KONE Q1 2018: INTERIM REPORT FOR JANUARY-MARCH 2018
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Essi Lipponen: Good afternoon, and welcome to Kone's Q1 2018 results webcast. My name is Essi Lipponen and I am from the Investor Relations team. I have here with me our President and CEO, Henrik Ehrnrooth; our CFO, Ilkka Hara; and Head of Investor Relations, Sanna Kaje. We will start with Henrik presenting the Q1 highlights and also the development in the market environment. After that, Ilkka will take us through the numbers. We will finish with Henrik presenting the market outlook and the business outlook. After the presentation, we will have time for your questions. I kindly ask you to limit your questions to one question at a time. Let's get started. Henrik please.

Henrik Ehrnrooth: Thank you Essi and welcome also on my behalf to our Q1 results webcast. It is again my pleasure to present to you our progress during the first quarter of this year. And we have a lot of interesting news to share. And if we straight go into the highlights of how we developed during the first quarter of this year, I'd like to start with the fact that we had a solid and good growth in our orders received on a broad basis in stabilising markets. This is really good news.

Our profitability continued to be burdened by a number of headwinds. That's of course something we're not happy about. We will go into that in more detail as well. We are seeing good progress in how we are driving our differentiation from our competition to add better value to our customers. And we'll talk about that as well during this webcast. But to dive straight into the highlights of the numbers, here clearly the highlight is a strong orders received that we had in Q1. Our orders received were just over EUR1.9 billion.

In comparable currencies, they grew by 6.8%. We can see, though, that the strengthening of the euro has a very significant impact on our reported numbers and on reported basis they actually declined 0.2%. We continue to have a strong order book, about EUR7.8 billion, and in comparable currencies that's also grown slightly year over year. Our sales, I would say, call it exceptionally strong growth in Q1, just over EUR2 billion and 10.6% growth in comparable currencies.

Our EBIT was now EUR 211.5 million or the adjusted EBIT EUR218.3 million compared to EUR245.8 million the year before. It is clear that we are not satisfied with the level of our EBIT and also the fact that our EBIT margins declined from 12.8% to 10.9%. It's something we are continuing to take action to improve this. And we continue to see now good progress in that. Also our cash flow declined and was EUR179 million compared to a strong EUR305 million last year. Ilkka will talk more about this. EPS EUR0.33 compared to EUR0.40 a year ago.

As we all know, our markets are changing. Customer expectations are changing. What I'm very happy about is the continued energy and positive forward-looking drive I can see throughout Kone in developing Kone going forward. And that I'm very pleased about and I think a big thanks goes to all of our employees for the great job they continue to do to develop Kone into an even better direction and drive our differentiation.

If I then look at the Q1 business highlights, orders received growth, I talked about that how it grew in all regions and all businesses. So what I'm very happy about is that the growth was broad based, quite even, strongest was in Asia-Pacific outside of China where we had very strong growth. And also the fact that second quarter in a row now we're starting to see a stabilisation of our margins in our orders received. So we can see that the actions we're taking on improving our pricing are bearing fruit.

We also had again a very solid development in our maintenance and modernisation business. We continued good growth in both businesses. Perhaps a highlight here is that when we look at Europe, and particularly Central and North Europe, we can see that the good development in new equipment business now for a few years is starting to also be reflected in the maintenance business. And we can see an improvement in maintenance prices, particularly in Central and Northern Europe. And I think we have done quite well in many of the countries here.

We are also seeing, on the services side, that our KONE Care and 24/7 connected services continue to be at momentum. We can see that both of these are differentiating us. And we can see continued good development, for example in KONE Care, how it's improving our pricing, how it's improving our hit rates and how the comments from customers are very clearly, they're saying[?], "Now you are selling something that suits my needs. And that's why I like you." Also 24/7 connected services, a good momentum here and we can see very strong overall progress in rolling out these services. KONE Care and 24/7 connected services are now available in more than 15 countries.

Also in the quarter we continued to strengthen our product competitiveness. In Asia we had some very important product launches, particularly in India where we launched a totally new mid-rise offering that is specifically designed for the Indian markets. I think the timing of this is actually very good. We are starting to see the Indian market recovering now. And I would claim that we have the most complete offering for the Indian market now and are very well positioned to capture the good growth we are seeing coming through in that market now. And we also strengthened and broadened our offering in China to make sure that we are strong in all of the key segments throughout the market and that we have done.

As you know, we started our Accelerate, Winning with Customers programme in September. Here we continue to drive that forward. We have good progress in the execution of this programme. The whole idea here is to ensure that we can have more customer-facing time with new services and solutions, and therefore bring new services and solutions faster to our customers with higher efficiency. And there are a lot of things that are going in the right direction here and we continue to execute on that programme.

Also what we did in the quarter is that we launched our new offering structure. And this is to ensure that our offering structure, overall what we sell to our customers, fully reflects our current strategy. And the whole idea here is to ensure that Kone is as easy of a company as possible for our customers to deal with. We can see that our customer's needs are changing very significantly. The way people work is changing and we can therefore see that that's putting new demands on office buildings.

We also see new demands on residential buildings. And we want our new offering to better reflect the needs of our customers and reflect our strategy of what we call that we want to have customer-centric solutions and services that fits their needs. And therefore we launched an offering structure looks like we have on the screen now. At the basis of it, we have our basic core business: equipment for new buildings, elevators and escalators for new construction to provide a great people flow in these buildings. And the maintenance and modernisation business for existing buildings to ensure people flow remains good and the equipment is kept in good condition and modernised. This remains the same and of course a very core part of our business.

At the next level we have our advanced People Flow solutions. Those are our solutions for smart buildings. Parts of these offering have been available already for many years. But that's of course an area we continue to strengthen and broaden to make sure that we have the best solutions for increasingly smarter buildings. Everything from destination to access control, but also information monitoring and how we can understand best what's happening in this building.

But then we have added a new layer that we call advanced People Flow Planning – People Flow Planning and Consulting. This service is specifically designed for our customers to meet their facing – to meet their changing needs. Here we are using all the insights and analytics we have from buildings when we connect the elevators and escalators, but also all the other data we have gathered over the years on these buildings.

The idea here is to ensure that we can help our customers make their buildings the best buildings to work in or live in by having the best People Flow in them. We're seeing a lot of good demand for our services in providing the analytics, design and planning for our customers as their needs are changing. So with this whole offering structure we want again Kone to be constantly an easier company to deal with, and very much structured in the way our customers want to face us and they want to buy from us. So that's the idea of this new offering structure. So that’s a little bit about how we're developing Kone and how also we are developing towards our strategy of winning with customers.

Market development, what have we seen in the markets. We start with the new equipment market overall. We can see that the new equipment markets grew slightly in the first quarter and actually we saw a slight growth in all geographic areas. In North America, the market grew already from a high and good level. Europe, Middle East and Africa also a slight growth particularly in South Europe and the Middle East. Central and North Europe, pretty stable on a good level. In Asia-Pacific we saw the Chinese market was now quite stable in units, and rest of Asia-Pacific group. And it was particularly India that returned to growth, and because of that we saw the whole Rest of Asia-Pacific growing. So overall I would say the development of the new equipment markets was very much in line with what we had expected at the beginning of the year.

If I then look at the service markets, here also we see growth across markets and across businesses. In North America both maintenance and modernisation markets are growing slightly.

I would say modernisation, we can see also that, given the good growth and momentum that that market has had for a good while already, we are now seeing that pricing has improved in the market.

In Europe, Middle East and Africa maintenance markets are growing slightly. And as I mentioned already we are seeing a slight improvement in pricing overall in Europe. And clearly the reason for this is that there are more units coming into service now from the better new equipment markets over the past years and also a better economic environment. And this particularly can be seen in Central and North Europe. Also modernisation markets are growing slightly. Asia-Pacific, good growth in maintenance and strong growth in modernisation overall. Not much new there.

And if I look a little bit closer at the Chinese market, as I mentioned, it was flat in the first quarter. Here if you look at the fundamentals of the market and start with housing inventories, we can see that in the higher-tier cities the relative inventory has a little bit edged up. Whereas the development, if you look at longer term, has improved in lower-tier cities. Actually, if we dig a little bit deeper into these numbers, we can see that the absolute number of apartments available for sale has actually declined. But if you look at the higher-tier cities we have also seen a decline in transaction volumes and therefore we see a little bit blip up here in the relative measure of the inventories. But overall we can say it remained at the relatively healthy level.

Housing sales and prices, here as I mentioned in the higher-tier cities we've seen that transaction volumes have declined a bit and prices are pretty flat, whereas the development in the lower-tier cities is good. So we can see that the government restrictions that have been in place now already for a good while, they are really having an impact. There are now some 100 cities where we see restrictions on apartment purchases and mortgages. And of course the idea of the Chinese government here is to cool down the markets. And we can see it is having a significant impact overall on the property market.

If I look at the property construction markets overall we can say that real estate investments actually grew very nicely beginning of the year. They grew at about 10%. The main driver behind this are the increasing land transactions and increasing prices of land. The overall elevator and escalator market was now pretty stable in the first quarter.

Now in connection with the Q1 results we also dive deeper into other markets and how market shares developed in the prior year. In the first quarter we always do a deep dive into market sizing and market shares. And as usual we then present that in connection with our Q1 results.

And if I look at the global new equipment markets, overall in 2017, as we discussed earlier, the markets remained stable overall at approximately 825,000 units of elevators and escalators. China maintain - remained by far the biggest market at 63%. Chinese markets was now quite stable after two years of decline in units, and also pretty stable in monetary value as they had declined for already some three years. So we saw a stabilisation of that market.

The growing markets were clearly Europe, Middle East and Africa and North America, whereas the rest of Asia-Pacific declined slightly. Kone's market share in 2017 was stable at approximately 19%, if we measure it in number of units. But as I think all of you know, our principle objective last year was to gain market share measured in value. In a stable market or even in somewhat declining markets, the most important way to gain in those markets is to gain by value and look at your pricing very carefully. And as you know, that has been very much our approach. And if I look at our market share measured in value it actually grew slightly. So I believe that that was very much in line with our approach last year.

The service markets continue to grow. The global install base grew to almost 15 million units last year and markets grew at close to about 6% in number of units last year. Clearly the Chinese market is the fastest growing given the number of new installations we see every year there. Modernisation markets also grew in all regions.

We consider ourselves clearly a challenger in the maintenance markets. However, if I look at our major competitors we clearly have the fastest growth rate. So we are catching up with the bigger competitors and we can see now that we have improved over the past years, our position and we are now number three – in number three position if we measure it by global service base, how many units we have in service. So we continue to grow faster than our main competitors. And last year our service base was more than 1.2 million units under service contract at the end of last year.

If we then look at our market positions in the various businesses and various markets, no big changes here. Europe, Middle East and Africa, we continue to be number two in the new equipment market. And in maintenance we are number three, but we have gained share here. In North America, in new equipment we continue to be number four. However, if I look at particularly the American market, the USA, we can see that the difference between the second, third and fourth player actually is quite small. So we have constantly strengthened our position there, particularly given the very strong position we have in the machine-room in that segment there. In maintenance we are a clear challenger with a number four position. In China we continue to be a clear leader in the new equipment market and also a leader in the maintenance market. Rest of Asia-Pacific we remain a leader in new equipment and number two in maintenance.

So the strong positions we have in new equipment clearly continues to fuel a good development in our maintenance base, and as we have seen consistently over the past years. So with this introduction of our highlights, market shares, I'm happy to hand over to Ilkka to review our financial performance during Q1.

Ilkka Hara: Thank you, Henrik and also welcome on my behalf to this results announcement call. And as normal I'll go through our financials a bit more in detail. And I'll start with orders received development in the quarter. Our orders received grew and reached EUR1.9 billion in the quarter. And we saw growth in all regions and in all businesses on a comparable basis. On a comparable basis our growth was 6.8% in the quarter. And more importantly we saw development that started already at the end of 2017 in our margins. They continued to stabilise in the quarter.

If we look at China in a more detail, in China we saw in both volume as well as in value growth in our orders. Our volumes grew about 5% and value grew slightly less than that. The price contributed positively year on year to that development, but mix had a slight negative impact in the quarter in China.

Then moving onwards to sales, so our sales reached EUR2.8 billion in the quarter which is, on a reported basis, 3.3% growth. And as said earlier by Henrik, so the growth was very strong at 10.6% on a comparable basis. And a high level of project starts really drove this strong growth development in the quarter, especially in the new equipment but also in the modernisation business. But overall sales grew in all regions and in all businesses. And if I look at this in more detail, so new equipment business grew at 14.6%, modernisation at 10.3% and maintenance contributed at 5.4% in this quarter to the growth.

From a geographical perspective, the strongest growth was in Europe, Middle East and Africa, 19.8%. Americas contributed at 3.5% and Asia-Pacific at 4.1% in this quarter in sales. Then looking at EBIT development more in detail. So our EBIT reached EUR 218 million and down in EBIT margin as we saw the headwinds continuing to burden our results, both higher raw material costs as well as the price pressures that we've seen earlier in our orders in China contributing to this development. And our adjusted EBIT reached 10.9% in the quarter down from 12.6% in the previous year's first quarter.

It's good to note that, yes, we did have headwinds, but good growth continued to positively contribute to our profit, as well as the significant impact that FX and currencies play in our results. So we had a EUR21 million impact from currencies in our results. Restructuring costs related to the Accelerate programme were EUR6.9 million in this quarter.

Then to cash flow, cash flow it's always difficult to measure cash flow in one quarter. You need to look at it in a larger context. But our cash flow in this quarter declined against a strong comparison period and reached EUR179 million in this quarter. If we look at the key drivers for this development, first change in our EBITDA was a negative contributor at EUR34 million. Also from a working capital perspective, in the previous year we saw a positive EUR31 million contribution from working capital, whereas this year we saw the working capital contributing negatively EUR62 million.

If I look at the business fundamentals, they continue to be intact. Our customer payment terms as well as payment behaviour continues to be the same. And I'm convinced that in the coming quarter we see the cash conversion recovering for the business.

Now handing it over back to Henrik to talk about markets and business outlook for the remainder of the year.

Henrik Ehrnrooth: Thank you, Ilkka. If we start with the market outlook that we expect for the full year 2018, firstly it is unchanged from what we said in connection with the full year results. And we expect the new equipment market in Asia-Pacific, that the market in China is expected to decline slightly or to be stable in units. And at the – our competition there will continue. Rest of Asia-Pacific market is expected to grow.

Also Europe, Middle East and Africa, North America a slight growth as well there. Maintenance, very much the same trends we've seen so far with growth across markets, of course the strongest growth in Asia-Pacific. And in modernisation, a slight growth in Europe, Middle East and Africa, North America and a strong growth in Asia-Pacific.

If I then turn over to our business outlook. As we have promised we have now specified in connection with Q1 results, our business outlook. We expect our sales to grow between 3% and 7% in comparable currencies. And we expect our EBIT to be in the range of EUR1.1 billion to a EUR1.2 billion. And this assumes that foreign exchange rates remain at the level where they were at the end of March of this year. So with this level there would be about EUR40 million negative impact from exchange rates on the EBIT.

There are a number of things that are driving us in a positive direction. It's the solid order book that we have, it's the solid and continuous good development in our services business as well as the continued performance improvements that we have been able to drive. What is however burdening our results, it's clearly the price pressures we have been experiencing in China over the past years. And now we are delivering orders that were booked last year with a lower margin that we can clearly see. Also that in combination with higher raw material costs that we expect to burden our results by about EUR100 million this year. Those are clearly weighing on the results.

And then if I look at translation exchange rates, the impact on our sales, if they stay at the level where they are now, would be about EUR300 million, and on our EBIT about EUR40 million.

So then to summarise. I'm very pleased with the good start we had in the year in orders received, given it was broad-based and given that we also stabilised our margins. The actions we're taking to improve our profitability and margins are working. We can see the focus we have on pricing is delivering results, and of course we need to do more there. But also the overall performance improvements are driving us forward. And I'm very pleased that our services that we have launched over the past year that are differentiating us, which are really a sign of how we want to work, how we want to show our customers that we help them succeed in their business, they are very much gaining momentum. Therefore we also see good progress in our strategy execution, continuously driving us forward. And finally, a lot of great opportunities from the changing market environment that we're seeing.

Also I'd like to highlight that we have today published our sustainability report for last year. I hope you all read it. There's a lot of interesting information in it, how we continue to make Kone a more sustainable company and how we are developing towards our target of being the leader in sustainability in our industry. So with this I'm happy to open up for your questions.

Jussi Koskinen: Jussi Koskinen and a couple of questions. First about this new offering. How about this actual product – elevator portfolio, haven't heard for a while about that. Any development or actions in that area? You talk much about new services, but how about the actual elevator portfolio?

Henrik Ehrnrooth: If you look at new product introductions, actually we have continuously upgraded and launched new improvements and broadening of our offerings. Over the past year, there's been a lot of work in North America. And we can see that has delivered a lot of results. Now we had launched a new mid-rise offering for the Indian market. And as I said, very well timed to capture the growth opportunity we see there. And also in China we launched a new broadening of our range to capture more of the market.

So we have continuously had new offerings and new launches for strengthening our product competitiveness. Last year also we had a lot on the high-rise side as we strengthened and brought new values to our customers there.

Jussi Koskinen: Then a second question about this value market share. Could you a little bit elaborate if it's contributed by some specific market area or drop[?] area or in what area you were successful?

Henrik Ehrnrooth: I think it was clearly everywhere. But I think in the market where we had perhaps the biggest difference between – in China our market share remained stable at about 20%. So we are a clear market leader there. But there we saw that we actually gained some market share if we measure it in value. They are pretty stable in units but gained in value. And that was through our pricing focus that we had.

Jussi Koskinen: Thank you.

Operator: Thank you. If you would like to ask a question please signal by press star one on your telephone keypad. We'll now take the first question from Guillermo Peigneux from UBS. Your line is open. Please go ahead.

Guillermo Peigneux: Good afternoon. This is Guillermo Peigneux from UBS. Thank you much for taking my question. I have two questions on China actually. First on pricing, could you comment on how the prices compare quarter on quarter? So I think you increased by 7%, if I recall correctly, your pricing for China in Q4. Did your pricing increase sequentially on Q1? That's the first question.

And the second question is kind of similar. Thinking about the margin of orders that you commented in your press release and the presentation, can you comment on how those margins compare Q4 and Q1? You already mentioned that margins were stabilised in Q4. I just wonder whether that stabilisation means that your order margins are improving at this point. Thank you.

Henrik Ehrnrooth: Okay. So, as you remember in Q4, we had a very good pricing development in China. And the 7% you mentioned, that was a combination of price and mix, and most of that was price. Now year on year, we were able to improve our prices a bit. Now for Q1, quarter on quarter, they were pretty stable. So we actually had good growth in our volume. And we're able to maintain the good price increases we were able to get in Q4. So I would say Q4, from that perspective, was a very strong quarter. That was okay that we are able to keep it, but clearly we continue to have good momentum there and high focus in this area.

Then when it comes to margins, when you look at the margins, there are clearly two things that impact your margins. One is the price and the other one is the general cost level or your cost level. So prices, as we have said, we have been able to improve slightly. But at the same time we have seen significant pressure from increasing raw material costs. So what we're saying is that for us to improve our margin we need to increase prices even more. So we're going in the right direction, but it's clear that the headwinds are quite strong from the raw materials.

Guillermo Peigneux: So can I read that as your margins are stabilising but still suffering here in Q1 versus Q4?

Henrik Ehrnrooth: Pretty stable Q1 versus Q4, yes.

Guillermo Peigneux: Okay, thank you.

Operator: We will now take our next question from Klas Bergelind of Citi. Your line is open. Please go ahead.

Klas Bergelind: Yes hi Henrik and Ilkka, it's Klas from Citi. So I have a couple of questions. First on EMEA, very solid growth this quarter, both on equipment and also when we look at maintenance sales versus my forecast. On equipment, is this year's mix looking at the different countries in Europe or market share gains or did you land a lot of projects? I know project starts drove higher sales and is linked to IFRS 15. But I'm interested in the orders. And also on the maintenance side, where we're now seeing pricing accelerating, is this just because of higher cost inflation or are you taking market share on the back of KONE Care 24/7, etc.?

Henrik Ehrnrooth: So if I start the – if I address the orders received, so in Europe, Middle East and Africa we actually had a good performance on a broad basis. And as you know there are growth opportunities in Europe. We have – South Europe is growing. Germany is growing. And we can also see in Middle East. So I would say just good broad-based performance. It was nothing – it was not that there was one market that was driving it all. But I would say a good broad-based performance. That's the message.

On maintenance, yes we had a good growth particularly in Central and North Europe in maintenance. And that is a combination of continued good convergence and good pricing performance. And one of the factors driving our pricing performance is our new KONE Care and our new services. So it's a combination of everything. And it shows that we're going in the right direction.

Klas Bergelind: Yeah, because you are a bit late to talk about positive pricing compared to your peers. So we should basically say that now the reception around the digital offering is sort of biting more.

Henrik Ehrnrooth: It's clear when you bring new offerings like this that are totally new for the market, we have them broadly available. It's now a lot of work with our customers and showing them how it adds value. But I think we're gaining good momentum here. And in every market where you have it and people are trained to do it, you are constantly gaining momentum. So, yes, we're going in a very good direction here.

Klas Bergelind: Okay, then I want to come back on price and mix in China. So pricing is up a bit, mix down a bit. Since like pricing is stable quarter on quarter, could you talk about why you didn't increase prices further quarter on quarter? Is it because you felt that the cost inflation is now under control? You didn't move on the EUR100 million in raw[?] mats or did the competitive pressures get worse this quarter? We're hearing that the consolidation among developers means that you and your competitors need to increasingly compete more on price. So I would be interested to hear why you didn't increase pricing further versus the fourth quarter?

Henrik Ehrnrooth: When it comes to pricing, of course, our ambition is very clear. In some quarters you have a better performance; in some quarters it was more stable. Now as the Q4 was really good; I would say this was quite okay – not quite as good as Q4 from a pricing perspective. Pricing, of course, there's a decision you make that you want to increase prices. But just remember that all of these are individual negotiations between us and our customers in a competitive environment. I would say perhaps what is impacting this, as I say, that it's a consolidation amongst developers.

And we have a very good position with the biggest developers in China. So that's okay. And also the fact that more of the growth now came from lower-tier cities where perhaps buildings are slightly lower. So average value therefore, probably a bit lower than in higher-tier cities.

Klas Bergelind: That was actually my final one, Henrik, on the mix there. So it was not just a project with a tough comp or this is purely down to sales to less high-rise in lower-tier cities, which then means that it should continue throughout the year, so to understand the mix as the year progresses, please.

Henrik Ehrnrooth: Yeah, clearly mix, if it’s more in the lower-tier cities there is some impact on the mix. And then you need to see what is the combination of price and mix. And you know overall I think we did quite well in this in Q1.

Klas Bergelind: Thank you.

Henrik Ehrnrooth: Thank you.

Operator: We will take our next question from Manu Rimpela of Nordea. Your line is open. Please go ahead.

Manu Rimpelä: Good afternoon, it's Manu Rimpela from Nordea. The first question would be on just the sales recognition on this IFRS 15 accounting change. So obviously we had a very strong Q1 in terms of sales recognition and you're guiding for 3% to 7% organic sales growth. So can you just help us to understand this? Are we kind of having this very strong starts impacting the new equipment part of the business in Q1 and that will kind of fade off towards the end of the year? So how do you think about your organic sales guidance compared to what you did now in Q1 already? And how should we think about the progression through the year?

Henrik Ehrnrooth: Ilkka, I will hand that question to you.

Ilkka Hara: Yes, so we did see a very strong growth in our sales in the first quarter. And that is, like you said, driven by the number of starts and the installation starts at site. And we're clearly expecting less growth in the second quarter. And the first half as such would then even itself out. And like you said so now that we are in the IFRS 15 world, we start to recognise the revenue immediately once we deliver the material to the site. So in that sense it is different but it's more driven by the way the work was defined for this quarter.

Manu Rimpelä: Okay, and then obviously the follow-up on the profitability of business. So we saw pretty big fall in the margins. That's [inaudible] partly but then probably impacted by the fact that you had a lot more revenue recognition in the project business. So should we also see an equal IFRS 15 related reversal of the – or improvement of the profitability in the coming quarters when we have a less of the project revenue getting recognised? Or how should we think about – just to understand how this new system works between the quarters?

Henrik Ehrnrooth: Some impact if I look at how – where we saw the growth, so Europe, Middle East clearly growing faster than the rest of the business. And, yes, some timing impact in profitability. But like I said, if we look at our guidance and how we've talked about it, so we more see that there is – the pressure on the margins will ease off at the very end of the year, towards the fourth quarter. So that's where we really – where we see the development maybe turning, compared to what it is today.

Manu Rimpelä: Okay, final question. On the pricing improvements on maintenance in Europe you're talking about. So have you seen that already flow through to your P&L and improve in the profitability? Because it doesn't seem so on the back of at least kind of Q1 margins.

Henrik Ehrnrooth: I mean, if I look at Europe and the maintenance business, it’s clearly, of course, a good thing when you increase prices. So yes, clearly that has an impact on your bottom line. So the answer to that is yes. But at the same time we also see a much higher labour cost increases in Europe this year than in past years. And I think that's a general phenomenon in Europe at the moment. But clearly it's a positive and good thing, the price increases that we have achieved.

Manu Rimpelä: If I may follow up on that, is the net price increases something we are seeing or is it just that prices are going up on the back of the inflation [inaudible] in China as well?

Henrik Ehrnrooth: No, I think it is a net improvement.

Manu Rimpelä: Thank you.

Operator: Thank you. As a reminder, please limit yourself to one question. We will take our next question from Lucie Carrier of Morgan Stanley. Your line is open. Please go ahead.

Lucie Carrier: Hi, thank you very much. Thanks for taking my question. Actually as a starter, I had a follow-up on one of your previous question regarding the outlook for the rest of the year. So it's clear you've mentioned that you expect in new equipment growth to kind of decelerate, of course, from what we've seen in the first quarter. But do you have – I mean, what’s the visibility you have really on your service business? Because maybe to the point of my colleague earlier how should we think about the margin mix for you in the next few quarters, considering that possibly it looks like you will have less new equipment than what you had in this quarter and maybe a higher share of service?

So I wanted to come back to that please, because the comment around the fourth quarter kind of margin pressure easing, that's something you had mentioned before. But now considering, with the mix we had in the first quarter and how you are guiding, I would like to have your view on the margin mix based on that.

Henrik Ehrnrooth: I would say that if you look at our maintenance business, there our growth has been very consistent in that business if we look for the past two years. So I think that’s what you can expect on the longer term. Modernisation, we have a good order book, so that should also grow. Yes, there's going to be a slight mix difference, but I would say, as Ilkka said, that if you look at the first half the whole thing is probably going to be pretty normalised, both from a geographic and a business perspective. So probably a little bit more services than new equipment in Q2 than in Q1, and then second half of the year probably more normalised.

Lucie Carrier: Okay, thanks very much. The second question was around the price increase in China. And you’ve mentioned that the fact that you had a bit more lower-tier city activity on average maybe was not reflecting so well on the overall price increase. Can you maybe tell us whether you've increased prices in China across the board or whether you're focused on a specific segment? And also, of course, without naming anyone but what are you seeing in terms of your competitor behaviour in terms of pricing in China? Because one of your competitors yesterday was not maybe not as positive as you seem to be today.

Henrik Ehrnrooth: Price increases, maybe in years gone by you were able to say that KI[?] increased prices with a flat number across the board. Pricing is understanding your competitiveness, understanding your market and understanding how you differentiate in each and every single situation. They're all individual cases. And therefore it is something that requires courage, knowledge and insight, and that’s how you drive them. If you are going to say that, okay, across the board we’re going to do something, that isn’t going to work.

So that is what it's all about. And that is why we continue to develop our capabilities, develop our skills out in the field and understanding where we have the best opportunities to drive it. And that's what it's all about. And I wouldn't start naming any competitors. What we can see is that competition is tight. China is by far the largest market. Yes, it's been more challenging over the past years. But it's still the largest market in the world. And clearly a lot of companies have ambitions there, as do we.

Lucie Carrier: But do you – I remember you had taken the lead in terms of price increase; in the third quarter you had said that. Do you feel that you’re still kind of leading in that effort in China?

Henrik Ehrnrooth: I believe so, yes.

Lucie Carrier: Okay. And then just one last question. It was just on – I mean, what can you comment at the moment around potential impact from tariffs in terms of your sourcing in the US, but also in China where I know you source locally?

Henrik Ehrnrooth: I think we have to see how this plays out. But so far, the impact not significant, but it's clear that we see many steel prices or different grades of steel in the United States have gone up a lot. And we've also see an impact on certain materials in China going up a lot. I would say that the situation from that perspective has been volatile. And I think it's still unclear. So far, not a major impact, but Ilkka would like to clarify, if you have seen something more specific there?

Ilkka Hara: Yes, we haven't seen major impact and are not expecting, with what we know today, to 2018. But naturally it's hard to estimate what the carry-on impact is across the globe for any foreseeable actions that will be taken as a counter measure. And we follow that, and all that we know is included in our guidance when it comes to the raw material impact for the year.

Lucie Carrier: Thank you very much.

Operator: We will take our next question from Omid Vaziri from Jefferies International. Please go ahead.

Omid Vaziri: Yes, thank you very much. I have got two questions. My first question is on the modernisation market. When we look at North America, I mean, given the age of the installed base there, why are we not seeing stronger growth, more than the slight growth that you are reporting in Q1, let's say? And we had a similar picture in previous quarters. And we're seeing Asia-Pacific market for modernisation grow with significant growth. So it's just a bit surprising.

Henrik Ehrnrooth: I would say the North American market has being very active already for a few years. So actually it's growing from a good level. North America is absolutely one of the largest modernisation markets. So I would say it's growing from a good level already. And therefore I think the activity level is high there. Asia, on the other hand, is growing from a low level because the equipment base is quite young. So it's only – the modernisation market is only emerging there at the moment and that's where we see a good growth. So perhaps that's the difference between the two.

Omid Vaziri: And just to clarify, when you guide for a slight growth in modernisation for this year, you're basically saying – you are not expecting an acceleration in modernisation growth in North America?

Henrik Ehrnrooth: As I mentioned, the activity level is at a good level there already. And we're expecting a slight increase from there. So we're not expecting any further big jump, no.

Omid Vaziri: Okay, that's clear. And my second question is around the maintenance market in China. You are clearly well positioned. And it looks like you have taken some share in the maintenance market there. Going forward, can we just again hear your latest thoughts on whether Kone can take market share from the local service providers, given how competitive this market has become regionally? And also how, with what sort of support – what would help Kone to do that?

Henrik Ehrnrooth: I'll say in all markets the way to gain share, clearly the key way to grow in the service business is through conversions – when you have installed the new equipment to convert that to service. And that's clearly the best way to grow and the way we continue to grow in all markets. But at the same time, we're of course active in the market. And what is shown time and time again is that with great customer service, with a good service quality and being able to provide services that fits your customer's needs more specifically, that's how you gain share and how you can win from the market overall. Clearly in Europe there are more competition from small independent players, still a lot of those in North America as well. So there's a broad competitive market. And of course we want to compete against all of that with good services, good performance and providing good value to our customers.

Omid Vaziri: Thank you. And is it possible to just hear from you maybe two examples of what's a good service in China for winning service – for achieving high conversion rates in China is?

Henrik Ehrnrooth: When you have large customers in China, I would say there are two impacts, if I take a little bit broader your question. So there are two impacts of the market consolidating. So the bigger strategic customers who are taking more and more share, the top developers, they also – service is more important to them because they have of course brand and reputation to make sure it stays intact. Because they often own these buildings and then want to have the service as well. And there they are very good at understanding what your service performance is.

What is the uptime of the elevators, what condition are you keeping them in, how well are responding, how well are you keeping them informed of what's happening, what is your transparency and what is your overall customer service? So we can say customer service also has a very big impact on the satisfaction of customers in this industry.

So it starts from the basics. And then when you really understand what your customers are looking for, what type of buildings they have, what type of tenants they have and what the specific needs are, you can then cater to those specifically. And that is what we're doing and why we're performing well in that market.

Omid Vaziri: Okay, thank you. And we’ve clearly seen margin pressures on the maintenance business. Is this mainly because of lower pricing, more competitive environment or is it more of servicing costs rising in the region?

Henrik Ehrnrooth: And which market you talk about now?

Omid Vaziri: The Chinese maintenance market.

Henrik Ehrnrooth: The Chinese maintenance market, actually we have a good profitability there. But there are big differences and you need to make sure that you have the right segments and there you can have good profitability. If you go to the most affordable segments there, it may be more challenging. So it really depends on what you cater to. But I believe that if you develop in a good way, your customers will understand and appreciate the service, in particular as we can see in overall aging of the installed base there.

Omid Vaziri: Okay, thank you very much.

Operator: Once again, as a reminder please limit yourselves to one question. We'll now take our next question from James Moore from Redburn. Please go ahead.

James Moore: Well, good afternoon everyone and thanks for taking my question. Because I have three, so I'm sticking with one to choose raw material. Your EUR100 million guidance, you kept it unchanged. But you mentioned steel prices are rising. You say you've got as much of the available information in the full-year 2018 guidance as possible. But could you allude to how much of that EUR100 million or how much of the year is locked in, if you like? And whether we should think about the current raw material prices affecting the 2019 headwind and not 2018. And if so, do you have an early read on whether that could be another EUR100 million given what's going on in steel prices?

Henrik Ehrnrooth: Thanks for the question, James. So if I look at the total and just to summarise, so with that we expect about a EUR100 million impact from raw materials to 2018. And we are about – we normally lock our prices between three to nine months depending a bit on the components and what we're talking about. And we're roughly, I would say, halfway through locked for the year in our price base. And like you said, there's been a lot of volatility in the market. But at least in the beginning of the year we were able to push some of the impacts to the latter part of the year.

James Moore: Okay, thanks a lot. I get back in the queue.

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

Martin Flueckiger: Okay, good afternoon, gentlemen. Martin Flueckiger from Kepler Cheuvreux. Just coming back to that raw material question. If I understood you correctly, you were talking about 2018 only. But what about the impact for 2019? I realise it's still early days. But given the pretty steep increases in hot steel prices, it looks like it's going to be delayed into next year. Is that the case? Is that how we should think about it?

Henrik Ehrnrooth: So first, like I said, we have kept what we have said earlier the same. And it's partly about us being able to work with our suppliers and partly about the market development. If I look at forwards to 2019, so obviously the impact of product mix as well as the geographical mix plays a big role there. But all things being equal and trying to estimate what it would be for 2019, then we do expect that at current levels we have a slight headwind for 2019 if the prices remain at this level.

Martin Flueckiger: Okay, thanks.

Operator: Next question from Glen Liddy, JP Morgan.

Glen Liddy: Good afternoon. Just coming back to margins and costs against the backlog, so Q1 the margin and the backlog is down again, I believe. How long will it be before all that negative margin has washed through to revenue?

Henrik Ehrnrooth: Let me understand your question a bit. So we've said now for two quarters that the margin on orders received has stabilised. It's clear that we are now delivering orders that we booked first half mid-year last year. So those are coming through. And if I look at the margin that we're delivering on booking, now it's probably not a huge difference between the two.

Glen Liddy: Right. So if we look to next year, if nothing changes on your raw material or your costs, you would expect your margins to rise?

Henrik Ehrnrooth: Clearly, if you grow, then also you get leverage from your costs. And it's too early to talk about 2019, but I think the ambition of what we're driving for is pretty obvious.

Glen Liddy: Okay, thank you.

Henrik Ehrnrooth: Thank you.

Operator: We'll take our next question from Mattias Holmberg from Dnb Markets. Please go ahead.

Mattias Holmberg: Hi. Thank you for taking my question. Sorry to sort of nag on the raw material here again. But I was just wondering if you could give some clarity on how much of the EUR100 million headwind on EBIT that has impacted already now in Q1. And also if there is any of the remaining three quarters of the year that you see sort of will be taking a larger or a bigger share of this EUR100 million headwind please. Thank you.

Henrik Ehrnrooth: So thanks for the question, Mattias and no worries. For the EUR100 million, it's roughly evenly split out between the quarters. So that's how it plays out.

Mattias Holmberg: Thanks. I'll step back in line.

Operator: We'll take our next question from Antpi Suttelin from Danske Bank. Please go ahead.

Antpi Suttelin: Thank you. This is a big picture question on China where I'm really struggling to understand. When I look at the Chinese floor space starts, I can see that they increased 8% in 2016. Then they increased again by 7% in 2017. And now they increased again year over year in the first quarter. But elevators don't follow for some reason, indicating that intensity is going down. Now can you talk a little bit about what's going on? Why is Chinese elevator intensity going down?

Henrik Ehrnrooth: I don't think elevator intensity is going down. I think on this, there can be quite big differences in the timing. If you remember for how long the floor space starts went down and our markets were still growing. So I think it's difficult to draw direct conclusions out of these two. But I don't think there's an indication that the intensity of elevators and escalators would go down in buildings. I don't have an exact answer to that. Perhaps where you'll see a better correlation is if you look at total real estate investments because that's the real money going in the buildings that you are constructing, and buying materials and labour for them.

Antpi Suttelin: Yeah, but if the inventory doesn't go down, then it has to mean that at some point elevators should start to follow the increase, which is now – I mean, over the past two years we are talking about 15% to 16% or even more of growth in starts. When would you expect this turn in elevator demand to start to become visible?

Henrik Ehrnrooth: I think you have to look at really a start is a start. But you then need to see the physical – actually things happening on the site. And therefore I would more follow the real estate investments because it tells more how these sites and the starts are progressing and how much actual money is being used to build them further. So I don't have a perfect answer to your question. And we've just seen that where we see better linkages to our sector compared to other leading indicators.

Antpi Suttelin: Yeah, okay. Let's keep following the situation. Thank you.

Operator: Once again, if you'd like to ask a question please press star one. We'll take the next question is a follow-up question from James Moore from Redburn. Please go ahead.

James Moore: Oh yeah, thanks for taking the follow-up. So I've got two, if that's all right at this point. On the cash flow, could you break out the inventory receivable, payable and other working capital movements? I am just trying to understand the EUR93 million worse result than last year.

Ilkka Hara: Thanks, James. So if I look at the big picture for the working capital development, so first we did see an improvement in working capital in the previous year. And now it turned out to be the other way around. For example, unbilled revenue increased in this quarter. We saw a lot of starts and a lot of installations. And as the projects continue and progress, then you build them but no one item that is developing, as such, negatively. And, for example, receivables are developing quite okay. They contributed positively but not as positively as the previous year.

James Moore: If that's positive, what's the other EUR100 million? Is it inventory or payable or other?

Ilkka Hara: Well, also currencies play a role. So if you look at year-on-year comparisons, so from a working capital perspective, it's about EUR70 million impact that the currencies have year on year.

James Moore: Okay thanks. And the other question was a bigger picture question on your savings plan. Could you just remind us of the timing of when the savings will land? Are you still basically on the same path as before? And could you help us or remind us what proportion of those savings come from headcount-related actions versus sourcing and efficiency? I ask because I noticed your employees are up 6% year on year, which I wasn't expecting given your saving actions?

Ilkka Hara: Well, do you want to…?

Henrik Ehrnrooth: So I will address first the employees and you can savings. Why – where is actually the employees growing? And we have had this question before. And it's a good question. It's really because the service business in China and rest of Asia is growing quite fast. And remember, in last year again we hired about 2,000 new service technicians in China. So when the service business is growing faster, that is much more labour intensive and that's our own labour. On the new equipment side, on the installation side, it's principally subcontracted labour. But that's where you see, I would say, the majority of this increase is in service technicians.

James Moore: Good answer, thanks. And then just on the timing of the savings, maybe Ilkka, are you still happy with the balance of most of it being in 2019? Is the mix still the same?

Ilkka Hara: Well, I think maybe I got your question wrong but I'll answer what I think I heard. So first was question about how the savings are developing. And we've said that we have a number of initiatives ongoing to really look at how we can work smarter across the company, and therefore decrease the cost base. And we're aiming for at the end of this year to be in a position where we are having a EUR50 million run rate savings achieved.

Out of those savings we don't expect much of an impact this year yet as we need to still execute those projects. And then the total target for the programme is EUR100 million before end of 2020. So the remaining EUR50 million then will be split between those years. But as I said, it's still fairly early days, we are working hard and we'll keep you updated on how that split, as we get through this 2018 first.

James Moore: Thank you very much.

Henrik Ehrnrooth: Yeah. So we are progressing according to what we discussed in connection with the Capital Markets Day back in September.

James Moore: Thanks, Henrik.

Operator: Our next question is a follow-up question from Martin Flueckiger of Kepler Cheuvreux. Please go ahead.

Martin Flueckiger: Yeah, thanks for taking my follow-ups. Actually also two very quick ones. Firstly on EMEA, it looks like Kone is getting market share, particularly in the EMEA and also a little bit in China. Can you highlight the main reasons why you think that is, what you've been doing there and why you think you're being so successful? And in that respect, are we supposed to assume that the strong sales growth in the EMEA is more or less sustainable throughout 2018? That will be my first question.

Henrik Ehrnrooth: Let me address the market share question and then I'll hand over to Ilkka to talk about the sales growth in EMEA. So while I'm very happy about our orders received growth in Q1 and it shows we had a very good performance, after a good performance in Q1 just remember in one quarter all numbers is a short period of time. What I'm happy about is our performance was good broad based. I think when you look at market share you want to look at it over a longer period of time. And there we could see EMEA overall we gained some share last year. But this is one quarter and we don't measure our market share in just one quarter. But overall I would say the performance was good.

And then Ilkka, on the revenue growth in EMEA for the year?

Ilkka Hara: Yes. Well, the overall – so first I just wanted to clarify as we started the discussion first in the quarter. So if we look at the EMEA sales growth, which was 19.8% in the quarter, it's clearly one which has now impacted about the number of starts that we saw very strongly coming into the first quarter. And we are expecting that to even itself out during the first half. So clearly then seeing a lower growth in the second quarter as we get through with the project, as it normalises more.

And overall for the year, so we are expecting a good growth in sales. But it's good to remember that the maintenance business contributes more in EMEA, so that's much more stable than new equipment business overall.

Operator: Our next question comes from Ryan Gregory of Liberum Capital. Please go ahead.

Ryan Gregory: Hi, thanks for taking my question. I just had a follow-up on the working capital question from earlier. How do you see working capital progressing through the rest of this year, given the FX headwinds you're still seeing?

Ilkka Hara: So, where overall we got conversion[?], we are expecting that to recover in the coming quarters. And that's a similar comment on working capital. So now we saw a bit worse development in working capital compared to previous year; expecting that to then recover in the coming quarters.

Ryan Gregory: Okay, thanks.

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

Guillermo Peigneux: Thank you for taking my follow-up. And just regarding restructuring, are you happy with the current initiatives, or at what point would you basically study or try to analyse whether you need further restructuring to deal with the current cost pricing environment? Thank you.

Henrik Ehrnrooth: We are happy with our current initiatives. We have to remember that that is Accelerate programme, the principle reason for that programme is how we can speed up our ability to bring new services and solutions to the market. I mentioned we are in an environment where markets are moving and shifting quite fast. And you know what, this shift and moving of markets, that creates great opportunities. So these changes bring opportunity.

And we just want to be faster in capturing them. That's why we are working on providing better resources for our frontline organisations to spend even more time at the customer-facing end. And therefore we take a number of these functions that are not customer-facing and bringing some of those centralised. And I think those are very important and good actions. And what we will get from that is both ability to serve our customers better, be faster in bringing new services to the market, but at the same time gain efficiencies.

And we want to look at each three of these because then we really tie them to our strategy and how we develop Kone going forward. And I must say I am quite happy with the initiatives we have at the moment. And I think that they will have a good impact.

Guillermo Peigneux: Thank you. And my last follow-up is regarding China margins. I think in the past you mentioned that the China margins for equipment was significantly higher or higher than the group average. I just wonder whether this kind of gap has been diminishing over the last two years. Thank you.

Henrik Ehrnrooth: Clearly it’s been diminishing, that gap, that it was way much higher. There's still very good margins in China, not quite as good as they were some years ago.

Guillermo Peigneux: Thank you.

Henrik Ehrnrooth: Thank you.

Operator: We'll now take a question from Daniel Gleim of Main First. Please go ahead.

Daniel Gleim: Thank you very much. I have two clarification questions. The first one is on Ilkka's remarks with regards to the recovery of the networking capital. Were you referring to the absolute networking capital number or the cash flow contribution from networking capital?

Ilkka Hara: I was more referring, first, at the cash conversion level overall in our cash flow.

Daniel Gleim: So networking capital will become again a positive contributor to free cash flow? Is that the right read?

Ilkka Hara: Well, this also we said that we had quite a good business terms when it comes to overall working with our customers and getting paid with those. We do see opportunities when it comes to working capital on managing our receivables better. As long as you have receivables you can always do it better. And then obviously we need to work closely with our suppliers as well. So I see opportunities, but from advances payment perspective I don't expect that the rate will improve much going forward.

Daniel Gleim: And the second question would be on the lead[?] periods for the stabilising order quality that you're seeing at the moment. I think Henrik was referring to you've been converting orders for sales at the moment that were taken in as orders at the mid of last year, i.e. less-than-a-year lead period. Is this the right reading or was it simply a misunderstanding?

Henrik Ehrnrooth: I think I said first half to mid last year. But yes, I think that it varies. I think most markets these times are pretty stable. And clearly with the new revenue recognition, we start recognising the revenue earlier. It's then a question when it's completed. But actually we are also seeing some markets where actually lead times are getting shorter, like China. Because we can see that when our customers – when liquidity situation is tight they want to order as late as possible and then get quick deliveries.

And that we're seeing and that's why we have had also good deliveries, good delivery growth from China. So that is also a competitive advantage in that market in being able to deliver fast. And that's what many customers are starting to ask for there. So overall, not a big change.

Daniel Gleim: Very clear, thank you very much.

Operator: Our next question comes from Tomi Railo of SEB. Please go ahead.

Tomi Railo: Hello, this is Tomi from SEB. Can you give a comment on the Chinese maintenance growth in the first quarter?

Henrik Ehrnrooth: Yeah, so our sales growth continued to be good double-digit growth in China. Our number of units under contract increased again by over 20%. And you asked what is the gap between the two. So our service revenues on contracted revenue is increasing at a good rate. But then what is quite stable is the revenue from the so-called first service contract, which is what is part of the new equipment sales, but we then record as service revenue as they get for the first period. So that part of revenue is quite stable whereas the contracted revenue is then growing at a good rate.

Tomi Railo: Thank you.

Operator: Our final question is a follow-up question from Martin Flueckiger of Kepler Cheuvreux. Please go ahead.

Martin Flueckiger: Yeah, thanks gentlemen for your patience. Just a follow-up, just trying to get this a little bit more structured in my head. Your sales growth performance in Q1 for both EMEA and the group, what would it have been at constant exchange rates without the adoption of IFRS 15?

Ilkka Hara: Literally, there's no number that I can tell you without IFRS 15 because we changed the systems to reflect the new revenue recognition. It's clear that the number of starts was stronger than normally. And if we look at that, we start to recognise the revenue as we completed the work. So though it would have had a negative impact, but it's – I don't have the numbers to tell you unfortunately.

Henrik Ehrnrooth: It probably would have been somewhat lower, but we don't know how much lower.

Ilkka Hara: Yeah.

Martin Flueckiger: Okay, thanks.

Operator: We have no further questions at this time.

Essi Lipponen: Okay, so as that was the last question for today, we are now ready to close the event. Thank you all for the active participation and good questions. And have a nice rest of the week.

Henrik Ehrnrooth: Thank you.