KONE Q3 2017: INTERIM REPORT FOR JANUARY - SEPTEMBER 2017

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Sanna Kaje: Good afternoon, and welcome to KONE's Q3 Results Presentation. My name is Sanna Kaje, and I am the Head of Investor Relations. As usual, I have here with me today our President and CEO, Henrik Ehrnrooth, and CFO Ilkka Hara. Henrik will first talk through the Q3 highlights. Ilkka will then dig a bit deeper into the numbers, and Henrik will then talk about the outlook for our markets and our business. And in the end, we'll have time for your questions.

Henrik Ehrnrooth: Thank you Sanna, and also welcome on my behalf. It's my pleasure again to share our development in Q3, and how we have continued to develop KONE in a very positive direction during this quarter. We had many positive developments how we are driving KONE forward in what is a quite a challenging environment, particularly in the new equipment markets.

Highlights for the Q3 is that our orders received returned to growth in China. And in particular that our focus pricing actions had now a positive contribution to our orders received growth. That is very important and we are definitely showing the way in the Chinese market with this. Our new services that we launched in February, they are gaining great momentum. And we can see that they are taking us definitely in the right direction, and providing very good differentiation for us.

What we're not so happy about though is that our profitability continues to be burdened by a number of headwinds, and therefore our EBIT declined in the quarter. That's something we need to continue and are continuing to work on. Those are the highlights. And let's go straight into some of the key figures. Highlights of the key figures, orders received and sales growth. Orders received a little bit over €1.7 billion and in comparable currencies it grew by 2.1%.

We can see that currencies have quite a significant impact now this quarter because the reported currencies declined by 1.8%. Our order book continues to be very strong at €8.7 billion, some growth from last year. Sales about €2.2 billion, 4.4% growth, and here in particular it's our services business that continues to grow at a good rate. And also, if we look at geographically; Europe, Middle East and Africa growing strongly in the quarter and continued good growth from North America.

Our EBIT, €307 million in the quarter compared to €331 million a year ago, so margin 14% compared to 15.3% a year ago. Here clearly, we want to achieve more and we are taking action to improve it. In the quarter, we also introduced adjusted EBIT that is to reflect the costs that we have from the Accelerate programme where they are excluded from the adjusted EBIT although it was not a big difference between EBIT and adjusted EBIT this quarter.

Cash flow, about at the level of our EBIT €303 million, down from a very high level of €400 million last year. But as we know one quarter is a short period of time and always important to look at it from a slightly longer-term perspective. And then of course we had our first nine months to look at it. If we look at our nine months, we can see also that our orders received now year to date returned to slight growth 0.6% and €5.7 billion in total. Our sales at about €6.3 billion, growth of 3.1% in comparable currencies and EBIT now €851 million compared to €901 million a year ago.

Here similar things as to Q3 that there are a number of things that are positive in our EBIT such as our service business growth, growth in Europe, Middle East and Africa, North America. However, we have a number of things that are burdening the result such as margins in China, raw materials, currencies and so forth. Margin now at 13.5% compared to 14.6% a year ago.

Our cash flow for the first nine months, a solid €928 million, so a good conversion from EBIT to cash flow.

However slightly lower than a very strong €1.1 billion last year. But if you look at the cash flow for the first nine months, our working capital was more or less stable. And what I'm happy about is that particularly in the challenging Chinese market we continue to have a strong cash flow. So that was a great achievement. Earnings per share €1.34 compared to €1.42 a year ago.

So we look at the environment we're going through we know that particularly the global new equipment markets continue to be challenging and highly competed. But what I'm very happy about is that our people continue to develop KONE in a very consistent and positive way forward, looking forward understanding what the customer's needs are and therefore delivering solutions based on that. And I must say that the moment of how we're driving KONE forward in this respect is very positive. And there again our employees deserve a big thank you for that. So those are the highlight numbers.

If we then go to our sales split for the first nine months, not big differences from a year ago. Maintenance increasing share slightly. Geographically, it's clear that North America continues to increase in share of revenues as well as Europe, Middle East and Africa. And I think it's overall good, the geographic mix is getting a bit more balanced, particularly with the higher share of North America, and that's a good thing.

So then the business highlights for Q3. So a number of positives and particularly how we're developing our business overall. It starts with orders received and sales continue on our growth path. That is very good. Our focus pricing actions, particularly in the highly competitive Chinese market, are definitely bringing results and also productivity improvements in many areas. Our new services are gaining very good momentum. We launched in February our new KONE Care, and a 24/7 connected services. And we can see that they are definitely differentiating us in the market. We are very much showing the way in the market with 24/7 connected services. And we haven't seen anyone else with something compared to our KONE Care and that is something our customers are telling us is differentiating us. And it's actually very positive from their perspective, so this is good.

We also a few weeks ago launched our residential flow solution. And I must say that this has received a lot of interest from our customers. It again shows that the way we develop our solutions, the way we co-create together with customers, brings results, and all of these are great examples of that. And that's why I feel great about our direction overall.

We are continuing to face a number of headwinds. Particularly what I am not happy about is that our profitability has declined. And it continues to be burdened by a number of headwinds. Ilkka will talk about this in a little more detail, but it's clear that we need to continue to take action to compensate for this. And we can also see that competition remains intense in most markets, particularly in the largest markets.

But if I look at again the environment, and try to give a good picture a bit more broadly how we have developed, we know that the Chinese market is by far the largest new equipment market in the world. We also know that it's highly competed. Our focus during more than a year has been to ensure that we can turn the pricing in the market. We know that pricing has been a lot under pressure in China. We've taken significant action, and the great thing is we can see positive results. We have been able to turn the pricing to slight positive now. And I definitely believe that we are showing the way in the Chinese market with this.

And it's important to note that in a highly competed market such as China, in order to be able to increase prices you need to have a number of things in place. It starts with having a great overall competitiveness, a good portfolio, a good competitiveness of the organisation. It also requires a very strong accountability locally throughout the organisation to drive this. And it also requires courage and strong competition to drive it forward. And we are showing the way. We have been able to slightly improve our pricing in China in a very competed market. And I think this again speaks volumes about the strength of our China theme, and what we can achieve when we put our mind to it.

The other thing I wanted to highlight overall from development is that when I look at our new services, our new solutions, they are definitely taking us in the right direction. Our customers are very positive about these new services, and showing us that they are differentiating us in a very clear way. Because of this we want to now accelerate this development, and that's why we launched our Accelerate Winning with Customers programme earlier in this quarter.

I've been asked by many people that why did you launch this programme now, and also what is it all about? Why now? To give you a little bit of perspective, when you look over the coming years we can see an increasing pace of new services and solutions launches. We can also see the demands of our customers are increasing, so general speed is just increasing in the market. With the change that we're driving through this programme, we want to empower and strengthen our frontlines even more than today, to spend even more of their time with customers to be able to be bring new service and solutions and value add to our customers faster, and that way gain a benefit.

In order to do that, we are taking a number of known customer-facing functions that still we do in our frontlines in our country organisations, and bringing the accountability of this up to an area level. That means that our frontlines can then spend even more time on really adding value to customers, and driving that accountability going forward. What will remain important for KONE is that our accountability is very far down in our organisation. That's why we're responsible how we deliver value to our customers. That's why we started it now.

We have three clear objectives with the programme. The first one is to build better customer-centric capabilities. That's again about strengthening customer interface that I just talked about. When we enable our frontline organisations to spend even more time serving our customers, we will be faster in bringing new services and solutions to the market. That's the increasing speed. When we combine some non-customer facing functions to an area level, we will also gain efficiencies.

And when I think about this whole programme from a profitable growth perspective, it's clear that it’s the two first parts, customer-centric capabilities and increasing speed that have the most significant impact on our profitable growth. It's clear that efficiency is also incredibly important in a very competitive market. But better we serve our customers, the faster we bring services and solutions to them, the more we will achieve growth and better pricing and that is the biggest impact on our business and on top of that efficiencies. That's why we have done it and that's the idea of this programme. It's all about our strategy and how we speed up our strategy execution. So that is about KONE’s development overall in the third quarter.

We will then next go to the markets. To start with the new equipment markets we can see that overall volumes in the new equipment markets were rather stable in the third quarter. However monetary value markets continued to decline slightly. Europe, Middle East and Africa overall slight growth, growth in particular in South – the many southern European countries and in the Middle East. Central and North Europe is more stable at the high level. North America continues to grow. Asia Pacific, now the Chinese market, was rather stable in number of units, however pricing continues to be under pressure. I would say pricing probably now stable quarter on quarter. And we are clearly performing better than the market in that respect. Rest of Asia Pacific markets are now declining. And they are declining mainly because of the decline in the Indian market. The Indian market has faced three significant reforms over the past twelve months. And while each of these reforms we believe are good long term – for the long term, they have created quite a lot of uncertainty in the markets in the short term. And that's why I believe that we’re probably to see a better development towards the end of this year. But overall Rest of Asia Pacific markets are declining.

If we then look at a little bit more closely again at the Chinese property markets, what's happening there? As you know we've been talking for a long time about the improvement in housing inventories. That the fundamentals of the market have become more healthy. Now in this quarter, we saw a slight uptick in housing inventories. And the reason for that is lower sales volumes of apartments in the quarter. The reason for lower sales volumes are clearly the restrictions that the government has imposed on more than 50 large cities in China. And we can see that these restrictions are having an impact.

So if we try to look at the Chinese market my judgment would here be that overall the market has become healthier from a fundamental perspective because the inventory situation has improved. And we can see good continued underlying demand. On the other hand, government restrictions are having a significant impact on the market. So when we think of the market towards the end of this year perhaps beginning of next year, it's clear that the government restrictions will have a significant impact on the development.

The overall elevator-escalator markets has now been rather stable. And we can see continued growth in total real estate investments. Although a large part of that growth in real estate investments is due to land purchases, and higher land purchase prices. But that's in summary our thoughts on the Chinese market.

If I then turn to the service markets here, trend is very much the same that we talked about previously, and also in our Capital Markets Day. Europe, Middle East and Africa, and North America continue to grow slightly. Southern Europe highly competed, but growth – some growth everywhere. Asia Pacific continued growth in the market. That's a strong growth that's positive. Modernisation markets slight growth overall. Now Europe, Middle East and Africa more stable, slight growth in North America and good growth in Asia Pacific. So pretty much the same trends we have talked about earlier.

So with that, that's the markets. And then let me turn over to Ilkka Hara for our Q3 financials.

Ilkka Hara: Thank you, Henrik. And welcome also from my part to the third quarter call. I'll walk you through in more detail our financial performance in this quarter, and I'll start with orders received. Our orders received reached €1.7 billion in the quarter, which represents 2.1% growth on a comparable basis. And I think the key highlights from the quarter is that our orders received returned to growth in China. We also continued the growth in Europe, Middle East and Africa as well as in America. In Asia Pacific however, our orders declined overall. And I'll talk a bit more in detail in the other slide as well about currencies, but clearly they had a negative impact on our performance in this quarter overall. The relative margin of our orders declined slightly but remained at a good level overall.

Then let's look at sales in more detail. We reached close to €2.2 billion in sales in this quarter, and really the driver for the sales growth being services as Henrik highlighted earlier. Sales growing at 4.4% on a comparable basis in this quarter.

If we look at the drivers driving the performance on sales from a business perspective, so modernisation growing at 9.5% has been the highlight, but also maintenance contributing at 5.1%, then new equipment at 2.7% to our sales growth. From a geographical point of view, Europe, Middle East, Africa contributed over 10%, so 10.4%. America is growing also at 7.5%, and Asia Pacific declining at 2.4% where you can see now the orders received development that we saw in China in earlier quarters now coming into sales and impacting that.

Then lastly about EBIT. And as Henrik highlighted already in the beginning that we can't be fully satisfied with the performance we have an EBIT from an EBIT perspective. We continue to see our EBIT margins still being burdened by several headwinds. And reaching now on an adjusted basis €311 million which represents a decrease of 6.2%. However, if we look at the details behind that, I would highlight first that the currencies have a negative impact of €13 million out of the €21 million difference compared to last year. Also, our increased investments to R&D and IT represent close to €10 million out of that. So in summary our services growth as well as the productivity improvements that we've done across the businesses are pretty much equalling the raw material pressure as well as the margin pressure that we witnessed in China in the previous quarters. So there's some headwinds, but also some tailwinds which are represented in our EBIT development in the quarter.

With that, I'll ask Henrik to come back and talk a bit more about the market and business outlook for the remaining of 2017.

Henrik Ehrnrooth: Thank you, Ilkka. Going to the outlook for the markets for this year, we now have only one quarter to go. So we have slightly specified and adjusted our outlook for Asia Pacific. We now expect the Chinese market to be relatively stable in units for the full year. And we expect the very fierce competition to continue. Rest of Asia Pacific, we expect the market to decline slightly in 2017 but probably towards the end of the year see some growth. Europe, Middle East and Africa and North America, both markets are expected to grow slightly. So the same as previously. Maintenance markets, we expect them to continue developing very much the way it had a developed so far same as modernisation markets overall.

If we then look at our business outlook, that is unchanged. So we expect our sales to grow between 1% and 3% of comparable currencies. And we expect adjusted EBIT to be in the range of a €1.2 billion to €1.25 billion. And that assumes that translation exchange rates remain approximate at the end of September level for the remainder of the year. So that is the unchanged outlook.

If I then summarise, what is important is that orders are back on a growth track. We can see that the actions we have taken and are taking to offset the headwinds we are facing that they're working and we continue with that. And strategy execution is progressing well. It doesn't feel that we are on the right track, and we can concretely see that that's why we want to speed up our development. And to end on a little bit lighter note here in the picture you see a very important building that was inaugurated during this year is the Elbphilharmonie in Hamburg an absolutely spectacular building. It's a very unique building that has got a lot of accolades, and also an important part of that building is that the architect could not have achieved his vision without some very special and unique escalators that we delivered there. It's one of the main attractions of the building is to see those escalators. So perhaps worth a visit to go and see them. So with that I'm happy to turn over to questions.

Operator: We'll take our first question –

Sanna Kaje: Yes, we now have some time again for your questions and we can go straight to the telephone lines. I would like to remind you to ask one question at a time please.

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

Lucie Carrier: Hi, good afternoon gentlemen, and good afternoon Sanna. Just you know the first question I would have actually is on China. But maybe as a different than normal on services we are hearing more encouraging comments in terms of service demands of China from some of your competitors, but also from some of the components suppliers into elevator in China. And I was wondering if that was due to kind of new regulations that been put in place. And whether you could comment on that service momentum also from the profitability standpoint for you? And that's question number one. I'll have a few other after that.

Henrik Ehrnrooth: Okay there hasn't been any concrete in China wide regulation there are certain specific regulations rolled out by certain cities to test what connectivity means and how you can change a service based on that but it's nothing significant on the regulatory side. I would say that the main change is that customers are starting to appreciate more and more good services. And that is something we of course like because we have a very strong service organisation in China with a very broad reach how we train, bring on new service technicians to continue to serve our customers very well. That is all a positive. Overall, we have good development in our service business in China. It's again also a highly competed part of the business. But again, I would say that it's increasing expectations from customers which is just a positive thing.

Lucie Carrier: Thank you. The second question I had as well is around the China mix, and I was wondering, you know, considering you have seen a rebound in the quarter of your orders in China in value, whether you could give us a bit more visibility on which part contributed a little bit better to the mix.

And to your point out your price increase, I mean how do you see this kind of impacting the rest of the market? We also heard some of your competitor mentioning some pockets of better pricing here and there. So how do you see that environment overall as we continue into the year and into next year?

Henrik Ehrnrooth: Yeah perhaps the most important thing is that we believe that it's important during pricing trend in China. We can see and we have seen increasing costs on the input side. And we've of course seen now a few years of clear price decline. So we want to just show the direction there. There are always many aspects to achieve that and clearly there are always some pockets that are better. Some that are weaker but we have to remember China is a very big market and we operate in all parts of those. So you need to get a broad based good improvement.

I wouldn't single out any pockets specifically or segments. Perhaps it's important when we talk about this pricing, we talk about in the volume business. So it's not that we would have had more larger projects or things like that. But this is our volume business and we can see that the actions that we have taken are bearing fruit. We're not talking about the significant change, but at least we have turned a corner. And with that I believe we are definitely showing the way in the market. And again, you can only do that with a strong competitiveness and very strong organisation. So again, I'm very happy about what our China team has achieved here.

Lucie Carrier: Thank you, and just last question. Just to double check on the guidance. It seems I think you are suggesting that you should be around more the low end of your guidance on raw mats for this year. So I just wanted to double check whether that was correct and whether you know from an R&D and IT standpoint considering you've had already three big launches this year, how we should think about the magnitude from here in terms of those investments?

Henrik Ehrnrooth: Let me. I'll first answer the latter one. Ilkka can answer a little more specifically. But we have to remember that when you look at R&D and IT expenditure, what you see are certain launches but of course there's a constant pipeline of that. So the fact that you've seen a few launches that's not the biggest impact on what the costs are. It's how you develop your pipeline and portfolio overall.

But Ilkka, could you comment on the raw material and overall costs for IT and R&D?

Ilkka Hara: Yes, certainly and thanks for the question. So let's start with the raw materials. And we started the year with a guidance of – we see €50 million to €100 million from raw materials to our results. And now from our perspective, we're estimating that to be slightly above the €50 million for the year. We have one quarter to go. But at the same time this is not an exact science. So we don't buy raw materials, we buy components, and therefore trying to give you a sense of the magnitude of the impact from them to our results. So that would be kind of more details on that one.

Then secondly on R&D and IT so we guided for this year that we're expecting a 40 basis points increase to our R&D and IT spend. And so far in this quarter, we’re at 40 basis points and year to date as well. And we expect that to continue for the remaining of the year as an investment level.

Lucie Carrier: But you don't expect a step-up now from here considering you are at the run rate of 40 bips currently?

Ilkka Hara: Sorry, we had a step-up of 40 bips this year. On an absolute basis, we continue to probably invest on that magnitude going forward. So we don't see a decrease, let's put it that way, on an absolute spend.

Lucie Carrier: Okay, all right, clear. Thank you very much gentlemen.

Operator: Our question comes from Andre Kukhnin from Credit Suisse. Please go ahead.

Andre Kukhnin: Yes, good afternoon everybody. Thanks very much for taking my questions. I’ll have to go in China as well, so apologies in advance. But on pricing a couple of things to check. Could you confirm that you are putting this price action through on both brands KONE and Giant? And also are we right to think that the volume part of the business is somewhere around 8% across the whole China business for you?

And then also just to check the kind of indications of price increases we've heard are around 5%. Is that kind of the right ballpark for you? And just to finish off on this if I may, in terms of that realising how much room is there for that kind of list price increase not to materialise or not particular kind of like for like part of the business i.e., is there a dealer discounts or some sales incentives that can be utilised? This is kind of taking the large project business completely aside from it and looking at the volume purely? Thank you.

Henrik Ehrnrooth: Okay, we had quite a few questions. Let's try to take them one by one. Yes, definitely both brands, I mean it's something we've taken action in both of our brands to increase the pricing. And the majority of the business in China is a volume business, large projects infrastructure maybe 10% of the market overall, and then other major projects maybe similar size. But as we know that those come not in the same stream. That they can vary quite a lot quarter to quarter to quarter. But the majority of the business continues to be and it's the volume business both for residential and certain commercial projects.

I can't comment really on price increases. Therefore, certain targets – of course you can put the list price up, but then you know it depends on what kind of discounts and how you manage that. I would say that like for like we're talking about a slight increase that we have achieved. Of course it's more important to see what you have achieved rather than what may be talked about. So I think that comes over time.

Andre Kukhnin: Great. Thank you, Henrik. I appreciate it. Can I just follow up on the modernisation question before, and the regulation part of it? I think you answered it in relation to the connectivity. But can I ask is it about the – with relations to new safety norm, the E and H12050, I think we've heard some suggestions that that may kind of accelerate the demand for modernisation of installed base in China, because there may be some series of inspections being kicked off across the country as of New Year 2018 on the back of that. So could you clarify on that please?

Henrik Ehrnrooth: There is no nationwide significant regulation that we're seeing now come into play. There are certain cities that are taking stronger action. There are certain regulations that will come into the Chinese market, but it's not some next year yet. Those will then bring Chinese code again closer to the European code.

Andre Kukhnin: Thank you.

Operator: We will take our next question from Manu Rimpela, Nordea. Please go ahead.

Manu Rimpela: Thank you. My first question would be on the drive pricing situation still in China. So could you comment on how are you seeing the net pricing? Obviously prices are going up, and are you able to actually offset the cost inflation because I think you mentioned that the order intake margins are still down?

Henrik Ehrnrooth: So we talk about price to customers, that's the main price we talk about. And you're right in that way, in that raw materials particularly if they stay at the current level that's another significant headwind. And that requires further price increases to compensate for that.

Manu Rimpela: So at the moment, you are not able to fully compensate the raw materials with the price increases if I understood you correctly?

Henrik Ehrnrooth: That's why yes, we've said that we have a sort of slight decline in the margins of orders received. All right, I think that the most important point here is that I think we've turned the momentum in China and really showing how the market direction as the clear market leader in China. I think that's an important thing that we do that.

Manu Rimpela: Again, then the second question would be can you confirm that you still have the Chinese margins which are above the group average?

Henrik Ehrnrooth: We have a good business in China. Yes, our margins in China are above group average yes.

Manu Rimpela: Okay, thank you. And then finally on the service pricing across the group, can you comment about how do you see the situation? Are you able to raise services prices or maintenance prices? And let's just say for instance in the US where you had strong volumes for quite some time. And then comment how you have this new programme that you have all these new service concepts impacting pricing? And are we seeing anything of that already in your figures?

Henrik Ehrnrooth: So service pricing varies a lot to market to market. And it's usually a very direct correlation of the strength of the new equipment market. So that tells how many new units are coming to the market. So some Central and North European markets are clearly better than Southern European markets, and some parts of United States is then better than other parts of the United States. So it's quite local, but overall I would say we have done better in that area this year than for example last year.

And then our new services, we can see that they are positive from three perspectives. First our customers are clearly giving us very good feedback about them that we are differentiating, and at least some that we now provide them with services that they wanted to have. This is very important. That means our hit rates are better for us and our pricing is also slightly better there. But remember that to roll out this over entire service portfolio takes time. We are now in about eight countries and we are increasing the number of countries all the time. And yeah momentum is good, and we can see that definitely this is the right direction for a service business.

Manu Rimpela: If I may follow up on the service question. So if you look at the group as a whole, so can you say that this service pricing contributing positively to your margins, or are you still lagging cost inflation, wage inflation there?

Henrik Ehrnrooth: In most places it would be a slight positive contribution. But again, it varies quite a lot market to market and then which markets are growing, so mix may be slightly different. But overall, I would say that we have done better this year on that front than last year.

Manu Rimpela: No further questions.

Operator: Our next question comes from Guillermo Peigneux from UBS. Please go ahead.

Guillermo Peigneux: Thank you. Good afternoon, everyone. I was wondering about the situation in the market as you see it's stable in China. But also at the same time we're starting to see all the early indicators now starting to erode, not only in tier one cities but also in lower tiers including tier two and a slowdown on tier three at the national level as well. So I was wondering whether is it fair to assume that the stable market can be just lagging the weakness we saw in some past statistics on whether our recovery should be expected in the market before we see the deterioration again in 2018?

Henrik Ehrnrooth: Clearly we have had now many things that have gone in the right direction over a period of time, if you look at apartment sales and starts and so forth. And we know that our sector comes a little bit with a delay to this. It's too early to comment on how we expect our market to develop next year. Because it will depend upon how the government restrictions are kept in place or how they deal with those. So let's see towards the end of next year, but currently we see a pretty stable market overall.

Guillermo Peigneux: And my second question in regards to actually the aftermarket in China as well. I guess normally you mentioned in the past the 60% conversion rate. Is that improving as kind of a first question regarding the Chinese market? But also at the same time it takes longer time to service the market than in Europe. I think it's just one year longer period before you actually enter into a revenue stream. If we think about these and the fact that the order intake has been weak for a year, is it fair to assume that aftermarket will slow down at some point over the next year or so?

Henrik Ehrnrooth: I didn't quite understand. If I just first clarify what do you mean it takes a year longer to get the revenues in China than the rest of the world?

Guillermo Peigneux: Yeah, sorry normally what you have is time to service in Europe tends to be anything between well roundabout speaking to 12 months between the installation and service first service point. And in China it takes two years normally to service. In the past I read these statistics, hence actually there's one extra year so to say when it comes to basically from installation to the first revenue stream. Okay.

Henrik Ehrnrooth: Okay, I didn't understand your question because the point is that you will in both Europe and in China immediately start servicing when the elevator is handed over to the customer or escalator, you will start generating service revenues. In the first year in Europe for example that's the first service revenue, but that's something we accrue out of the new equipment sales. So we will generate service revenues also during first year. In China that first service period maybe up to three years, so we are generating service revenues during that period of time. They are – just were sold as part of the new equipment contract. So in both countries you start generating series revenues immediately.

If you look at – if I address it in a slightly different way, our conversions in China first of all are improving slightly. And the number of units we're converting are growing. That's great. So our service base is actually growing strongly in China. If you look at our overall first service revenues they are only growing slightly. So that's of course a little bit then burdening the overall growth rate of services. But if you look at how many contracts we're signing up and our service base that continues to grow at a strong rate, over 20%.

Guillermo Peigneux: And is it fair to assume then order intake slowing down will mean that the service growth at some point will be slower, or it will continue to grind higher at this pace?

Henrik Ehrnrooth: There are of course two factors that impact service growth. One is how big the service underlying service base is which for us is rather large. And then how many new units you come? And it's clear that if you have a slowdown in new equipment and the bigger your service base gets, then of course the percentage growth will get lower, but you continue to grow and continue to add to that base. And that's the important point.

Guillermo Peigneux: Thank you so much, very helpful.

Operator: If you find that your question has been asked today you can remove yourself from the queue by pressing star two. We'll now take our next question from Matthew Spurr from RBC. Please go ahead.

Matthew Spurr: Hi there. Yeah, I might switch from China. Can I ask about the Europe growth in the quarter please, Henrik? So 10.4%, I think at constant currency, that's pretty good. And if I look back at the order trends in the new equipment or in the modernisation have been good, but I don't think they've been sort of double plus in your little diagram. So could you give us a little bit of colour on what's going on in Europe please?

Henrik Ehrnrooth: Okay, it's also as you remember quarter to quarter, it may fluctuate. So our revenue growth in Europe wasn't so strong first two quarters. Now it was stronger. So it's also a bit seasonal, but we have had a very strong order intake in both our new equipment and our modernisation business over the past couple of years. So now we can start to see that in our revenues. So it's nothing more to that just at now this quarter we had a little bit more revenues coming through.

Matthew Spurr: Okay. And then I had one again on China, just on the whole pricing strategy. It was early last year when you sort of had a little bit of a change in pricing strategy and ended up having to give away a little bit of market share. But is the difference now just that the market isn't declining, it’s that you can be more successful at leading pricing but not giving up market share? Is that the main difference from early 2016?

Henrik Ehrnrooth: I don't think we've given up market share to start with. I think we more or less held our market share and continued to be clearly the largest player in the important Chinese market. Always when you have a large – a highly competed market like the Chinese one even if it's stable, again I would repeat that in order to be able to improve prices you need to have a strong overall competitiveness. With a good portfolio of solutions and products you need to have a strong organisation that takes the accountability and responsibility for driving this, and really understands how you add value to your customers, because without adding value to customers you don't increase prices. And as I said, it takes courage as well when you can see a very highly competed market around you, you need to then understand how you drive forward and believe that by adding value to customers you can do it. And that's what we've done. We started to take very determined action, a large organisation takes a while to roll this out. But I believe that we are very much on the right path here.

Matthew Spurr: Okay, thanks.

Operator: Our next question comes from James Moore from Redburn. Please go ahead.

James Moore: Yeah, good afternoon Henrik and Ilkka. Everyone thanks. On China pricing, I just wanted to be clear that the slight sequential Q-on-Q price uplift in China in orders in RMB that you talk about, was that less than the sequential Q-on-Q Chinese raw material cost uplift?

Henrik Ehrnrooth: Yes, and that you can see therefore that our margins slightly is still declined even though we're able to improve pricing somewhat. And that's why I said earlier that given when we look at raw material prices are now we know that they're highly volatile. Where it’s going to be next year I don't know, but they have just recently spiked up a fair bit again that actually this trend that we are driving is needed.

James Moore: Yes and what sort of price rises do we need for the current spike up to be broadly flat net?

Henrik Ehrnrooth: Net, you need a few percentage points.

James Moore: Yeah. And on raw materials, I’m modelling 40 next year versus 60 there? But your Swiss friends are talking about 2018 pressure being the same as 2017 pressure. Do you think we ought to think about next year's pressure being similar to this year on raw materials?

Henrik Ehrnrooth: Let's see. I’m not going to make a prediction where it's going to be next year. The only thing we can see is that the volatility is high, and where they are at the moment they are quite at a high level. And that would indicate quite a significant headwind, and that's what we're determined to everywhere continue to drive better pricing by adding value to our customers. But let's see where we are next year. I think it's too early to comment at this point.

James Moore: Okay thanks. And you mentioned earlier the service pricing is getting better this year versus last, so it’s encouraging. Is that European maintenance pricing pressure easing or is it better US maintenance pricing?

Henrik Ehrnrooth: It depends. Many countries we have – if you do slightly better on your pricing and renewals of contracts, that's how we get it from a broad portfolio. Clearly, usually it comes more from the countries where new equipment markets have been stronger for the past year. So, but the overall situation is slightly better than last year.

James Moore: Great, thank you very much Henrik.

Henrik Ehrnrooth: Thank you.

Operator: Our next question comes from Glen Liddy from JP Morgan. Please go ahead.

Glen Liddy: Hi there. It's just a few different things. Your pricing's improved in China. But are you changing any of the other contract terms, either extending service periods in that initial sale or payment terms or anything else?

Henrik Ehrnrooth: This is all when we comment like for like payment terms, we continue to have good payment terms. Sometimes you may have a longer first service period but that's included then in the new equipment price. So when we comment on this, we very much comment like for like.

Glen Liddy: Okay and the margin in the backlog, you've been quite clear is down slightly. Is the decline greater now than it was at the beginning of the year?

Henrik Ehrnrooth: Clear, now [inaudible] pricing it's – it was more beginning of the year than it's now.

Glen Liddy: Okay. And finally, on raw materials, you were hoping to enter into some longer contracts with your suppliers. Have you reached the limit of how long your contracts might be now on average, or is there still latitude to lock in prices further?

Henrik Ehrnrooth: Locking prices, that's something we've done successfully over the past year. Now remember that you then rollover something and get a slightly smoother effect. When the market is volatile you can block some prices, but also the terms that what suppliers are willing to do, it may not be the most favourable. So you have to always look in the market what makes sense at any given time but perhaps you've slightly less locked in prices now than we would have had last year at this time.

Glen Liddy: Again, thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: Our next question comes from Antti Sutterlin from Danske Bank.

Antti Sutterlin: Hi, this is Antti. The Chinese held their meeting, the big meeting and I wonder whether that made you any more optimistic or pessimistic as regards to the development in China construction and elevators?

Henrik Ehrnrooth: Yeah, I don't think there was anything that surprising coming out of that meeting. I would say they are emphasising a more sustainable growth both from economic and environment perspective which is I believe good for long-term growth. Urbanisation will continue and we have to see what detailed policies comes out of this for [inaudible] and so forth. But I don't think that there was a big change how we would view the market. We can see that a lot of people continue to move into the cities. We continue to see that consumers are getting wealthier, want to upgrade and all that has a good impact on our markets. I know I wouldn't say a big change out of that.

Antti Sutterlin: Okay then I can note that you and also Schindler became a little bit more positive in China for this year. I wonder whether this has any implication for next year in your view? And then, by the way, what is your next year view on China?

Henrik Ehrnrooth: Let's come to that in – let's come to that in January. As I said earlier there are a couple of important things. One, I believe the market is fundamentally more healthy because inventories for unsold apartment has continued to improve over the past year. So underlying health has improved. That's a good thing. The other part of the equation are government restrictions that are having a significant impact on the market. Let's see how they develop. That will impact the market next year.

Antti Sutterlin: Okay, thank you.

Henrik Ehrnrooth: Thank you.

Operator: As a gentle reminder, if you'd like to ask a question it's star one on your telephone keypad. We will take our next question from Andre Kukhnin from Credit Suisse. Please go ahead.

Andre Kukhnin: Oh yes, thanks so much for taking the follow-ups. So I tried to follow Sanna's rule. Can I just double check on the pricing and versus raw materials and apologies for labouring this. But if you talk about slight price increase in your Chinese new equipment business and taking say a couple of percent as an example that yields about €35 million if you take 2% on 85% of your Chinese sales and then 80% that for the volume business.

And we're talking about raw material impact across the group of about 50 and then we're going to scale it down by Chinese business. So is this kind of the right way to think about the delta or are we talking about fifty plus million this year and then the headwind for 2018, and setting that against the price increase in China? And as a result saying that the orders margin is declining?

Henrik Ehrnrooth: Okay. So first of all, clearly when you look at pricing, yes you can count it over the total business that we have there. There are of course many puts and takes. You have raw material price increases, but then we've a lot of actions that we have taken to mitigate that, and we have talked about the 50 million. We are sure that we'll be able to mitigate a lot because if everything would come straight through we would have a much higher increase.

It's always many puts and takes. It's also part of the mix of the business that you have. We've to remember that now we have – we are more or less at last year's level. But before that we had seen a significant decline, and what are we delivering from the order book is of course comes with a delay. So when you take all of these factors into play you can still see a slight decline in the order book, but clearly we're going in the right direction now.

Andre Kukhnin: Great, thank you. I appreciate that. And just on something else completely: in terms of the cash performance and working capital within that, what drove that? I think there was a sort of 33 million outflow. Was that FX or anything underlying? Could you please comment on that?

Henrik Ehrnrooth: You want to comment on that?

Ilkka Hara: Yes, so on working capital in total we did have a significant impact from currencies in the change. If you look at the underlying commercial terms that we have, we continue to work on advanced payments in all regions across the globe, and no changes there in underlying terms for the business.

Andre Kukhnin: Great. Thank you very much, and just a last one follow-up for me. Thank you for clarifying the dynamics between the first maintenance and paid maintenance contract in China. Are those paid maintenance contracts, are they any kind of fundamentally different to elsewhere in the world in terms of what you kind of sign up to provide there, or anything in the pricing structure obviously the kind of the labour rates are different and therefore the levels are different. But is there any kind of fundamental difference in terms of how these contracts are structured for you in China versus elsewhere?

Henrik Ehrnrooth: From contract perspective, no significant differences. There are clear differences between the regulation between different markets, how you perform your service and what the requirements, how often you perform it, and how you do it and so forth. So that's where the differences are between markets. But the fundamental structure and contracts are not big differences.

Andre Kukhnin: Great, thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: Our next question comes from Lars Brorson from Barclays. Please go ahead.

Lars Brorson: Yeah, hi Henrik. I just had a couple of quick follow-ups. And I know we are really sort of running around talking about China pricing and backlog margins quite a lot here. But it is important because it's obviously forward-looking, and I'm not quite sure I understand correctly. But maybe I could just be clear, you're saying you're fully offsetting raw materials inflation in China new equipment this quarter to the earlier question earlier? Can I just ask why is backlog margins down then?

Henrik Ehrnrooth: I don't think I say that we are – I say that we have improved pricing slightly. But where raw material prices are right now, we would need to improve them even slightly further to compensate for that fully.

Lars Brorson: Okay. And again, I mean backlog margins down now less than it was earlier in the year is perhaps less surprising. This is the fifth consecutive quarter of decline. It's obviously annualizing now. So it's quite a – not an easier comparison, but I wonder whether you could give us some sense for how the backlog margin is progressing relative to the raw material headwinds.

Should we expect this now to be sort of the last quarter if you like of backlog margins down given the measures you're taking on pricing?

Henrik Ehrnrooth: As you know, we don't comment on pricing going forward. That's something always individual deals between us and our customers. So we don't comment on pricing going forward. And I don't know where raw material costs will be in three months time for example. So we have to see, I think, our objective and our direction that I've communicated should be pretty clear.

Lars Brorson: It's obviously positive to see you lead the market on pricing. I would expect that. I wonder how much of that is a reflection of your slightly smaller exposure to the larger project and infrastructure business. You are obviously trying to give an indication of what you're doing on a like for like basis. It's also true to say perhaps at least from what we heard from your peers there's much greater pricing competition on some of the larger projects. Would you say that that's fair and, if so, how much is this better pricing relative to market a reflection of that?

Henrik Ehrnrooth: As I said earlier, this is like for like at least when we talk about the volume business. So what mix you have between larger projects and smaller projects? That's out of this equation. This is like for like for the volume business that we are talking about. So the mix in a volume business may have improved somewhat. But if you take large projects out of that, we've taken large projects out that equation here. And I would say that we have very strong market position also in large projects both infrastructure and others. So again, we are a clear market leader in China, and we have a good exposure to most of the markets. And that's really the strength we have there.

Lars Brorson: All right, okay thanks.

Henrik Ehrnrooth: Thank you.

Operator: Our next question comes from Lucie Carrier from Morgan Stanley. Please go ahead.

Lucie Carrier: Hi, hello again. I just, as we have still a bit of time I just had another question actually on the mix of new equipment. It seems that you have had very good momentum coming from North America in terms of new equipment orders and I'm just wondering also in terms of the overall mix for that new equipment business, whether that could be a bit of a help as well?

Henrik Ehrnrooth: We have had – yes we have clearly had – have had a very good momentum and development of our North America new equipment business, but so have we done on so many European countries. So yes, perhaps yeah we know that the Chinese new equipment business is more profitable, but still we have good businesses in these areas and developing them nicely. So perhaps it may be a slight mix headwind, but still the most important thing is that those are all developing in a good direction, and both growth and profitability wise.

Lucie Carrier: But just to follow up, I mean when you think about the new equipment business particularly in North America how does that compare maybe with EMEA in terms of a margin profile?

Henrik Ehrnrooth: It's not that significant of a difference.

Lucie Carrier: Okay.

Henrik Ehrnrooth: Thank you.

Operator: As a final reminder ladies and gentlemen, if you'd like to ask a question, please press star one. We'll pause for just one last moment. And we will take a question from Andre Kukhnin from Credit Suisse. Please go ahead, sir.

Andre Kukhnin: Yes, hi again. Just last follow-up from me. On the China retrofit opportunity, if something else come up in discussions and quite surprising that the numbers that are being suggested on potential number of lists that can go into the existing buildings to retrofit buildings of seven to nine story high that did not have elevators at the moment. Is this something that you see as relevant and kind of in the near term on sort of a one or two-year view or is that just kind of something that is would be nice to materialise at some point in the next ten years? Thank you.

Henrik Ehrnrooth: I don't know exactly when it will materialise. But you know we talked about the earlier regulation in China. There's a lot of talk – a lot of discussions and constructive and positive discussions about various regulations in China. The exact timing of those when they were rolled out is unclear. Then when you talk about now the retrofitting of elevators in the building, seventy-nine stories also a lot of discussions ongoing on that. And I believe at some point, it will be a significant opportunity to improve the usability of these buildings, but still exact timing when there may be some regulations is unclear.

What we can start to see already is that some customers are asking for it. I think that it's the same discussion as in Europe that how do you split the cost between the different floors of the building and all of that. So all of that discussion is ongoing and what it will mean, and when this will come through we will have to see.

Andre Kukhnin: Thank you. And if you are you ready for it in terms of kind of product offering the channel to market capacity?

Henrik Ehrnrooth: I think, we have shown quite many years in a row that when a good opportunity comes up we are pretty quick.

Andre Kukhnin: Great. Thank you very much for all your time.

Henrik Ehrnrooth: Thank you.

Operator: Our next question comes from Daniel Gleim from MainFirst. Please go ahead.

Daniel Gleim: Yeah. Thank you very much for taking my question. Can you hear me?

Henrik Ehrnrooth: Yeah.

Daniel Gleim: Thank you. So the first one I have is on the maintenance acquisition opportunity in China. We heard from some competitors that they are now starting to eye on potential acquisitions also on the service side. Is this something that you are also eyeing on or is this to be excluded for the time being?

Henrik Ehrnrooth: Our principal focus is clearly organic growth because we have very good organic growth and a good pipeline there. That's – we deliver new equipment with good margins and then convert into service. That's clearly the best business we can do. If there are good opportunities that come up, clearly that's something that is interesting to us at the moment are if you look at the past year’s main focus has clearly been on organic growth.

Daniel Gleim: Thank you, very clear. And maybe Ilkka, when you say the absolute investments next year are not going to go down. They're going to be stable, are you referring to euro amount or are you referring to the percentage number in terms of sales?

Ilkka Hara: More referring to the percentage – as percentage of net sales in my comment. This year we clearly wanted to highlight the fact that that went up and we see more stability then going forward at least at this stage. So we haven't – we continue to monitor the opportunities for investments and then decide based on those.

Daniel Gleim: Very clear. Thank you very much.

Ilkka Hara: Thank you.

Operator: As there are no further questions, I'd like to turn the call back for any closing comments or remarks.

Sanna Kaje: Thank you, Henrik. Thank you, Ilkka. And thanks for all the good questions from the lines. I would still like to remind everyone about the IFRS 15 call that we will have on 16th November. So if you have any questions regarding that, please join. Otherwise with that, I would like to wish everyone a great remainder of the week. Thank you.

Henrik Ehrnrooth: Thank you.

Ilkka Hara: Thank you.

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