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Otis Worldwide Corp. (OTIS)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Otis' First Quarter 2024 Earnings Conference Call. This call is being carried live on the Internet and recorded for replay. Presentation materials are available for download from Otis' website at www.otis.com.

I'll now turn it over to Michael Rednor, Vice President of Investor Relations. Please go ahead.

Michael Rednor
Vice President, Investor Relations, Otis Worldwide Corp.

Thank you, Sara. Welcome to Otis' first quarter 2024 earnings conference call. On the call with me today are Judy Marks, Chair, CEO, and President; and Anurag Maheshwari, Executive Vice President and CFO.

Please note, except where otherwise noted, the company will speak to results from continuing operations, excluding restructuring and significant nonrecurring items. A reconciliation of these measures can be found in the appendix of the webcast.

We also remind listeners that the presentation contains forward-looking statements, which are subject to risks and uncertainties. Otis' SEC filings, including our Form 10-K and quarterly reports on Form 10-Q, provide details on important factors that could cause actual results to differ materially.

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

Judith F. Marks

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

Thank you, Mike, and good morning, afternoon and evening, everyone. Thank you for joining us.

Starting on slide 3. Otis started the year off with a solid first quarter, again confirming and demonstrating the continued strength of our Service-driven business model, as we outlined during our Investor Day in February. Through the hard work and commitment of our colleagues across the globe, we achieved mid-single-digit organic sales growth driven by our Service business.

We expanded adjusting operating margins by 80 basis points with both Service and New Equipment operating profit margins expanding 70 basis points and 20 basis points, respectively. With another quarter of maintenance portfolio growth above 4% and solid Modernization sales, we delivered 6.5% Service organic sales growth. Mod orders increased 12.9% in the first quarter with growth across all regions, while challenging market conditions in New Equipment continue. Delivering operational excellence across the organization drove 10% adjusted EPS growth.

This quarter, we executed our capital strategy with excellence. We continue to work to repatriate cash from overseas and use it for the benefit of our shareholders. As such, we were able to repurchase $300 million of shares in the quarter. Additionally, yesterday, we announced a 14.7% increase to our quarterly dividend. We have nearly doubled our dividend since spin, emphasizing the importance we place on delivering shareholder value.

We also made important progress towards our environmental goals. Earlier this month, the science-based targets initiative approved our near-term science-based greenhouse gas emissions reduction targets. This is a meaningful step on our sustainability journey, and our steady progress meeting our commitments will be shared in our next ESG report expected to be published later this year.

Turning to our orders performance on slide 4. New Equipment orders were down 10% in the first quarter as anticipated due to the tough compare versus the prior year. Double-digit growth in EMEA and mid-single-digit growth in Asia Pacific were more than offset by a double-digit decline in the Americas and high teens decline in China. Nevertheless, our New Equipment backlog at constant currency was roughly flat versus the prior year and up slightly versus the prior quarter.

Service segment, we continue to deliver consistent solid performance with another quarter portfolio growth above 4% and demonstrating the value of modernization as a new strategic imperative, 13% orders growth and 15% backlog growth at constant currency, setting us up well for modernization sales through the rest of the year and into 2025.

Reflecting the hard work of our colleagues around the world, let me highlight a few orders we received during the quarter. In China, Otis Electric will provide 46 escalators and 9 elevators for an expansion of the Shenzhen Metro Line 5. The elevators and escalators will be installed at three new stations connecting to the city's grand theater, where passengers can transfer to two other metro lines.

In Canada, Otis will provide 19 elevators at the South Niagara Hospital, a 12-story facility that will consolidate and expand acute care services in the region. It's designed to meet the Canada Green Building Council's LEED Silver standards and is an important step towards becoming the first well-certified hospital in Canada. These elevators will be equipped with Otis ONE, EMS Panorama and autonomous mobile robot system integration.

In Japan, Otis is modernizing 6 elevators and 6 escalators at the Hamamatsu Act Tower in Hamamatsu City. We look forward to continuing to service the 212-meter tall tower as we've done for nearly three decades. And in the United Kingdom, the National Health Service of Wales has been an Otis customer since 2018 and has recently renewed their service contract, covering 450 elevators across many health facilities in the country for an additional five years. Building upon our trusted relationship, we will now modernize 19 elevators at the University Hospital, Wales and Cardiff.

Turning to Q1 results on slide 5. We delivered net sales of $3.4 billion in the first quarter, with organic sales up 3.8%. Despite dynamic market conditions, we have delivered organic growth every quarter since the end of 2020. Adjusted operating profit, excluding a $7 million foreign exchange headwind, was up $50 million with both segments contributing. Adjusted EPS grew 10% or $0.08 in the quarter, driven by strong operational performance, improvement in the tax rate, early results from UpLift and the benefit of a lower share count offset headwinds from foreign exchange translation and increased interest expense.

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

Anurag Maheshwari

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

Thank you, Judy. Starting with segment sales performance on slide 6. Otis New Equipment organic sales were roughly flat in the first quarter when compared to the prior year. Americas grew mid-teens and solid backlog conversion, EMEA and Asia Pacific both grew low-single digits, driven by growth in key markets, and China experienced a double-digit decline due to the lower backlog and weaker market conditions that Judy mentioned.

New Equipment pricing was strong in the Americas, EMEA and Asia Pacific in the first quarter, up low to mid-single digits. In China, while the pricing environment remains challenging, we continue to drive productivity and capitalize on lower commodity prices.

Service sales were $2.2 billion in the first quarter with organic sales growth of 6.5%, reflecting growth across all regions and in all lines of business and marking the 12th consecutive quarter of mid-single-digit or greater organic sales growth.

Maintenance and repair continues to perform well, up 5.8% from portfolio growth, robust repair volumes and maintenance pricing, which was up more than 3 points excluding the impact of mix and churn. On Modernization, double-digit growth in China and Asia Pacific drove organic sales up approximately 10% in the quarter.

Turning to segment operating performance on slide 7. First quarter New Equipment operating profit of $71 million, was up $6 million at constant currency. Favorable pricing, productivity and commodity tailwinds more than offset mix headwinds and drove 20 basis points of margin expansion.

Service operating profit of $523 million, was up $47 million at constant currency as drop-through on higher volume, favorable pricing and productivity more than offset annual wage inflation. This led to margin expansion of 70 basis points for the segment.

Additionally, the ramp of UpLift initiatives alongside cost controls, improved our SG&A as a percent of sales by 50 basis points year-over-year. All in all, we expanded overall adjusted margins by 80 basis points and grew EPS 10%.

Shifting to cash. We generated $155 million of adjusted free cash flow in the first quarter, reflecting a build in working capital, following a snapback from a strong Q4 and the timing of billings in the quarter.

We are off to a good start. The strength of our Service business, including the execution of our Modernization strategy, combined with productivity efforts and the UpLift program more than offset the subdued New Equipment markets. As a result and with good line of sight through the rest of the year, we are raising our profit guidance.

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

Judith F. Marks

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

Now on slide 8. Before I discuss our updated 2024 financial outlook, let me briefly update you on our global market outlook.

For the New Equipment market, our expectations for the Americas and EMEA remain unchanged, down low-single-digit in units. We now expect Asia to be down mid-single digits in units versus the prior outlook of down low to mid-single digits due to weakness in China. There is no change to our outlook for Asia Pacific as India, Southeast Asia and the major infrastructure pipeline remained strong. We're revising China to be down high-single digits to down 10% as activity remains sluggish.

Although New Equipment markets remain challenging, Service market strength continues with low single-digit growth in the Americas and EMEA and mid-single-digit growth in Asia, driven by China. Installed base growth is driven by units that were booked roughly two years ago, installed over the past year or so and are now starting to roll off their warranty period. Therefore, we still anticipate the global installed base to add roughly 1 million units, a growth rate of mid-single digits.

Turning to Otis' 2024 financial outlook. We expect net sales in the range of $14.5 billion to $14.8 billion, with organic sales growth of 3% to 5%, overall unchanged versus the prior outlook, although we made some modest changes within the segments, which Anurag will discuss in a moment.

Adjusted operating profit is expected to be up $135 million to $175 million at actual currency and up $160 million to $190 million at constant currency, up $10 million from the low end of the prior outlook. Adjusted EPS is now expected in the range of $3.83 to $3.90, up 8% to 10% with $0.03 improvement versus the low end of the prior guide.

We anticipate adjusted free cash flow to come in at approximately $1.6 billion. In addition to returning nearly all free cash flow generated to shareholders, we're also performing well on our cash repatriation programs, and we are raising our target share repurchases to approximately $1 billion for 2024.

In addition, we are acquiring the remaining minority interest in Nippon Otis in Japan for approximately $70 million with cash. This will be about $0.01 accretive to EPS in 2024 and another $0.01 in 2025.

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

Anurag Maheshwari

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

Taking a more detailed look at our outlook and starting with sales on slide 9. We expect total organic sales to remain consistent with our prior outlook. For New Equipment organic sales, we still expect to be roughly flat, with no change to our outlook in EMEA, up low single digits. However, driven by a weaker market, we now expect China New Equipment sales to be down approximately 10%, offset by better-than-expected backlog conversion in the Americas and Asia Pacific.

For Service, in-line with our prior guide, overall organic sales are anticipated to grow 6% to 7%, including maintenance and repair within a range of 5.5% to 6.5%. For Modernization, we anticipate organic sales growth of 8% to 9%, an increase versus the prior outlook of approximately 8% as we continue to execute on the expanding backlog.

Turning to slide 10. At constant currency, operating profit should grow $160 million to $190 million, an increase of $5 million at the midpoint versus prior expectations due to continued strong contributions from Service. On Service, we now expect operating profit margin at the high end of the prior guide, up approximately 50 basis points for the year due to solid first quarter performance.

For New Equipment, net of the previously noted puts and takes, we still anticipate adjusted operating profit margin to be flat to up 10 basis points. Better flow-through of pricing from the backlog is offsetting the added mix impact from the weaker China outlook. We expect overall adjusted operating profit margin expansion of 50 basis points as a result of Service volume, productivity and pricing tailwinds alongside ramping UpLift benefits.

Turning to cash flow. There is no change to our outlook, and we expect to achieve adjusted free cash flow of $1.6 billion, largely driven by net income growth. In addition, our continued efforts on cash repatriation gives us confidence to repurchase $1 billion in shares up from $800 million previously. This, combined with the recently announced increase in our dividend, allow us to return approximately $1.6 billion of cash to shareholders, up from $1.35 billion in our prior outlook.

Moving to the 2024 EPS bridge on slide 11. We have raised the low end of our guidance for adjusted EPS by $0.03 to a range of $3.83 to $3.90. That is over $0.30 of EPS growth at the midpoint, driven almost entirely by growth in operating profit.

Before we turn to questions, let me provide some more color on the second quarter. Starting with Otis. We expect New Equipment to be down mid- to high-single digits, reflecting the more challenged market conditions, though with backlog holding steady sequentially. Within Service, maintenance portfolio growth should remain above 4% and Modernization growth or Otis growth should remain above 10%.

For sales, we expect New Equipment to be down roughly mid-single digits organically due to China headwinds and a tough compare with approximately 10% growth in the prior year. Service should continue at roughly the same organic growth rate as Q1, netting to low single-digit overall organic growth for the quarter. Based on the recent deterioration in FX rates, we anticipate a headwind when compared to the prior quarter, netting to roughly flat sales versus the prior year.

Turning to profit. New Equipment margins are anticipated to come in right around 7%, while Service margins are anticipated to be roughly the same as Q1 or slightly higher.

Below the line due to the timing of certain tax benefits, the tax rate is expected to come in around 20%, and this benefit in combination with the lower share count will more than offset the headwind from higher interest costs. Absent further Forex volatility, this should lead to approximately $0.10 of EPS growth or another quarter up 10%

or greater. This implies first half EPS growth of roughly $0.20. And when adjusted for the tax rate impact, EPS growth should be fairly level loaded between the first and second halves of the year, largely driven by operating profit growth.

In closing, first quarter results further demonstrate our ability to execute our strategy to create momentum to perform for the remainder of the year. Growing our portfolio, leveraging our steady New Equipment and expanding Mod backlog and ramping on the UpLift program, alongside continued operational performance, set us up well to achieve our financial outlook and return $1.6 billion cash back to shareholders.

With that, Sara, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question comes from the line of Rob Wertheimer with Melius Research. Your line is open.

Rob Wertheimer
Analyst, Melius Research LLC Q

Thank you. Good morning, everybody. Happy to be here.

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

Good morning, Rob.

Rob Wertheimer
Analyst, Melius Research LLC Q

So my question is just around Mods, where sales and orders are showing obviously healthy double-digit-ish growth. Would you talk a little bit about margin in those orders in the backlogs and the drivers of it? I know you're working on standardizing production on the product and a bunch of stuff, I don't know if price is a positive driver there in the backlog as well as you kind of continue on that journey to bring margins up and above? [indiscernible] (00:18:53)

And I wonder if you could just talk a little bit about what the environment is out there for that product? Is there a lot of customer pull on it? Do you have solid demand where you can kind of embrace pricing, maybe just the demand environment around that? Thank you.

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

Sure. Thanks, Rob. Listen, Mod was up nicely in all regions. I think our strategy is on track. Our team is executing that strategy. And these are still early days in what will be probably more than a decade-long Mod growth market. So we're really encouraged by what we're seeing. Orders up almost 13% in the quarter, backlog up 15%. So now we're just building on quarter after quarter of double-digit growth.

The standouts, we really saw in the quarter from the demand side, Asia Pacific and Americas, were up really nicely, but Asia Pacific was the standout and China did well, too, double digit. So everyone, again, all regions are up. We're seeing a mix of major projects and just really good volume package demand by customers and we're performing well.

In terms of the margin, I'll turn it over to Anurag for help with the backlog, but what I think is important, what we shared at Investor Day was that we would shortly be surpassing – Mod margins would be surpassing New Equipment margins. I'm really pleased to share that in Q1, we saw that inflection point and Mod margins are now higher than New Equipment margins. Anurag, let me let you add some color.

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

A

Yeah. Thanks. Just to add to that, so in a few quarters ago, we said that we should be higher than the New Equipment margin. We are here right now, modestly higher, as Judy said, one quarter does not make a trend, but we are very encouraged by what we are seeing in terms Mod margins. And as the year goes by, we should see more of the expansion on Mod margin and more differential between that and New Equipment.

What's driving the Mod margin expansion is more of us becoming more productive on the cost side, right? The initiatives that we mentioned around standardization, be it across the supply chain, be it the factory, be it the product and doing field installation at a lower cost, all of this is helping out and it's really driving the margin expansion. So it's more on the productivity side that we control. But we've got to do a lot more than that and let's see how the year plays out, but very encouraged.

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

A

Yeah. And the last thing I'll add, Rob, is that Mod market has potential of several million units in every one of our regions. So this won't be lopsided growth. We anticipate significant growth by all regions.

Michael Rednor
Vice President, Investor Relations, Otis Worldwide Corp.

A

Perfect.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you.

Operator: Your next question comes from the line of Julian Mitchell with Barclays Capital. Your line is open.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi, good morning. Just wondered when you're looking at the overall sort of global picture on New Equipment. The backlog was flat at constant currency year-on-year, with TTM orders down. It seems like TTM orders should be down again in the second quarter. Just wondered how you're thinking about the year as a whole, if you could frame up sort of any expectations in New Equipment around, say, book-to-bill and how we should think about the confidence in the New Equipment backlog not shrinking year-on-year over the balance of the year?

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

A

Yeah. Thanks, Julian, for the question. Listen, as we said, Mod was down about 10% in the first quarter, second quarter – sorry, New Equipment was down 10% in the first quarter, expected to be down mid- to high-single digit in the second quarter. So as the year kind of progresses, the compares do get better in the second half of the year because we started seeing the slowdown on the New Equipment side, especially in Americas and EMEA more towards starting from 2Q of last year. So let's see how that progresses.

If we perform in line with what the market does, the backlog on New Equipment could be down a couple of points. If we do better than the market, then it could be flattish. So there is a possibility that the New Equipment backlog as we end this year, could be flattish-to-down low-single digits.

And as we kind of mentioned at the Investor Day, if you look forward to the next few years, clearly, we're expecting New Equipment to be flattish. But where we see a lot of growth coming in is on the Mod side. And the Mod backlogs are up 15%. If we continue to perform well in the Mod – New Equipment and Mod as we end the year, that backlog should be up low-single digit as we enter into 2025.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

That's helpful. Thank you. And then just maybe, my second question on the Service margins, very good performance in the first quarter, up 70 bps year-on-year. Based on what you said about the second quarter could be up similarly year-on-year sort of 60 bps, 70 bps in Q2 and the first half. So that guide of plus 50 bps of margin for the year, is that just reflecting sort of it's still only April a long way to go? Or is there anything specific happening with costs or technician wages or something in the back half? Maybe just any update around that wage inflation headwind?

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

Yeah. Let me unpack a few of those questions, Julian, and start with Service margins. It is early in the year, but what we're seeing, again, with the portfolio growth of 4% plus what we're getting in Service pricing like-for-like over 3 points, we're feeling good there. We do have a mix coming into play a little bit as Mod revenue grows, and it grows a little faster than maintenance and repair. There's a little bit of a mix there that we've kind of factored in to that margin outlook. But we've done – our team has done a fantastic job on the productivity side, especially in the field and on driving repairs and the repair backlog as well, especially in the Americas.

So right now, we'll continue to watch it. We feel comfortable at the 50 basis points. This is our 17th straight quarter of Service adjusted operating profit increasing, and it is the engine, as you know, to our model and our service-driven business model.

Wage inflation, we're not seeing anything unusual. And obviously, we focus on productivity to offset that.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Great. Thank you.

Operator: Your next question comes from the line of Nigel Coe with Wolfe Research. Your line is open.

Nigel Coe
Analyst, Wolfe Research LLC
Q

Thanks. Good morning, everyone. So as a proud Welschman, I was very pleased to hear Wales getting called out a couple of times there, so thanks for that, Judy. So it's not – it doesn't happen very often on these calls. So...

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

A

I know. It's fun selecting them, Nigel.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Yeah, I appreciate that. The 2Q color, quite unusual for you guys to give so much color on the quarter. So I'm just wondering, is this like a new world we're in here where you're going to give us a bit more kind of quarterly color, or is there just some unusual stuff happening in the second quarter and [indiscernible] (00:26:32) you wanted to call out?

And then, maybe in the spirit of maybe helping us to fill out the model, perhaps, below the segment line, I mean, tax rate seems like it's coming a bit lower. But anything on corporate expenses that we should bear in mind as well?

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

A

Yeah. Thanks for the question, Nigel. The reason, we gave a little bit – we typically give quite good color on the New Equipment and Service, how it's trending for the quarter. Gave a little bit more color this time was exactly the question you asked, was on the tax rate, which was much lower in the quarter, coming in at 20% for the full year. The guide is roughly the same at 25.5%, but because of planning and discrete items, they shift quarter to quarter. So, wanted to kind of highlight the fact that where tax was coming in for the quarter. And obviously, the team is doing a really good job in terms of managing it through the course and bringing it down in years to come.

On the corporate expense, yes, it's going to be a few million dollars high in the quarter, probably 0.9% to 1% of revenue. As we look at this year, nothing unusual there, except for Forex, we do have some Forex headwinds and that does get reflected in our corporate expense. So that probably increases by 5 basis points to 10 basis points.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. That's really helpful. And then on the free cash flow, I understand it's mainly AR timing, but is there anything in the mix of business, I don't know Mods mix or anything else that may be leading to a lengthening in the billing cycles there? Just curious seeing AR increasing from 4Q to 1Q. Anything to call out there, or was it just timing?

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

A

Well, it's essentially timing. I mean if you look back at the past few years, we have more than 100% conversion. We are confident that we will get to the 100% conversion this year. We built up a couple of hundred million dollars of working capital, a part of – a little bit of it was because of lower down payments due to lower New Equipment orders, but a larger part of it was just the timing of billings through the course of the quarter, where a lot happened in the month of March. We've already started unwinding that in the second quarter, we'll get to the $1.6 billion, and the confidence is reflected in the dividend and us increasing our share repurchase of $800 million to $1 billion. So no real structural change in terms of collection or in terms of cash flow generation.

Nigel Coe
Analyst, Wolfe Research LLC

Q

That's great. Thank you.

Operator: Your next question comes from the line of Steve Tusa with JPMorgan. Your line is open.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hi, good morning.

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

A

Hi, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

I think that there has been, from your peers a little bit of chatter around China and pricing there. Can you maybe just clarify what you're seeing on the ground?

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

A

Yeah. Let me break it into New Equipment and Service pricing. China is by far the most competitive pricing market we are in anywhere in the globe, and it's the only region where we are not getting price for New Equipment.

Now we've offset that with both productivity and a great job on commodities, where we've seen – we've locked in and we've seen steel prices, which are 80% of our commodity purchases come down. But it is extremely competitive. And we see that through the public bids, we see that through the volume bids, and we just see that through the segment. I mean the segment itself, the New Equipment market is weak. It's down 10% in the quarter, and we're calling it down high-single digit to 10% for the year, and that's after really two years of it already being down.

So if you ask us, Steve, we would tell you that the China segment for 2024 will be at about 450,000 units, and we expect New Equipment pricing to remain competitive. Again, focusing – we focus, we brought in some new product innovations in the quarter, and we'll continue to exercise and work with our dealers and our agents and distributors and increase our sales channel and continue to grow share.

On Service pricing. Service pricing, again, in China is kind of flattish. And – but the drivers are less price in Service and more on productivity, volume, density and Otis ONE and Otis ONE is really a nice contributor for us. We grew our portfolio in China. We're now at 400,000 units and more than half cover with Otis ONE, and that's driving some significant productivity challenges. But we are – price in China is challenging.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

When you say challenging, I mean, can you give us a little bit of magnitude around that? I mean, is that down 5%, down 10%, like just any kind of magnitude on a year-over-year basis?

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

No. I mean it's been challenging. This is year three of challenging pricing there. Again, Sally and the team are just focused on productivity, on commodities, on everything we can in terms of getting cost out of our products even from an engineering perspective and installation. So I think we've done a really good job there staying as neutral as we can in terms of price/cost.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay.

Michael Rednor
Vice President, Investor Relations, Otis Worldwide Corp.
A

Perfect. Great.

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

And Steve, just to add to that, right, so because it's a deflationary economy, the input costs are coming down. But if you look at the overall New Equipment backlog for us, even after having about $20 million of pricing tailwind in the quarter, flushing through the P&L, our backlog margin for New Equipment is still higher relative to last year. I mean Americas, EMEA at mid-single-digit price increases, Asia Pacific low. So really, really good progress in terms of backlog margin, building it up and flushing it through the P&L as well.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Yeah, that makes a lot of sense. All right, thanks, guys.

Operator: Your next question comes from the line of Joe O'Dea with Wells Fargo. Your line is open.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC
Q

Hi, good morning. Wanted to just start on your observations of ABI and Dodge Momentum, most recent prints, how that aligns with what you're seeing in the market, clearly, some softening in those lead indexes. While at the same time, your Americas New Equipment outlook actually improving a little bit since prior. And so whether this is the result of just kind of long lead times on projects or if there's any kind of incremental softening that you're seeing on the ground out there in North America?

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

Yeah. So in North America, I would tell you that the New Equipment market segment that we saw in Q1, it remained weak but it was at a lesser pace than the weakness we saw in the second half of 2023. And you saw we delivered – we increased price and we delivered on the backlog significantly because our revenue was up 15%. Our orders challenge in the first quarter was a really tough compare. North America to us is Canada and the US. We had several major, major infrastructure orders in Canada first quarter last year. So I would tell you it's more of a compare.

We are expecting more New Equipment stability in 2024 than in 2023. But the latest ABI data at 43.6%, I mean this is the lowest since December of 2020 and now another quarter of less than – less below 50%, which means things are contracting similar Dodge is down.

So we're watching it carefully, Joe. What I would tell you is all verticals this quarter in North America were down. Commercial was down more than resi. Resi is becoming more stable. And for the part of infrastructure where we compete and where we are successful, that has been more stable as well.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

That's helpful. And then just on capital deployment and increasing the share repurchase for the year, it sounds like some opportunities there related to repatriation. My question is just related to the M&A side of things, what you're seeing on opportunities there, the pipeline just expectations for being able to execute on any bolt-on opportunities this year?

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

A

Yeah. Well, as Anurag shared on the cash repatriation, Kudos to our team, this is the first time I think we've made a significant decrease in our cash balance, bringing it down from $1 billion to $900 million and continuing to focus on how we can do that since spin. So that's allowed us to repatriate $300 million and gave us the confidence between the cash and the repatriation to increase. This is the first time we're doing – we've announced a share repurchase that starts with $1 billion since spin. So it's our fourth year patriot – of cash buybacks – of stock buybacks. But we're feeling confident there.

In terms of M&A, the bolt-on business is still healthy. We've got a good book of business. It's just kind of timing when those get closed. We outlook every year, about $50 million to $100 million of bolt-ons. For us, they have to – eventually, they have to be accretive. They have to as well be – give us the density and be in the right locations and have one of our teams that knows how to integrate them well. And I think we've proven that year after year and decade after decade.

In terms of anything else, generational, obviously, we've got a strong balance sheet. These opportunities don't come up frequently in the elevator and escalator market. And we will continue to evaluate anything that comes to market. But I – again, being the leading provider, our Service strategy is working, our capital strategy is working, our operational strategy is working. So we don't feel the need to have to do a generational M&A, but of course, we'll take a look at it.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Thank you.

Operator: Your next question comes from the line of Nick Housden with RBC Capital Markets. Your line is open.

Nick Housden
Analyst, RBC Europe Ltd.

Q

Yes. Hi, Judy, Anurag, Mike. Just on the outlook for Modernization. The sales growth guidance was tweaked up to 8% to 9% growth but that's against a backlog that's up 15%. So I mean I'm just trying to understand what the relationship is between backlog growth and maybe the next 12 months of sales growth that we can expect to see there? Is it just to do with conversion times, why it wouldn't be a little bit higher than that?

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

Yeah, you got it. It's more around the conversion time, right? So if you look at our Modernization sales growth, it's actually been picking up every quarter. There's no reason why it should not be going up double-digit in the next three to four quarters. And as the sales conversion catches up with our backlog. And part of it is the same thing which is driving our margin increase. I think it's more around standardization of products, reducing the lead time from the factory, reducing the lead time to install it. I think those are drivers which will help us get there. So it's ticking up in the right direction, but where it should kind of mirror is where the backlog grows at, and we should be there in the next few quarters.

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

Yeah. Nick, what we've done is we've taken everything we've learned in New Equipment, Service over four years, whether that's go-to-market strategy, whether that's sales specialization driving common installation beyond industrializing the packages, the supply chain and everything else. So we're really encouraged by the continued Mod trajectory. And as we said, we're going to continue to expand margins there and focus on backlog conversion.

Nick Housden
Analyst, RBC Europe Ltd. Q

That's great. And then just on the Service pricing, I think you said a couple of times that it was 3 points in the quarter net, maybe I'm misremembering, but I think previously you'd commented saying that you were expecting 100 basis points of net pricing for 2024. So I'm just wondering where the extra 2 points has come from?

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

Just to clarify, the 300 basis points that we spoke excludes mix and churn. So it's a gross pricing. The net for the quarter was a little bit higher than being flattish over there, but it's consistent to what we are seeing in pricing in the Service business. So EMEA is seeing mid-single-digit price increases. Americas close to that. Asia Pacific has always been on the lower side. So from a pricing perspective, it's sticking well in the market, and we're seeing good traction over there.

What's really helping our Service margins to grow besides that is clearly more on the productivity side. And with the productivity because of that, we kind of increase the profit on the Service business for the year.

Nick Housden
Analyst, RBC Europe Ltd. Q

Great. Thank you very much.

Operator: Your next question comes from the line of Miguel Borrega with BNP Paribas. Your line is open.

Miguel Borrega
Analyst, Exane BNP Paribas

Q

Hi, good morning, everyone. I've got two questions. The first one, just on China. For several quarters now, you mentioned three years in a row that you're seeing price pressure. I know you're offsetting with lower product costs, but where do you think the price – that the floor of pricing is? When you look at your competitors that are putting pressure on pricing, how long do you think this will keep going?

And then long term, where do you think margins in China New Equipment will ultimately converge to, if you think they will end up at Western levels? That's my first question.

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

A

Yeah. Let me start, and Anurag will add on the margin side. But Miguel, we – listen, I'm not here to declare a trough. As soon as we see that in terms of the competitive pricing and the segment, we will share that but we're not predicting it this year as you can tell with our outlook. Again though, I can say, having been in China in March and meeting with multiple government officials as part of the China Development Forum, there are efforts underway. The government is taking action. It has not changed sentiment or the liquidity easing yet. But as that happens, obviously, our team will respond. They'll respond quickly, and where we have the ability to see price inflect, I believe you will see us do that as we have led in pricing in China many times. Margins?

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

A

Yeah. Just exactly. It's a balance between the pricing and the share of segment, and I think we look at both. In terms of margins for us, if pricing is coming down in China, as we earlier mentioned, it's also commodity prices. We've seen tailwinds over there, and we're taking cost out and seeing more supply chain efficiencies. So we are maintaining our margin rates in China. And as we go forward, between price, between share, between margin, we're going to find a balance between all three of that so we can continue to grow our profitability as we move along.

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

A

Yeah. And that's really what you're seeing, Miguel, with us really now. Service now being 25% of our revenue in China and growing. The Mod element of that grew double-digit last quarter. That's going to continue to grow and continue. So you'll see this trade we normally do between volume, price in every market, but in China, explicitly, we see it moving to becoming more of a mature market and reflecting that, especially in Service.

Miguel Borrega
Analyst, Exane BNP Paribas

Q

That's great. Thank you. And then just a follow-up on capital allocation. So after you upped the dividend and buyback, I know you're buying the minorities in Japan. So does that mean there's not much out there? I know you talked about bolt-ons, but how would you think about potential targets in Southeast Asia, Japan also? What would be the rationale for buying more companies in Southeast Asia versus the rest of the world? Thank you very much.

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

A

Well, our M&A approach for bolt-ons, no matter where it is, is a similar model. It's got to again be accretive to us. It's got to be in a place where we know how to integrate it, and it's got to happen in a location where it adds density to our routes.

Now we're fortunate in most markets that, that works for people when they're ready to sell. But we're always interested in bolt-ons everywhere in the world. We ended up buying Schindler's portfolio in Japan in 2016, and that integration has gone extremely well. And our team has continued to grow our Service business in Japan, where conversion rates are highest in the world, call back rates are lowest in the world. So it's a high-quality, good margin business for us, and we thank our partners in Nippon Otis, but it was time we felt to – like we've done with our disciplined capital everywhere else, for us to get our legal entities in order as well as get our balance sheet in order. So you'll see that in the NCI line in the future. And it just like we did Zardoya made sense to us.

Other – as I said, other larger properties we'll evaluate, but again, only where they make sense for Otis and for us, for us serving our customers as well as for our shareholders.

Operator: Your next question comes from the line of Gautam Khanna with TD Cowen. Your line is open.

Gautam Khanna
Analyst, TD Cowen

Q

Hey, good morning, guys.

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

A

Hey, Gautam.

Gautam Khanna
Analyst, TD Cowen

Q

Wanted to ask about India specifically, and just what – it sounds like that's a source of strength still. If you could just talk about what the big drivers are there? And if you could dimensionalize how big that is relative to the rest of Asia-Pac?

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

A

Yeah. I mean India – yeah, India – Gautam, thanks. India is the highest growth market anywhere in the world. It's the number two New Equipment globally after China, but it's got different attributes than China because the conversion rates look far more like mature markets like the Americas, like EMEA. We've been doing – we installed our first unit in India in the 1890s. So – and we've had an operating company in India for a long time. We've got a great presence there. I really like our position there. We've got a factory there, so we have Made in India product across elevators and public and commercial escalators.

The growth we're seeing is really in every area, but infrastructure is moving very rapidly. Obviously, large population, that population, the rising middle class is driving not just urbanization, but demand for higher-end residential, especially multifamily, so – and multi-use. So every vertical in India is growing, and we see that market growing double digit, and we are investing in it. We're investing in it in terms of adding colleagues and field colleagues. We've got them all over the country.

Obviously, our factory is driving significant production increases quarter-over-quarter. Our supply chain continues to focus on local and developing more of that local supply chain. It is competitive. And we have to hit some competitive cost points, but our team has managed through that extremely effectively. But think of it as more – even though it's a high-growth market, more of a mature market, where you don't have this thousands of ISPs, you have this ability to convert at the 90-plus level like a mature market, so our Service portfolio grows there as well. And we have a really strong team under Sebi's leadership in India that understands how to do business in India, do it well, do it right and quarter-after-quarter has just proven significant growth. We are very, very bullish on India. And we'll continue to invest there.

Gautam Khanna
Analyst, TD Cowen

Q

Thank you. That's helpful. And I just wondered if you could also just talk about supply chain generally. Where, if any, constraints still exist, and how your own lead times have changed over the last three months? Thanks.

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

A

Yeah. We – the good news is we've worked through the majority of any of our supply chain issues. From a comfort perspective for you on commodities, we expect this year after last year, we drove about $44 million, $45 million of savings on commodities. This year, we're looking at $15 million to $20 million. We think we can get that on top of last year's. And the only reason I say $15 million to $20 million instead of $20 million is we've seen steel increase in certain parts of the world. But we are locked in terms of our commodities for the rest of this year from a productivity and a cost standpoint, fairly well, 60% locked, 80% on steel, our magnets are fully locked. So our supply chain team has done a great job through the challenges and now is optimizing. So it's not impacting deliveries at all. And really, there's no single call out. Are there still some people that are recovering, some smaller suppliers? There are, but we have continued to focus on dual sourcing, resiliency in our supply chain. And I've got to tell you, our factories on New Equipment this first quarter, they delivered.

Gautam Khanna
Analyst, TD Cowen

Q

Thank you.

Operator: This concludes the question-and-answer session. I will turn the call to Judy for closing remarks.

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

Thank you, Sara. Hey, we are quite pleased with our first quarter results as we make steady progress delivering value for our customers and shareholders throughout the remainder of the year and beyond. Everyone, thank you for joining us. Stay safe and well. Goodbye.

Operator: This concludes today's conference call. Thank you for joining. You may now disconnect.