. We continue to see a good growth in all businesses in sales, and our sales reached €2,558 million. On a reported basis, that's 11.7% growth compared to last year, and on a comparable basis, that's 9.4%.

If we look at where the strongest growth was, from a geographical perspective, then Asia Pacific was 11.5% growth and there, especially the strong deliveries we saw in China were driving the growth overall. At the same time, Europe, Middle East, Africa grew 8.1%, as well as Americas contributing at 7.6% growth rate.

Also, if we look at from a business line perspective, both new equipment as well as modernisation grew over 10%; so new equipment growing at 10.2% and modernisation at 10.9%. At the same time, the number that I would highlight from this is actually our maintenance growth, which is 7.4%, and that's quite a good growth rate for the business in this quarter.

Then, moving to adjusted EBIT development. And our adjusted EBIT grew to €322 million in the quarter, representing 17.6% growth compared to last year. We also saw our adjusted EBIT margin growing from 12% to 12.6% in the quarter. If you look at what's driving the adjusted EBIT development, then growth had positive impact. Also, we saw profitability, so the actions that we've taken on both pricing, but also improving our efficiency, coming through in the results.

Currencies had an €8 million positive impact to the results and IFRS16, €2 million. At the same time, Accelerate programme costs were €8 million in the quarter. Our benefits from the programme were more than €10 million in this quarter.

Lastly, to cash flow. So, we had a strong cash flow quarter and our cash conversion continued to be strong. Cash flow at €463 million in the quarter. Obviously, one quarter is a short time to measure cash flow, but also the first nine months with over €1,164 million is very strong cash flow. We continue to see networking capital contributing positively, driven by both strong development in our advances received, as well as progress payments from our customers.

It's also good to note that IFRS16 has a positive impact to our cash flow of €87 million for the first nine months of the year. But regardless of that, the cash flow has been strong.

With that, I'll actually hand over back to Henrik to talk about market and business outlook for us.

Henrik Ehrnrooth: Thank you, Ilkka. Let's then wrap up with the outlook for our business and our markets. For 2019, we expect the new equipment markets will be relatively stable or grow slightly. In China, we expect markets to grow slightly in units ordered as it's done so far this year, so the same trend to continue, while in the rest of Asia Pacific market expected to be pretty stable year-over-year. So, we had some growth in beginning of the year, now a slight decline.

North America, Europe, Middle East and Africa, expected to be rather stable. Maintenance markets, no changes there, so growth in all geographic regions. Slight growth in Europe and North America and good growth in Asia Pacific. And pretty much same in modernisation; that's good growth opportunities, Asia Pacific the fastest, but also some growth in Europe, Middle East and Africa and North America.

Then, our business outlook for 2019. We now have nine months behind us, so we have slightly specified our outlook. Sales we expect to grow between 5% to 8%, though we previously expected the growth is between 4% and 7% in comparable currencies. And EBIT we expect to be in a range from €1,190 million to €1,250 million, with previously expected range to be €1,170 million to €1,250 million. And we expect that there's some tailwind from the foreign exchange to the tune of about €20 million, it's pretty same as previous quarter; slightly adjust slight specification on the outlook compared to what we said in Q2.

What's driving our performance? It's clearly the solid order book we have, the growing service business and how we are driving improvements throughout KONE including Accelerate. What is burdening the result? Raw material prices and trade tariffs. And then, as we mentioned, what has been an increasing trend is the labour and subcontracting cost increases as a result of labour and resource shortages.

We also thought at this stage, as we usually do, it's good to give a little bit of a view into 2020. What are we seeing now? What we are seeing that there are a number of things that are positive for us. They're definitely driving our performance. They include our strong order book and also that we have been able to slightly improve our margins of orders received – that's clearly a positive. The solid growth we have in our service business, the constant compounding we have had there, of course, sets us up for a good situation. And also Accelerate savings and performance improvements in general are positive.

But, as always, there are also some negative headwinds for us; labour and subcontracting, cost increases due to the resource shortages that we had talked about. But also I think it's clear to everyone what we can see is that the overall world economy is weakening. So, that we think is a headwind, and also the geopolitical uncertainties.

When I look at KONE's overall situation, I think we look with quite some confidence into 2020. We have a strong order book. We have a growing service business. We are executing. So, we think also in that environment we can perform. And, of course, our objective continues to be to grow faster than market, even if the market environment itself is more challenging. That is what we have been doing and that's what we intend to continue to do.

So, to summarise, we had a broad-based good development across our business in the third quarter. And we believe that we will enter year 2020 in a strong position.

With that, we are happy to turn over to your questions.

Sanna Kaje: Yes, plenty of time for questions now, and I think we're ready to start from the lines. So, Operator, please.

Operator: Thank you. If you wish to ask a question at this time, please signal by pressing star one on your telephone keypad. Please ensure your mute function is turned off to allow your signal to reach our equipment. If you're using VoIP phone, you might have to enable touch tone signals pressing send DTMF button on your device dialling – before dialling star one. We will now take our first question from Klas Bergelind from Citi. Please go ahead.

Klas Bergelind: Yes. Hi, Henrik and Ilkka. It's Klas from Citi. I've got three questions, please. First on the cash flow for you, Ilkka. Obviously, a strong growth for you in China for quite some time now, but now we see a further delta on cash. Is that also the collection terms improving in China, is the share of prepayments going up and quicker cash collection? Just interested in the mix there within China. I will start there.

Ilkka Hara: Overall, so in – if you look at the cash flow, so it's not only China contributing positively, but overall cash flow have been strong across the businesses and across the geographies. But from an advances point of view, China is a big market and a large part of the advances are coming from there, so that's contributing positively.

And from a collection point of view, there hasn't been that big of a change in that one. It's been rather stable. Maybe this quarter was a bit better, but not the meaningful driver for the improved cash flow as such in China.

Klas Bergelind: All right, thank you. And then my second one is for you, Henrik. And I need to ask you on Thyssenkrupp and your ambition here. I will try and see if you can answer some questions in this forum. First on the antitrust. There are some regions in Europe where you will face issues, but you say that these can be solved and I get that. At the same time, news agencies are reporting of you delivering some of the lowest bids and it might be because of these issues that the net effect of the synergies might be low, pose[?] remedies, for example, on service density. Or are we missing something on the synergies? I know you will say it's a dream team and I can see that. But if you could drill down a bit more on the synergy potential – post potential remedies. You talked about digitalisation being at the centre of a potential deal. Henrik, could you help us to perhaps understand the opportunity on the cross-selling as well with Thyssenkrupp? Thank you.

Henrik Ehrnrooth: First of all, I'm not going to comment on any specifics, and I'm sorry, I'm not going to go into any of the synergies. I think I would repeat what we said before. As you already alluded to, that we think that this is the ideal combination. If you look at the geographic complementarity of the two businesses, if you look at the potential you can have from synergies and combining and if you can – the potential you can have from even faster and more actively build out new services broader to your customers, I think those are all fundamental positive things.

We've said that we think it's inherently doable. What it will mean, I can't – I don't know exactly and therefore, I'm not going to go into that. I think we just have to be patient here and wait for whatever process they are running to play out. And we will continue to see a lot of rumours. There are lots of rumours around this process. I would just urge everyone to be quite critical of what we see and what we read because not everything is true and even close to true. So, I just leave it there.

Klas Bergelind: Okay. Okay, thank you, Henrik. I had to ask. My final one on pricing. We keep hearing from some of your peers that while price cost is improving in China, it's getting weaker in North America and pricing is obviously flat now in China. We[?] are coming from a tough comp[?]. In North America, we've seen multiyear recovery and non-res activity is a bit weaker now. China looks – I mean, it's good, but looks pretty choppy[?]. So, how should we square this with your cost comment, Henrik, that cost increases on subcontracting will likely to continue into next year? Should we be more cautious on price costs going forward? If you could just comment along price and cost, please?

Henrik Ehrnrooth: Well, as you know, we don't comment on pricing going forward. That's always individual negotiations between us and our customers. And, of course, what we want to do is provide a good of outcomes as possible to our customers and that way create win-wins and improve pricing.

But if you look at the trends we see in North America, if you remember, we have been multiyear – we had actually quite a favourable situation where pricing improved. It's clear now the markets are stabilising. We are seeing a more competitive environment. And, of course, we then need to take action and make sure that we can compensate that with productivity and work even harder with our customers.

In Europe, perhaps we have seen better pricing environment now slightly. And that's why[?] we've been able to improve pricing, but of course, there's been a very high need for it, but there's resource shortage that's really principally a Europe and Asia problem. So, we have been able to increase prices. Clearly, prices have gone up more than margins because costs have also gone up.

So, I think that we are in a pretty good situation. But we have to see where the market is next year. And of course, we're going to continue to be out there, work with our customers, want to add value to them and that will, in the end, determine how successful we are here.

Klas Bergelind: Yeah. Just a quick follow-up on cost for you, Ilkka. Shall we see another €20 million, €30 million delta from subcontracting in 2020? I think that that was what you guided for in 2019. Are you ready to make such a comment for 2020?

Ilkka Hara: Well, 2020, it's a bit early to still comment. But if I look at the situation, so we do say that especially in Europe there is a pick-up in prices more than normally. Let's say, maybe some tens of millions would be at this stage my guidance.

Henrik Ehrnrooth: Pick-up in cost you mean?

Ilkka Hara: Pick-up in cost, yes.

Klas Bergelind: Thank you.

Henrik Ehrnrooth: Also remember, what is there – so there's always – you can look at just what labour costs increases are. That's one aspect. But when you have a situation where you have resource shortages, that means that, of course, subcontracting becomes more expensive. There is more competition for those resources.

But as well, what it means is that you will have much more over time. You have much more juggling between projects. And of course, those are always things that are not – they are not good from a productivity perspective. But we're working. We are making some good progress in being even better in how we plan our work, how we work with our customers to do it, but there is a clear headwind in Europe. And yeah, there are just – I think the whole construction sector at the moment is suffering from shortages for skilled labour and, of course, it's skilled labour that we work with.

Klas Bergelind: Thank you, Henrik.

Operator: We will now take our next question from Lucie Carrier of Morgan Stanley. Please go ahead.

Lucie Carrier: Hi. Good afternoon, gentleman, and good afternoon, Sanna. Thanks for taking my question. I have three. I will go one at a time. I was hoping, maybe, I could follow-up on some of the comments on pricing from Klas earlier. And specifically on China, the fact that you – that the price increases cannot stop, is that on the back of the raw material situation? Is that because the market maybe is starting to slow, other type of pressure? And I was opening you could comment on the negative China mix that you also mentioned in the quarter. That's the first question.

Henrik Ehrnrooth: So, I'm not sure if raw material is the big – that's the competitive environment. We can also see that clearly the big developers are getting stronger. But I'd say that has been still a net positive for us. Overall, pricing environment has been pretty stable. I wouldn't say – if I look at the China market today and if we look a couple of quarters forward, I actually don't expect to see major changes in activity. And now we have had a slightly growing market. So, that's where the overall situation is, and competitive situation. I think we are in a pretty good spot overall at the moment.

Lucie Carrier: Sorry, and on the mix –

Ilkka Hara: Yeah, sorry Lucie. First on the pricing. So, maybe after the comment that if you look at quarter-on-quarter this year, relatively stable pricing actually in China, but year-on-year improving. And now the comp for Q3 was a bit tougher, so that's maybe more so than a big change in the pricing environment as such.

And maybe I'll continue with the mix. So, yes, the mix had a slightly negative impact, but wouldn't be too much above[?] the trend that such. Our GK brand was a bit better performing this quarter and that's driving the mix.

Lucie Carrier: Thank you very much. My second question was around the sales guidance. And so, if I back out the fourth quarter based on what you've done so far, it implies quite a broad range between, I would say, flat to about 7% organic growth in the fourth quarter. So, I was just curious if you could give us some colour, why do you see such a broad range? I mean, we are two months away from the end of the year. And at the same time, we've also – I've also noticed that it seems the execution or turnaround of the backlog seems to be a bit faster than expected. So, is there a risk that we have maybe front-loaded a little bit the third quarter versus the fourth quarter here?

Henrik Ehrnrooth: I don't think – our deliveries happen when our customers need those deliveries, so I wouldn't think about front-loading. I would – Ilkka, if you want, you can comment more specifically on this, but I would just observe that, I think, overall we give quite specific guidance. And yeah, okay, maybe for one quarter that may appear broad. But I think for the full year, we give pretty specific guidance. And clearly, there could be various outcomes.

I think one of the trends we've seen over the past year is that clearly in China the order book is rotating somewhat faster. And that is just something we've seen over the past years. Other than that, no big differences in other markets. And why have we had a good growth this year, is because orders received have been strong in China and that has been also delivered quite broadly to customers.

Ilkka Hara: Yeah, I don't think I have much more to add then. The biggest moving part is obviously what are the customer projects that are going forward in the coming months and how are we able to then deliver our production and complete installations for those products, both in new equipment as well as the modernisation. Which is the most – where we still have most[?] perfect visibility and our maintenance is more stable. So, not more to add there.

Lucie Carrier: Thank you. And just my last question. I was hoping if you could give us maybe – if we look at the order trends year-to-date, can you maybe give us a bit of a split between growth in new equipment, modernisation and maintenance year-to-date, how you're tracking?

Henrik Ehrnrooth: So the good thing is we have had good growth in all of those, but do you want to open – I mean, of course, in orders received, it's mainly about new equipment and modernisation. So, Ilkka, do you want to open more?

Ilkka Hara: Well, if we look at overall the trend what has been going well from an orders perspective, then new equipment has been strong, especially in China from orders perspective. And then if we look at modernisation, so that's been slightly better in terms of growth for the first nine months of the year. But slightly better modernisation overall, but not that big of a difference.

Lucie Carrier: Thank you.

Henrik Ehrnrooth: So, I think to Lucie's question again, I think the most important thing, if we look at our growth this year, is actually – it's not some individual things here or there. It's actually been broad-based and quite consistent. And I think that is the ideal situation to have in a business.

Operator: We will now take our next question from Andre Kukhnin of Credit Suisse. Please go ahead.

Andre Kukhnin: Good afternoon, and thanks for taking my questions. I'll go one at a time. Firstly, could we talk about the service growth in the quarter, specifically maintenance accelerating to about 7.4% from about 5%, 5.5% run rate. Is that just timing of things in the quarter and a bit of an easier comp, or was there any underlying tick-up there? And if there was, could you share with us what's behind it?

Henrik Ehrnrooth: I would say nothing specific there. I would say we have had a continued good growth in our service base. That's been growing at about 6%. Then, our new services are adding slightly to it, not much, but just slightly and that's positive. And then, repair activity has also been high, so all of these together have contributed to it. So, historically this is a very – very, very good performance.

You have to remember that if we look at earlier this year, we had a little bit of headwind in the growth because we have had an automatic doors business in North America that we had sold little bit over a year ago, and now that didn't impact anymore. It wasn't a big impact previously, but had a slight impact, and now at least that didn't drag anymore.

Andre Kukhnin: Great, thank you. And new services adding sub 1% or is it now edging over 1%?

Henrik Ehrnrooth: I think if I look at all of them together, we start probably at 1% additional growth from them. Yeah, about there.

Andre Kukhnin: Great, thank you. And then, if we move on to the labour inflation topic, can we just break it up between labour inflation and service contracts and then installation. In service contract or labour inflation for maintenance, do you expect that to be at a higher pace in 2020 versus 2019, or similar or lower level of installation?

Henrik Ehrnrooth: We have to see. Things haven't quite played out. If you think about where is the largest service business by revenue, it's clearly – it's Europe and almost all labour costs there are based on some general bargaining agreements. And I don't think there are answers in many of them yet. We just know that demands are much higher than in the past. So, it would be an incremental headwind. And I think if you look at Asia, that's a pretty constant, quite high increase. But that's something we've seen year-over-year and managed. So, I think Europe is probably the main one here where's the difference.

Ilkka Hara: To answer that the way to think about it is that there's always some inflation in labour costs. But now in Europe, recently we've seen increase in that. So, that's clearly the incremental that we're talking about here.

Andre Kukhnin: Right. So, that it's not acceleration in one year that is the issue, right, because you price up in Europe, at least on service contracts. They get generally priced up on indices in the following year based on indices performance in the prior year. Is that still the right rule of thumb?

Henrik Ehrnrooth: So, I think quite a few of those have a general – the ones that have a formula tends to be more CPI or general inflation that we know is actually quite low. So, it's not helping that much. It's helping – if they increase, we can price some of that more. But I think overall, it is a slight – or it is a clear headwind. But we need to just work all the time on our pricing and our productivity to counteract that.

Andre Kukhnin: Got it. Thank you. And installation costs across the portfolio is about 20% of new equipment revenues. Is that still the right rule of thumb?

Henrik Ehrnrooth: If I take as an average, probably little bit more, little bit more, yeah. But not – yeah, of course, much higher in North America and then lower in Asia, but yeah.

Andre Kukhnin: Right. And you're seeing high single-digits inflation there. Is that what you're pointing to?

Henrik Ehrnrooth: Again, one aspect is just what you see labour cost increases – just straight out labour cost increases and that's one aspect. The other aspect is, again, subcontracting, and clearly when there's tightness in the market, the subcontracting, they have more pricing leverage. But also, when you have this tightness, you – as I mentioned, you get more over time and more juggling between different sites to make sure you meet your customer requirements and all of that.

So, all of that is a negative driver for productivity. Therefore, you cannot adjust – calculate straight from what a labour cost increase would be. But we're working on it. We think we'll get there. But at the moment, it's a little bit more of a headwind than in the past and what we had expected.

Andre Kukhnin: Great, thank you. And just very final one. On digital investment side, you've been running, I think, a relatively stable, I think, pace of around €50 million, €60 million for last two or three years. Is there any reason for us to expect that to change for 2020?

Henrik Ehrnrooth: Yeah. So, what you can see externally is we report R&D number and part of digital is in there, part of digital is in our IT costs and other costs. But I would say that I think the activity level we'll keep it high, simply because we can see that the services we have brought out have a clear benefit. Customers appreciating those, they are paying for those and I think we have a good leadership position here really how we do it broadly.

So, we will continue to invest proactively. As an absolute number next year, it's probably going to be somewhat higher. Is it going to be much higher as a percent of sales, that we have to see. But I would overall say that we keep high activity level here and exactly how much we spend next year, we still – let's see, we haven't quite decided that.

Andre Kukhnin: Great. Thank you very much to both of you.

Henrik Ehrnrooth: Thank you.

Operator: We will now take our next question from Daniela Costa of Goldman Sachs. Please go ahead.

Daniela Costa: Thank you. I wanted to ask you two things. First of all, on margin and on your comments on margin year-on-year now turn back to growing year-on-year after a while, and you mentioned you want to – that's the trajectory. Can you comment on whether that – is that trajectory linear from here or should we be aware of – are there any particular seasonality or any considerations, given what you have still in the backlog, that we should think about it from any path that is different from a linear progression?

And then related to that, you were doing much higher margin pre-2017. Has anything fundamentally changed in the industry that you think would prevent you? I'm not asking when, but at some point, to go back to those levels. We've also seen margins coming down for some of your other peers, so interested in whether there have been any structural shifts in the industry which makes going back to those prior peaks feasible to assume? Thank you.

Henrik Ehrnrooth: So, if I start with the latter question, it's clear that the whole industry and we have seen some headwinds on margins all the past years. What is the biggest impact from us is clearly that if we go back to 2016 and 2015, we had very strong margins in China. We still have good margins in China but that's where the biggest delta comes from. But if you look at our business, how we're developing it, yes, we do believe that we can recover. We're not giving a timetable of recover and get back to those margins. That is definitely our ambition. Exactly when that will happen I'm not going to comment on, but we still think it is possible.

Then, you asked what margin trajectory from here, as you know, we don't guide beyond this year. But I think it's clear that our ambition is to improve our margins also next year. Is it going to happen and how it's going to happen per quarter, I can't say, but that's the ambition, that's what I can say.

Daniela Costa: Thank you.

Operator: We will now take our next question from Martin Flueckiger of Kepler Cheuvreux. Please go ahead.

Martin Flueckiger: Yeah. Good afternoon, gentlemen, and Sanna. And thanks for taking my questions. Starting off, I have three questions and I'll take one at a time. Starting off with the, let's say, broader environment, global environment in new equipment. Judging from your last three quarterly results reports, it looks like the new equipment market has seen somewhat of a slight slowdown. Now, I was wondering whether you would confirm my impression, firstly. And secondly, can you talk a little bit about what you've seen recently in the market with regards to recent tender activities and major projects in the pipeline? And what you think the expected implications are for market growth in the various regions? That would be my first question.

Henrik Ehrnrooth: I think we can – I think your perception is probably right one, that we're coming from a situation where we actually had a very long recovery in North America, where Europe, driven by Central North Europe had been quite strong and actually many – and Middle East also doing pretty well. So, all of those being flat or little bit weaker. So, yes, market growth there is somewhat weaker.

China now – well, this year and last year has been growing slightly so that's clear recovery from a couple of years back. But overall, we are in a pretty stable environment now from having been a slight growth environment. It's not the massive difference. But I think it's a slight difference.

Martin Flueckiger: Okay. And with regards to the recent tender activities in major projects, can you make some comments on those two issues, please?

Henrik Ehrnrooth: I don't think we have seen a massive difference here. There's, of course, going to be difference region-by-region, but not a big difference overall.

Martin Flueckiger: Perfect, thanks. Then just coming back to China, if I may. I heard your comment at the beginning of your presentation, Henrik, with regards to the ongoing tightening mode in real estate policies. Just wondering where you see the momentum going on. Is it more in terms of easing or is it more in terms of tightening? It's quite – being such a huge country, it's quite difficult to really follow the main trends. I was wondering whether you could elaborate on that a little bit and provide some clarity where you see the real estate policies going. Is it more towards easing, more towards tightening?

Henrik Ehrnrooth: I think one of the key things to keep in mind is what the government and the President repeat quite frequently, that houses are for living in and not for speculation. I think that tells quite a lot their mindset overall. And that is why we have continued to see – on the residential side, we have continued to see restrictions on how we can finance them, how many apartments we can buy, prices and so forth.

And probably not going to see big differences there. We've seen in a couple of cities where they eased these restrictions a bit and immediately growth have taken off, and they put them back, those restrictions, just to avoid bubbles to occur. So, I mean, I can't predict exactly where they're going to be. But I think this overall guidance, I think, is quite clear from what they think.

And then what we see in stimulus, they then[?] talk more about infrastructure. As you know, what they are attempting to build out are these key hubs where you have then major cities with hubs with high-speed railway connections to them. That's why they are focusing on infrastructure at the moment.

If I look at the next couple of quarters, which is probably the visibility we can have, I don't see a big change happening. But I can, of course, not predict what government actions may be, and we know that those are important.

Martin Flueckiger: Perfect. And then my final question, just wanted to go back to the issue of raw material prices and how you see those developing. We're now almost one month into the fourth quarter and I remember there was a discussion in the second quarter call also with regards to your expectations going into 2020. And I was just wondering whether you can provide us with an update on that, where you see raw material prices going for Q4 and going into 2020.

Ilkka Hara: So, if we look at, first, 2019, so we've been quite consistent now that – and have actually good visibility to the outcome already with pricing that we have with our suppliers. So, raw materials, including the tariffs, have a bit less than €50 million impact to 2019. So, that's been quite stable and there's less moving parts for this year.

Next year, there still continues to be moving parts in terms of orders coming in, but also exact timing of projects, how they go forward. And obviously, raw materials can still fluctuate going into next year. But if I just look at where we are today, so then raw materials are more neutral impact for 2020 than anything else.

Martin Flueckiger: Thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: We will now take our next question from James Moore of Redburn Partners. Please go ahead.

James Moore: Hello? I'm sorry, can you hear me?

Henrik Ehrnrooth: Now we can hear you. Yeah.

James Moore: Yeah, apologies, the phone was on mute. If I could follow up on two of Andre's topics earlier and back to the strong 7.5% maintenance growth, I understand your repair and disposal point. But could you scale the growth regionally for maintenance, such an[?] important[?] part of your business in China versus the Americas versus Europe?

Henrik Ehrnrooth: So, we had good growth – actually, good growth in each of those regions, clearly fastest in Asia Pacific, where we had double-digit growth. Europe, we had high single digits.

Ilkka Hara: Yeah.

Henrik Ehrnrooth: And North America slightly lower.

James Moore: And that seems above your comment for the full year rate. And is that just because of the repairs part of the business or is there potential for a similarly high fourth quarter?

Henrik Ehrnrooth: I think – let's see where we end up. I think you know what our ambition is, so let's see.

James Moore: Okay. And on your wages and subcontracting point, I have got some notes that say you thought that wage inflation was 3% and subcontracting zero in 2018, but that lifted to something like 4% as an inflation for both of those buckets in 2019. I'm wondering as we look into 2020, what percentage rate of inflation you think that the €2.8 billion of wages and the €600 million of subcontracting will face? Is it another 4% year or might it moderate against that or even increase against that 4%?

Henrik Ehrnrooth: I think subcontracting must be more than 4%. But I actually don't –

Ilkka Hara: I don't think we've said exact numbers on this one. And it actually varies market-by-market on the general labour agreements that one makes. And then, subcontracting definitely is much more volatile than the underlying labour agreement.

Henrik Ehrnrooth: But I think that our message is that it's probably an incremental headwind for next year.

James Moore: Sure. Another headwind but the pace of inflation, whatever that is all in for wages and subcontracting in 2019, do you think it's a similar degree of percentage inflation?

Henrik Ehrnrooth: Based on what we said earlier, probably on own labour, we don't quite know yet, but you could assume that it's somewhat higher.

James Moore: Okay, thank you. And just turning to currency, if I could. I was running at current rate, so I thought you might see a small negative impact in 2020 at current rates but nothing major. Is that something you think fair?

Ilkka Hara: Yeah, that's correct. So, minor impact.

Henrik Ehrnrooth: And probably slightly negative impact.

James Moore: Okay, thank you. And just lastly, if I could. The potential for regulation change in China on the maintenance side and the number of visits, is that a city-by-city conversation or one nation conversation? And can you update us to what a possible timetable could look like?

Henrik Ehrnrooth: Yeah. So, it starts with national regulation where they set the policies. And then it gets usually implemented province by province, city by city. There's – clearly, there's been some trials in some cities on how you can do this. So, there's a lot of activity and lot of thinking going in there. We don't have exact clarity of if and when something will happen. If it happens, then usually it starts from a government level policy for how you do it, and then it's going to take quite a while to implement it throughout the country. So, we think that's a longer term thing that we expect would likely to happen, but let's see. But it's not going to impact us on a short-term basis.

James Moore: And in the instance that you do get a reduction in number of visits, do you think you can continue to offer a value-selling proposition on the digital side of your maintenance contracts, that means you don't have to pass it all on and you could capture some of the value there?

Henrik Ehrnrooth: That's of course the ambition we would have, and this is what they've said, it's not just a simple – the thinking is that it's not just a simple reduction number of visits, that you would need to then have them connected and monitored remotely and have information on them. And, of course, the objective would be that you could show your customers you serve them better and that's what creates added value and not price everything away.

James Moore: Thanks very much, Henrik.

Henrik Ehrnrooth: Thank you.

Operator: We will now take our next question from Antti Suttelin of Danske Bank. Please go ahead.

Antti Suttelin: Thank you. This is Antti from Danske. Three questions, please. First of all, what kept your margin back, so to say? You had strong increase in sales and you said it throughout 2018 that your order intake margin was stable year-over-year. But one could have expected, I think, a little bit more margin improvement.

Henrik Ehrnrooth: Well, I would say that we had some good drop-through and always there are positives and negatives that happen in business and some fluctuations. So, I don't have a more specific answer to that.

Ilkka Hara: No, there's always fluctuations quarter-by-quarter, but overall no more details to be shared here on that one.

Antti Suttelin: Okay. Then, next, your China outlook, in the sense that we can see from the numbers, Chinese numbers, that right-to-use land sales have been cut back quite notably. Is this any concern to construction starts next year, and potentially also to elevate the demand next year in China?

Henrik Ehrnrooth: Firstly, I would say that we think that quite many of the big developers have ample land bank, but of course, over the long-term that's an important number. Now, we see a little bit better land sales again. So, it doesn't – it's quite a long-term forward-looking indicator to us. And if you look in history, you need to look at longer-term trends to see what the impacts are.

So, of course, if that would be a long-term downdraft, of course, that would have an impact because it's a strong indication of developers, how much they are – because they're investing in the future by buying land. At the moment, I wouldn't be too overly concerned yet, but of course, we need to continue to follow it.

Antti Suttelin: How long do you think it takes before this impact becomes visible at the consumer company side – sorry, construction company side?

Henrik Ehrnrooth: If you think about, that has to be before construction activity and we had – if you think about the past couple of years that we had for quite a long period of time – first of all, I don't have an exact answer for you. But we had a quite a long period of time when new starts were increasing and you guys were asking, 'Why can't we see it in your industry, why can't we see in your industry?' And now, this year we have started to see it coming through. So, it can be quite a delay because we come more at the tail end of the projects. But unfortunately, I don't have a specific answer to your question how long that time will be.

Antti Suttelin: All right. And then finally, just what is driving modernisation up 11%? Is this – I assume this must be market share or –

Henrik Ehrnrooth: I think, first of all, markets are growing slightly, but we believe that we have grown faster in the markets and it's a good productive activity from KONE with a good competitiveness. That's the only way you grow. You have to be out there working with your customers, showing that you help them resolve their problems and do a good job for them. That's what it's all about.

Antti Suttelin: Where is the KONE's market share in modernisation at the moment?

Henrik Ehrnrooth: It's – I would say it's – I don't have a specific number because there's – the date on the modernisation market is not that exact. What we know is that it is higher than our market-sharing maintenance [inaudible]. And in market sharing maintenance, we are probably – we have 1.3 million, a little bit more, units in serving – our total market is about 15 million.

Ilkka Hara: It's not very visible. Modernisation market, it's not very easy to evaluate and have a good view on that one.

Antti Suttelin: Yeah. Okay. But thanks for the answers. Thank you.

Henrik Ehrnrooth: Thank you.

Operator: We will now take our next question from Daniel Gleim of MainFirst. Please go ahead.

Daniel Gleim: Yes. Good afternoon, and thank you very much for taking all of our questions. My first one would be on your remark that you saw an improvement in the relative margin of orders. Could you pinpoint for us which region you saw this relative improvement?

Henrik Ehrnrooth: I would say the biggest impact we did see in Europe and some Asian countries.

Daniel Gleim: And what is your estimate for the lead period of that improvement to come through in sales? Is mid-2020 too early or is that roughly the right number? How do you think about that?

Henrik Ehrnrooth: Probably around that, yeah.

Daniel Gleim: And the relative improvement in the third quarter compared to the second one, was there an acceleration or is it roughly the same ballpark?

Ilkka Hara: Different. So, maybe if we comment on orders received margins, so it is one where there's many moving parts. If you think about, first, that different type of projects and also you have different type of countries and we tried to neutralise for those when we comment. So, at the end of the day, it's not exact one number. But it's not that different the improvement between the quarters.

Daniel Gleim: Okay, thank you for that. And my second question circles around China. How much of your China growth in the order intake was market share gains of your own versus market shares that your customer gained? Do you have a ballpark estimate for us, how should we think about the split here?

Henrik Ehrnrooth: I don't really know what the difference is. I mean, I think we work with a very broad set of customers, so sorry, I don't really understand the question.

Daniel Gleim: I mean, the question here is, how long can this strong order intake growth last? And one of the meaningful drivers has been the consolidation of large developers. Now, if you think about your own growth, partially that's driven by customers gaining share, and it's partially driven by you gaining share versus other bigger OEMs that might have the same exposure to the same developers. My question really is how can this abnormal growth last that stems from the big developer consolidation? The limitation for that we will see it as going to 70% in the future. That is the way I think about that question now.

Henrik Ehrnrooth: Well, I would say that, look, we serve a very broad base of customers in China. Our aim is to really find always where the growth opportunity is. So, we don't really think about it that way. We said it's been helpful for us that we have a strong position there. But of course, we're constantly building relationships and market shares beyond that as well. So, I think the fundamental way how you build market share stems from your activity, your competitiveness and how much you add value to your customers. That is, I think, the fundamental and most important question that we're focusing on. I can't say where we will be next year. We don't guide and we don't give you indications of that. I think our objective is clear that our objective is to grow faster in markets overall ,and then we have to see next year where we get to.

Ilkka Hara: Maybe from these large customers – and definitely we see opportunity to continue gaining share with them as well. So, it's not something where we only grow with them and definitely [inaudible].

Daniel Gleim: Have you historically seen any other market maturing where there was a developer consolidation and where you can give us a ballpark number where the consolidation has stopped, so that we can think about where this might be heading in China?

Henrik Ehrnrooth: Well, I think we should keep in perspective, again, that just the scale and the size of the China market and the size of these developers is just – it's very different than any other markets. So, I don't think we have any direct precedents or comparisons. The China market is unique in its size, breadth and also its pace of development.

Daniel Gleim: All right, I'll leave it at that. Thank you very much.

Henrik Ehrnrooth: Okay, thank you.

Operator: We will now take our next question from Debashis Chand of Société Générale. Please go ahead.

Debashis Chand: Hi. Thanks for taking my questions. I have two questions, please. The first question is on China in the infrastructure business. So, previously you have mentioned it's around 10-15% of the sales in China. Now, given the strong growth we have seen here over the last three quarters, is there any change in that share? Or other way around, are you gaining market share in that segment versus some of your more established peers in that segment?

Henrik Ehrnrooth: I think we had performed reasonably well in that segment. I can't say exactly but maybe it's today – I think when we said 10-15% we said of the total market. I'm not sure if we commented how much it's of our business. So, I think we commented that that's how much of the market. It's probably now more in the 15% of the market size. And we have performed quite well there, but it's not the only reason. I think we performed very well in the residential market and the commercial market and high rise[?] market. Without being broad-based competitive and broad-based strong performance, we wouldn't have had the orders-received growth we have had.

Debashis Chand: Okay, got it. And my next question was on new services. Could you give some more colour and which region has seen more traction in terms of adoption? Is it more in the Asia-Pacific, China, or is it more in Europe where you're seeing more acceptance, given it's 1% growth you have seen adding to the service growth this quarter? So, just wanted to get a perspective, where you're seeing more traction on this by geography?

Henrik Ehrnrooth: Okay. We see more traction in countries where we started early. So, we didn't start in all countries at the same time. So, it was a gradual roll-out. But I think the strongest traction we see in the countries in Europe where we started the earliest. So, we have very good momentum in some and we're building in others. But then you also have specific markets. In some markets in Asia, we can see that the adoption of new digital services is quite high, but it varies market to market.

So, I would still say that we are early on and we see that it doesn't take off day one. You really have to build up your own capabilities, get your customer acceptance. But once you get there, then you start to build up a momentum and it's where we started earlier where we have the best momentum.

Debashis Chand: Thank you.

Operator: We will now take our next question from Andre Kukhnin of Credit Suisse. Please go ahead.

Andre Kukhnin: Hello again. Thanks so much for taking my follow-ups. I'll just go quickly through them. On tariffs for 2020, I think you quantified it at around €10-15 million. Could you please remind us on that?

Ilkka Hara: I think I've commented 2019 with – I was saying that it's more than €10 million impact to 2019. And if – well, obviously, it's something which moves continuously, so let's follow it through but it has less of an impact in some millions in 2020 additional.

Henrik Ehrnrooth: Incremental.

Ilkka Hara: Yeah, incremental, yeah.

Andre Kukhnin: Okay.

Henrik Ehrnrooth: And [inaudible] and see what happens.

Andre Kukhnin: Of course, yes. Okay, great. And I just want to talk about this China potential regulation change that you discussed earlier. So, you see that it needs to happen at the national level first, that there's are no way individual cities or provinces can start rolling out this out more broadly, replacement of physical visits with remote monitoring.

Henrik Ehrnrooth: That's what we'd expect that you first will get, and that's where we have seen the work happening is on a national level. Then we know that there's been some trials in some cities. But to get a broad-based change, we would – we think we would need to see first a change in national regulation and then cascade it down gradually from there.

Andre Kukhnin: Right. And in terms of that work, I mean, those pilots have been ongoing for a while now. I think two years we've been tracking some of the city names, if not longer. Is there a major hurdle there that the government struggles to overcome at that national level, or is it just a lengthy process that is progressing and should arrive to an outcome at some point?

Henrik Ehrnrooth: I would say it's more the latter.

Andre Kukhnin: Okay. And would you venture an estimate on when you think the government could be ready to change that?

Henrik Ehrnrooth: I'm not going to make any estimates on that. I think we just have to follow it and be assured when we have news and when there's clarity, we'll share that with you.

Andre Kukhnin: Great, thank you. And just a couple more on China. We got some data points on – or a data point, I guess, on office vacancies rising. I think CBRE were reporting that about – I think on 17 major cities. I'm just weary of picking one thing and running with it. Wondered if you have got – or if you track any more comprehensive datasets, specifically on commercial and office, specifically in terms of vacancies. And where do you see that – the state of that industry, that segment at this point?

Henrik Ehrnrooth: I think that's pretty consistent. We said about the market that commercial was slightly weaker. So, I haven't seen the CBRE report. But I think what we've seen more stronger has been residential and infrastructure markets. I still believe in this – in the city hubs that we're looking at, there's still opportunities. But overall, yeah, they've been a slight slowdown in that market.

Andre Kukhnin: Got it. Thank you. And finally, in China on digital. Are you being able to sell it as an add-on service there with the same progress or same ease as the same traction as you're getting in Europe? Or is it generally tough to sell and that's where you need to balance maybe providing it at, I don't know, more attractive terms because it improves stickiness or other benefits that come with it? I'm asking that because we see some evidence of local players that tend to treat digital as a free add-on to existing service.

Henrik Ehrnrooth: As you know, that our clear policy is that these additional services, they are a commercial service that we sell to our customers. Why do we do that? Because we think that there's a clear improvement for them and we see a clear value to them in these new services. And that same policy we have had in China, I would say, depends on segment-to-segment. Maybe commercial segments are – it works better, some residential perhaps more challenging, but still this is the policy we have and we are growing that business. And we haven't seen a reason to deviate from that.

I think it's very early days. Local players, we start to see some early initial services but I think they are not that many players who can say – who can demonstrate the consistency and actually the concrete outcomes and positive outcomes that we can do.

Andre Kukhnin: Got it. And would you say your attachment rate of digital to newly signed service contracts is similar in China to developed world, overall?

Henrik Ehrnrooth: Not quite, not quite. It depends on segment to segment.

Andre Kukhnin: But it's not widely different?

Henrik Ehrnrooth: It's not wide but slightly lower, yeah.

Andre Kukhnin: Got it. Thank you very much.

Henrik Ehrnrooth: Okay, thank you.

Operator: This concludes today's question answer session. At this time, I will turn it back to your host for any additional or closing remarks.

Sanna Kaje: Many thanks for all the good questions and we are, of course, happy to help if any further questions arise. We'd like to wish you all a nice rest of the week. Thank you.

Henrik Ehrnrooth: Thank you.

Ilkka Hara: Thank you.