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# Otis Worldwide Corp. (OTIS)

Q3 2024 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning and welcome to Otis's Third 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's website at [www.otis.com](http://www.otis.com). I'll now turn the call over to Michael Rednor, Senior Vice President of Investor Relations. Please go ahead.

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**Michael Rednor**

*Senior Vice President-Investor Relations, Otis Worldwide Corp.*

Thank you, Krista. Welcome to Otis's third quarter 2024 earnings conference call. On the call with me today are Judy Marks, Chair, CEO and President, and Cristina Méndez, Executive Vice President and CFO. Please note, except where otherwise noted, the company will speak to results from continuing operations excluding restructuring and significant non-recurring items.

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

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

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**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

Thank you, Mike, and good morning, afternoon, and evening, everyone. Thank you for joining us. I hope all are safe and well.

Starting with Q3 highlights on slide 3. Otis returned to top line growth in the third quarter as we continued to demonstrate the strength of our service-driven business model with solid third quarter results. In Service, we delivered high single-digit growth in Q3, bringing year-to-date Service organic sales to 6.4% with all lines of business contributing. We achieved maintenance portfolio growth of 4.2% and our modernization backlog increased 12% at constant currency.

Through the first nine months of 2024, we have expanded overall adjusted operating profit margin by 60 basis points and achieved adjusted EPS growth of 8.2%.

In Q3, we generated \$381 million in adjusted free cash flow and completed \$200 million in share repurchases. Year-to-date, we've generated approximately \$900 million in adjusted free cash flow and returned \$800 million through share repurchases, as we execute on our disciplined capital allocation strategy.

Otis had several exciting accomplishments recently. For example, our manufacturing hub in Korea obtained ISO 50001 certification. Otis now has 11 manufacturing sites certified through the global standard for establishing, implementing, maintaining, and improving energy management. In addition, we announced the expansion of our Bengaluru manufacturing facility. This will increase our capacity and capabilities to help meet the growing residential, commercial and infrastructure demand for elevators and escalators in India, while also expanding our localized manufacturing strategy in the country.

And last, earlier this month, we're proud to be named one of the world's best employers by Forbes magazine for the third year in a row, reflecting our commitment to our colleague's well-being.

Moving to our orders performance on slide 4. New Equipment orders were down 3% in the third quarter, a sequential improvement versus the first two quarters of the year, despite continued challenging market conditions. Excluding China, orders increased approximately 10%. Orders returned to growth in the Americas, growing more than 20% with excellent performance in North America, while APAC delivered high single-digit growth driven by continued strength in Japan and Southeast Asia.

Orders declined by high single digits in EMEA due to continued weakness in Western and Northern Europe, bringing orders to 8% year-to-date after a strong first half. A greater than 20% decline in China was a result of continued economic softness in the region. Our New Equipment backlog at constant currency was down 3% versus the prior year, although similar to last quarter, the New Equipment backlog, excluding China was up low single digits.

This quarter marked two consecutive years of delivering 4% or greater maintenance portfolio growth in each quarter. And last, within Service, modernization orders increased 3% as we faced a challenging compare from the prior year in major project bookings. And we expect to see a bounce back to solid modernization orders growth in the fourth quarter. With modernization orders year-to-date up approximately 10%, our modernization backlog increased 12% at constant currency versus the prior year.

As our colleagues across the globe continue to deliver, we have several customer highlights to share from the third quarter. In Melbourne, Australia, Otis will modernize 30 elevators at 101 Collins Street in the Central Business District. Our SkyRise and Gen3 modernization specific products will be featured along with our signature ReGen drives and the Otis ONE IoT platform. Otis installed the building's original elevators in 1989 and has maintained them for the past 35 years.

In the United States, we're proud to support the expansion of the St. Luke's University Health, Anderson Campus Hospital in Bethlehem Township, Pennsylvania. Otis will install nine elevators, including five Gen3 Peak and one Gen3 Edge unit for a new five floor addition. The St. Luke's organization has been a valued customer for more than 10 years.

In the Nordics, our local teams have worked closely with customers to add more than 400 units to the portfolio. In Denmark, we've recaptured 275 units with [ph] DELMIA (00:06:21), a leading construction and housing business. And in Sweden, we've recaptured 132 units at Vällingby Shopping Center, the customer making a welcome return to Otis after 10 years.

Reflecting the continued strength of the infrastructure vertical, Otis was selected to provide more than 340 escalators and Gen3 elevators for the Tianjin Metro in China as part of the Metro's New Line 8 and Binhai B1 Line. This brings the total number of Otis units in the city's expanding metro network to more than 2,000. Tianjin Metro has been using Otis equipment for almost three decades.

Turning to Q3 results on slide 5. Otis delivered net sales of \$3.5 billion with organic sales up approximately 1%. Adjusted operating profit excluding a \$4 million foreign exchange headwind, was up \$8 million, driven by the Service segment. Third quarter adjusted EPS grew approximately 1%, or \$0.01, in the quarter against a tough compare of approximately 19% EPS growth in the third quarter of the prior year.

Operational performance was partially offset by foreign exchange headwinds. This brings the year-to-date adjusted EPS growth to 8.2%.

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

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## Cristina Méndez

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

Thank you, Judy. Starting with Q3 segment sales performance on slide 6. Total organic sales growth of 1.2% in the quarter was driven by Service, which was up 7.7%. New Equipment organic sales were down 8.2%, driven by a greater than 20% decline in China as market conditions remained weak. Excluding China, New Equipment sales increased low-single digit. The decline in China was partially offset by low single-digit growth in APAC, driven by strength in Japan and Taiwan, as well as low single-digit growth in the Americas. EMEA was roughly flat as the strength in Southern Europe was offset by Western and Central Europe.

New Equipment pricing was up low-single digits in all regions outside of China. Similar to last quarter, China continues to be under severe price pressure with continued declines of approximately 10% year-over-year, although pricing was relatively flat sequentially.

Services were \$2.2 billion, with organic sales growth of 7.7% as we delivered on our expected acceleration from the mid-single digit growth in the first two quarters of the year. We grew in all regions and in all lines of business. Maintenance and repair increased over 6% in the quarter, supported by continued strong portfolio growth. Maintenance pricing up around 4 points, excluding the impact of mix and churn and a ramp-up in repair volumes. Modernization organic sales accelerated in the quarter, up about 14% bringing year-to-date organic sales to approximately 10% with excellent growth in Asia Pacific, which was up 20%, including contributions widely across geographies.

Turning to Q3 segment operating profit performance on slide 7. New Equipment operating profit of \$84 million was down \$20 million at constant currency as tailwinds from pricing that continues to flow from the backlog

productivity, including the benefits of UpLift and lower commodity costs, were more than offset by the impacts of lower volume and regional and product mix headwinds.

Operating profit margins came in at 6.4%. Year-to-date, New Equipment sales are down over \$250 million, and operating profit has declined by \$20 million at constant currency versus the prior year. In China, New Equipment has been a revenue headwind for approximately \$400 million. That would imply a profit headwind of about \$100 million which we have largely mitigated through solid productivity and the benefit of commodity and pricing tailwinds.

Service operating profit of \$555 million, increased \$40 million at constant currency as [ph] drop (00:11:18) through on higher volume, favorable pricing and productivity, including benefits from UpLift, more than offset annual wage inflation. As a result, operating profit margins remained strong at 24.8% even while facing a difficult prior year compare where margins expanded 90 basis points in the third quarter of 2023.

Year-to-date, operating profit margins have expanded 60 basis points to 24.6%. With the benefit of our various UpLift initiatives, we drove year-to-date adjusted SG&A lower by \$18 million while improving as a percentage of sales by 10 basis points year-over-year. On a slight organic sales growth, these cost initiatives are helping to mitigate labor inflation headwinds. Supported by a sustained strong performance in the Service segment, we achieved total operating profit margins of 16.9% in the quarter.

Adjusted EPS grew 1%, or \$0.01, in the third quarter. With our operational performance and a lower share count contributing positively.

Moving to cash, we generated \$381 million of adjusted free cash flow in the third quarter. And we saw sequential improvement in cash from operations within the quarter. We continue to work to drive cash flow into year-end despite the various macroeconomic challenges that we are facing across our business, most notably in China due to the lower New Equipment orders.

Overall, year-to-date, we grew organic sales 1.2%, with mid-single digit or greater growth in all regions outside of China. With Service as the driver, we have delivered 60 basis points of margin expansion, 8.2% adjusted EPS growth, while returning \$800 million to shareholders through share buybacks. We move into the final quarter of the year with continued focus on operational excellence across the business while working to offset the macro headwinds we are facing.

Let me now turn it back to Judy to discuss our 2024 outlook.

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## Judith F. Marks

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

Now on slide 8. Before discussing our updated 2024 financial outlook, let me first update you on our industry outlook, including giving some color on how we anticipate 2025 markets to shape up.

On the positive side, we now expect the Americas to be roughly flat, up from the prior outlook as customer demand signals are showing signs of improvement. We expect China to be down approximately 15% and this takes our Asia outlook down to a roughly 10% decline. There is no change to our New Equipment outlook in EMEA or APAC. Overall, we expect global New Equipment units to be down high-single digits for 2024. Offsetting the pressure on new equipment markets, the service market remains resilient, and we expect the global installed base to grow mid-single-digits this year as units that were booked a few years ago are coming off warranty and converted into the service space.

Looking towards 2025, we expect the global new equipment market to improve despite the new equipment softness in China. We anticipate the combined Americas, EMEA and APAC new equipment markets should be up low-single digits in units. China remains a question mark, but at this point we currently anticipate a decline somewhere in the range of 5% to 10% in units, clearly dependent on the impact of government stimulus measures.

Overall, across all regions, we currently anticipate a sequential improvement in new equipment market growth rates next year versus this year's rates. On the Service side, the installed base should continue to grow at around mid-single digits, a clear demonstration of the resiliency of the industry. We anticipate the modernization market will continue to grow strongly in all four regions.

Turning to our financial outlook for 2024, we now expect sales of approximately \$14.2 billion with organic sales growth of approximately 1.5%. Service remain strong across all lines of business for both growth and profit, and Cristina will give more color on this in a moment.

Our sales outlook is at the low end of our prior expectations with the change driven specifically by China New Equipment. Adjusted operating profit is now expected to be up approximately \$105 million at actual currency and up about \$140 million at constant currency, with the change from our prior outlook similarly driven by China New Equipment. We anticipate adjusted EPS to come in around \$3.85, up approximately 9%, driven by strong operational performance and the benefit from a lower share count and continuous improvement in the reduction of our tax rate.

We expect that adjusted free cash flow to come within a range of \$1.4 billion to \$1.5 billion and plan to return the cash we generate this year to shareholders through dividends and \$1 billion in share repurchases.

We continue to make steady progress with our UpLift program, which is helping to drive a more efficient organization and deliver more value to customers while mitigating some challenges we faced for the past few quarters throughout the globe. Overall, our service-driven business model and overall company strategy remain on track, and we will continue to deliver value to shareholders, including the 9% EPS growth we anticipate this year.

Now, let me hand it to Cristina to discuss our outlook in more detail.

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## Cristina Méndez

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

Thank you, Judy. Taking a more detailed look at our outlook and starting with sales on slide 9. Total organic sales are expected to be up approximately 1.5%, driven by solid performance in our Service segment. We expect New Equipment organic sales to be down mid- to- high-single digit, driven by a decline in China due to the challenging market conditions that Judy mentioned earlier.

Total Asia is expected to be down high-teens in 2024 with a strong high-single digit growth in Asia Pacific, more than offset by severe declines in China. Our outlook for the Americas, EMEA and Asia Pacific are unchanged from the prior guidance.

Overall, the New Equipment segment has performed weaker than we expected this year, driven by the market situation in China. However, the rest of the world has performed better than we projected at the start of the year. And we anticipate the combined growth of Americas, EMEA, and APAC to be mid-single digit up for 2024.

Our Service segment continues to perform quite well and has been largely in line with our expectations as we have gone through the year. In line with our prior guidance, we anticipate Service organic sales to grow a bit more than 6.5%. This includes maintenance and repair growth of approximately 6% and modernization growth of at least 9% at or above the high end of our prior range.

We anticipate continued modernization sales momentum in the fourth quarter due to the timing of project execution from the backlog. We expect this to be the third year in a row of Service organic sales growth of 6% or better, offsetting the severe headwinds we have faced in New Equipment over the past years, and demonstrating the power and resiliency of our business model.

Turning to slide 10. At constant currency, operating profit is expected to grow approximately \$140 million. In Service, performance this year has been excellent year-to-date and we expect operating profit margin to expand approximately 75 basis points for the full year, driven by volume, productivity aided by UpLift and continued solid pricing.

For New Equipment, operating profit margins are now expected to contract 50 basis points versus the prior year. Tailwinds from productivity, including benefits from UpLift, commodities and pricing from the backlog are being more than offset by volume and mix headwinds emanating from lower China New Equipment sales, as a result of continued market weakness.

So, the updated outlook assumes a similar fourth quarter's organic growth rate in New Equipment to what we saw in the third quarter. And on constant currency basis, we would anticipate a similar dollar decline in New Equipment profit of around \$20 million to \$25 million with a slightly larger headwind at actual currency.

We expect overall adjusted operating profit margin expansion of 70 basis points driven by Service performance. The update to our outlook is exclusively driven by the change in New Equipment sales driven by China volumes. And we are mitigating this headwind through Service volumes, productivity and pricing.

Turning to cash flow, we expect to achieve adjusted free cash flow in the range of \$1.4 billion to \$1.5 billion. The lower operating profit outlook, coupled with fewer down payments from China New Equipment order volumes, are impacting our expected cash flow for the year. We continue to focus on what we can control to improve working capital, and we expect strong free cash flow ramp up in Q4 similar to last year.

Moving to the 2024 EPS bridge on slide 11. We expect to deliver adjusted EPS of approximately \$3.85. This is \$0.31 of EPS growth versus the prior year, or approximately 9%, largely driven by operational performance. At constant currency, we expect approximately \$0.36 of operating profit growth outside of China, while we anticipate China to be a headwind of about \$0.10 to \$0.15 for the year.

Reductions in the effective tax rate and a lower share count are anticipated to offset headwinds from higher interest expense and foreign exchange. Minority interest expense naturally move slower due to the weaker China performance.

Let me now give you some additional commentary on two areas. First, China, and second, how we see 2025 shaping up at this point. On China, although we have largely been able to mitigate the significant China impact on adjusted EPS year-to-date, in our EPS bridge, we have included a small range of China outcomes to give some additional color, due to the continued uncertainty in the market.



As we exited Q3, the New Equipment backlog in China is down mid-teens, and the book and ship business remained under pressure. While much has been said on the policy front in terms of possible stimulus in the region and we remain optimistic for the policy follow-through as we sit here today, unless the region begins to accelerate into year end, we could see it being upwards of a \$0.05 additional headwind to EPS. Lower China volumes and the mix impacts, naturally puts pressure on the exit run rate margin for New Equipment into 2025.

Now, let me talk a bit about 2025, starting with Service. We expect the Service business to continue performing well next year with mid-single-digit or better top line growth and continued margin expansion. While we expect to achieve approximately 75 basis points of margin expansion this year, we said at our Investor Day in February that the Service business over the medium term would achieve 50 basis points or slightly more of margin expansion annually.

So, as you think about the two years combined, we would expect to be somewhere between 100 and 125 basis points of margin expansion within the Service segment. On New Equipment, as in the past few years, excluding China, we feel good about the rest of the world combined growing low-single digit or better in 2025.

While there are still a few months to go which will determine exactly the orders in Q4 and our ending backlog heading into 2025, if we assume that the backlog ends this year down low-single digits. that would be a fairly good starting guidepost for New Equipment top line in 2025.

As Judy mentioned earlier, China remains uncertain for the New Equipment segment for both sales and profit. As without policy change and a stimulus action, we would expect our second half margin rate in New Equipment to persist throughout 2025. The margin rate within New Equipment is being impacted by the meaningful shift in regional mix, with more than 75% of the New Equipment revenue now being driven by sales outside of China. We will continue to work to offset the headwinds that this poses to productivity while continuing to drive the UpLift program and rightsizing our cost to align with the current market conditions.

In closing, our results from the first nine months demonstrate our ability to deliver on our service driven business model. We continue to focus on what we can control, including growing our portfolio, executing on our expanding modernization backlog, and continuing to drive productivity throughout the organization, including UpLift initiatives. We continue to drive results through the remaining of the year to set us up well to perform in 2025.

With that, Krista, please open the line for questions. Thank you.



## QUESTION AND ANSWER SECTION

**Operator:** Thank you. We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Nigel Coe with Wolfe Research. Please go ahead.

**Nigel Coe**

*Analyst, Wolfe Research LLC*

Q

Thanks. Good morning, and hope all is well. Thanks for the details on that FY 2025, Cristina. So it seems that China fundamentals are starting to really sort of deteriorate, and I'm just wondering that the message has been, obviously, pricing pressure being offset by deflationary input costs. But I'm just wondering if the OE pressure we're seeing right now whether that's really a function of lower China margins, not just the mix of China? And I'm just wondering if the pricing is getting irrational and whether there's any change in the strategy over the next one or two years within China?

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah. Thanks, Nigel, and good morning. Listen, the new equipment market, as you heard myself and Cristina say, in China, remains weak. It was down 15% this quarter, similar to second quarter and we think that's how the year is actually going to finish. We are constantly trading off volume, price and liquidity to make sure that our China business remain strong as we go into 2025. We now believe the China segment for 2024 will be at about 415,000 units.

As we've looked and as we've shared, our New Equipment revenue is down fairly significantly, double-digit. Our Service revenue is flattish to up slightly. Our portfolio units are still up high teens. So, the pivot and the strategy we've been making to Service is working, about a third of our revenue now in China is service. And as you heard Cristina say, we're down \$400 million in revenue year-to-date in China. We are going to – if you put in our guide, we're going to be down \$0.5 billion of revenue in China this year and still have organic top line growth for the company.

Now, when we look structurally at China, our New Equipment total contribution is really only down a couple of points. So, we are still seeing the deflationary environment. We're optimizing commodities to the best of our ability. And really trying for and focused on delivering down a few points, even though pricing remains competitive, it has always been competitive in China on New Equipment. We are not seeing irrational pricing. We're seeing sustained competitive pricing. And a 415,000-unit market to me is still a healthy market in terms of segment size for us to secure the business we want.

The mod market is growing and is picking up nicely, and you'll see us drive mod margin expansion as we grow scale there. Our mod orders year-to-date in China are positive. October was very positive, but for the quarter it was not at the level we wanted. And there was a little bit of resistance as people were waiting to understand more about the equipment renewal incentives that had been announced early in the quarter with not a lot of specificity. We're seeing that pick up. That was prior to the bigger stimulus that was announced later in the quarter. Our Service units are up yet again, high teens, the Service revenue was up 1%.

So, our business in China is reshaping. It's – if you think down \$0.5 billion, \$500 million, so that's the lowest revenue we've had in China since we've reported in 2017, which was in our Form-10. We did a look back two years, and yet as you look at the contribution even that our China team has made, it is not at that level of drop.

So, we're watching mix carefully. Obviously, the other three regions are adding significantly to the mix and the margin and the top line on New Equipment and the Service business, including in China, is doing very well.

**Nigel Coe**

*Analyst, Wolfe Research LLC*

Q

Okay. that's great, Judy. That's great color. Thanks very much. And then just a quick one on Service. The flat Service margins year-over-year, you obviously have kept the Service outlook unchanged. Was that sort of your plan for the quarter? And maybe just obviously, the mod mix would have been [ph] adverts (00:32:09), so just maybe a bit more color on in terms of the operating leverage within Services, and whether the labor inflation is actually getting a bit worse there in terms of impacting the margins, perhaps.

**Cristina Méndez**

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

A

Hi, Nigel, this is Cristina. So, on Service margins, they are coming broadly in line with expectations. And in fact, when you see sequentially, they are going up, it was 24.7% in Q2, 24.8% in Q4. And this is thanks to the flow-through of good volumes. And you have seen that there was a good ramp-up of Services in the quarter, coming mainly from the timing of repair and modernization. And we also have a very good performance in price. Price was up in the quarter approximately 4 points, excluding the impact of mix and churn. And we also have productivity and UpLift measures and all of this is compensating wage inflation that is broadly in line with expectations.

So, I would say very steady-state performance in Service, in line with expectations. And this can be even opportunity for Q4 as we see modernization is ramping up very nicely.

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah. Nigel, the other thing, if you recall last quarter, we anticipated repair picking up in the second half of the year and mod conversion picking up in the second half of the year. Both of those are contributing nicely. Repair was up 10%, was really led by the Americas, and mod, if you look at it really how we've performed on the delivery side of mod, we were over 13% in terms of sales. That's going to continue with our [ph] mod (00:33:44) backlog up 12%.

We keep anticipating repair to come – to normalize, so like a point above maintenance, but it looks like we'll wrap this year in fourth quarter again with strong repair, similar to third quarter.

**Nigel Coe**

*Analyst, Wolfe Research LLC*

Q

Okay. Thanks, Judy.

**Operator:** Your next question comes from the line of Jeffrey Sprague with Vertical Research Partners. Please go ahead.

**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Q

Hey. Thanks. Good morning, everyone. I hope everyone is well. Hey, Judy, can you also just drill a little bit into mod China, and I guess the specific angle on my question is kind of, if we think about mods globally or certainly

rest of world, right, we're thinking historically a little bit below new equipment, with the trajectory above new equipment. As you realign the business, does that playbook exist in the same way, shape and form in China?

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah, it does, Jeff. And good morning. So, mod margins in China look attractive, like New Equipment margins do in China relative to the rest of the world. And we're seeing that play out this year as well. It's early days for mod in China, obviously a younger portfolio, but a portfolio that will accelerate and grow more rapidly when you think about CAGR versus anywhere else in the world. So, we're in a unique position to do mod and industrialize mod with our kits from the start. There's not a lot of old units to modernize in mods, so most of these are Gen2 units, which means we're going to get the benefits of scale, commodities, we're already handling Gen3 mod on our Gen3 line in our factories in China.

So, I'm very optimistic about mod in China in terms of available segment, in terms of demand, in terms of rapid growth. And again, what we've seen early orders in October in mod is very promising. This equipment renewal program that I spoke about, just to give you a little context, was announced, I think, in the July timeframe. It was for everything from appliances to cars, but elevators and escalators were included which we thought was very important. The challenge is obviously, with all these getting the rules out locally and that has taken a little time, and the reason why I believe our mod orders weren't as strong as they needed to be in the third quarter.

You're going to see mod bounce back nicely. We've already seen it in October in China. You're going to see more significant mod orders. As we came into this quarter globally, our mod orders were up for seven or eight quarters double-digit, you will see a return to double-digit in the fourth quarter. And then the rest of the world, we saw some timing issues in mod in the third quarter in terms of some major projects. Those have moved to the fourth quarter, but we expect those to come in. And we did have a slight compare with a couple of projects in the Middle East from Q3 last year that were pretty significant mod projects.

So, we'll be back to double-digit in the fourth quarter, which means the backlog will remain strong going into next year. And I think what you've now seen is we've proven the conversion, the mod margin for the third quarter in a row globally was better than the New Equipment margin. So, the strategy we put in place last year to industrialize mod, we're seeing that take hold, and we're seeing mod margins now greater than New Equipment. And we do have line of sight to the 10% mod margins we anticipate in the medium-term.

**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Q

And then just really big picture on China. As we sort of step back, right, going from I don't know, call it, 650,000 units to 415,000, which you characterize as still healthy, I just wonder like big picture though, is that the right number, right? I think the second biggest market in the world is India, like 75,000, right? So, if China is overbuilt and the population is shrinking, doesn't that number just have to actually grind lower over a number of additional years?

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

I think there's a potential for it to grind lower, as you say, Jeff, but it's going to grind lower at a lower rate. You've taken a third of the volume out from 650,000 to 415,000. And next year, when we are looking at again without stimulus impact, down 5% to 10%, what that means is we're actually going to see sequential growth improvement

in New Equipment in 2025 at Otis over 2024, because of the China not decaying or decreasing as much as it did this year.

So, when we look at the compares and sit here this time next year, we actually – and we'll give you the guide clearly in late January with all the specifics, but we actually see sequential top line growth improvement in 2025. We're going to see it in Service and we're going to see it in New Equipment.

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**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Great. Thank you. Appreciate it.

Q

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

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**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

Hi, good morning. Maybe just had one clarification on the sort of fourth quarter operating profit dynamics. So, I think you've guided the full year up about \$140 million at constant currency, that's on slide 11 and 10. And then I think, the nine months was up \$96 million on slide 20.

Q

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**Cristina Méndez**

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

Right.

A

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**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

So, you have this sort of \$40 million plus increase year-on-year in Q4. But I think New Equipment is down \$20 million or \$30 million in Q4. So, it's a sort of a bigger uplift in Service it looks like. Just maybe help us understand kind of what's driving that. I mean it looks like the sort of general seasonality in the Q4 guide is a bit stronger than your normal seasonality on profits.

Q

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**Cristina Méndez**

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

Hi, Julian. This is Cristina, and it's a very good analysis. So, as you have said, year-to-date, we have grown operating profit at constant currency of about \$96 million, which means margin expansion of \$60 million. And when you look into Q4, we expect Service to continue performing very strong, top line to continue growing on the back of good ramp up of repair and modernization, and a good flow-through of operating profit with additional margin expansion. Margin is expected in Service to be above 25% in Q4. But it's not driven by seasonality, it's just driven by their performance of execution, ramping up the top line and continually working on productivity.

A

On the other side, on New Equipment, we expect Q4 to be more or less at the same level of top line decline as in Q3, approximately minus 8%. And that means flow through into operating profit with operating profit margin below 5%, because we have the volume and the mix effect. And additionally, we see price and commodities gradually fading out in Q4.

But overall, we compensate the decline in New Equipment with a very strong performance in Service, in order to deliver, as you rightly said, approximately \$40 million, \$50 million operating profit growth in the quarter.

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah. And that 25% rate is very achievable based on everything we're seeing, Julian.

**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

Q

Thanks very much for that detail. And then maybe for the 2025 equipment margin outlook, I think, Judy, you had talked about the sort of New Equipment margin when you're thinking about next year and I realize it's early, but a good place holder might be, sort of margins next year in New Equipment similar to this second half. So, I think it's sort of third and fourth quarter, you're running at sort of mid-single digits there, 6% Q3 and it sounds like 5% or less in Q4 for New Equipment. So, sort of 5-ish-percent margin in 2025 for New Equipment as it looks today. Just help us understand kind of what's that assuming maybe for pricing? And are you planning or starting to enact further cost out measures, there's the UpLift program sort of working through in its second year, anything happening on there to try and get the sort of nose up on New Equipment margins?

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah. Without guiding, I think you're very accurate in terms of what you're seeing for 2025 New Equipment margins, again driven by the impact of mix as China contribution is less and the rest of the world is now, as Cristina said, over 75% of the revenue for New Equipment. Just so you get a sense, China is going to finish this year, all in at little over 13% of our revenue. So, it's really changed the dynamic. But our UpLift program is on track. Last quarter you saw we updated the outlook and the run rate and that is holding well and that will continue to deliver in 2025. And we've planned on that.

Before I turn this over to Cristina on maybe a little more color, why don't I just give you a – how the sales and the top line look for 2025. So, in New Equipment, again excluding China, our New Equipment backlog is up low-single digits. Right now, our New Equipment backlog is down [ph] three total (00:43:56) and we'll see where the fourth quarter ends up in terms of orders. Our New Equipment top line, we'd expect low-single digit growth next year for everywhere outside of China. And China, we would expect along the lines that we saw this year. But we'll – we have to wait and see, we haven't preprogrammed any stimulus. So, I think we're all waiting to see what happens in next week, at the end of the week with the National People's Congress.

And we are prepared for the stimulus, whether it comes with new equipment or mod. We have the capacity, we have the capabilities, both in our factory and in our field. So, in New Equipment, all in, the growth we think will be down low- to- mid-single digits, kind of plus or minus where the backlog comes in at the end of the year.

On Service top line, really strong Service portfolio growth. And if I could just take a minute, we talk about this 4.2% a lot and we've had eight straight quarters or two years of that. What I think it's important for everyone to understand is with the largest Service portfolio in the globe at 2.3 million units growing to almost 2.4 million by year end, we're adding 25,000 units every quarter to our Service portfolio.

And as we shared at Investor Day, our average service customer has four units. So, we're adding 25,000 customers, which is why we have such faith in our service-driven business model that drives maintenance, that drives repair, and it drives additional density for us that gives us productivity, all of which support again, this high margin Service business. And with our retention rate at almost 94%, it also then drives that continuous relationship for 15, 20, 30 years, that gives us the modernization business.

So, Service next year as we look at it, maintenance and repair is going to be driven by that strong portfolio growth and very solid repair volumes. We've been getting price on service this year, as Cristina said, like-for-like pricing increased 4 points. We're watching inflation but we will get price next year. Will it be at the same level? Depends where we are in the world with inflation, but we get price on the maintenance side and the portfolio growth, it'll be a tailwind in 2025.

Repair volume, very strong, as I said, north of 10% growth. We still see solid repair backlog going into next year. Expect that to normalize. But you've heard me say that every year, so, but we do expect it to normalize. And mod, as we exit right now, the third quarter backlog is up 12%, and we did 9 – we're looking at 9% high single-digit plus, that's what you should expect next year too, if not better, because the mod backlog is growing.

So, I just wanted to give you some color on the portfolio itself and on the top line, which is why as we look out in 2025 and even 2026 beyond as we look at the medium-term, this near-term New Equipment in China doesn't get me concerned, because we're still growing mid-teen-plus, if not high-teen portfolio in China and the rest of the world is growing our portfolio low single-digit. So, we don't see that there being a knock-on effect a few years out, because we have time to work it, we have time to do recaptures, and we are focused on improving our retention rates. Our conversion rates are doing much better in China and the like.

Let me turn it over, Cristina, for you on any other comments on profit?

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**Cristina Méndez**

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

A

Yeah. No, thank you, Judy. And let me comment, Julian, on the profit side, and you had a very good analysis. So, as Judy recapping there the top line, we expect next year, low-single digit up, that is sequentially slightly better because of less decline or lower decline in New Equipment. But now on the margin side, Service will continue with margin expansion. You'll recall that we said back in February in our Investor Day that Service was going grow 50 basis point of annual margin expansion. This year we have overdriven, we are 75 basis point. When you put together 2024 and 2025, we expect margin expansion of around 100, 125 points in Service.

On the other side, New Equipment, as you rightly said, we have the effect of volume from mix. But additionally, as I mentioned before, next year, the commodities and price tailwinds that we benefited this year are going to gradually fade out. So, all of these together would mean that the second half of the year margin rate is going to persist in 2025, and it would mean approximately 50 to 100 basis points of margin decline.

But when you put everything together, we have a stronger Service segment, a weaker New Equipment, but overall, operating profit is expected to grow mid-single digit next year.

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**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

Q

That's great. Thank you.

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**Operator:** Your next question comes from the line of Joe O'Dea with Wells Fargo. Please go ahead.

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**Joseph O'Dea**

*Analyst, Wells Fargo Securities LLC*

Q

Hi. Good morning. Thanks for taking my questions. Can you elaborate a little bit more on Americas and Europe and the growth that you're seeing in the backlog, and price versus volume? And just as we consider multifamily



pressure and office pressure, but the growth that you're seeing and an outlook for growth into next year, trying to understand kind of market versus share gain and other factors at play?

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**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah. Thanks, Joe. Listen, in the Americas, I'm really pleased this is really the first quarter we're seeing really early projects moving forward again with green shoots. We all know the indicators, ABI and Dodge, I won't repeat them for you. And I know we like to think some are leading, some are lagging. I think that you're going to see this all settle out over the next 12 to 18 months. We are definitely seeing improvement in the new equipment market segment in Q3, you saw orders were up 23%. We knew we needed that. We said we'd come back in the second half, and we delivered.

And actually, in North America, we increased our pricing. It was the best we did anywhere in third quarter. It was low single-digit but it was the best anywhere in the quarter in the world. If you look at Americas for the year, year-to-date, we're down 9.5% in orders. But if you eliminate that large infrastructure job we won in Canada in the first quarter of 2023, we have shown nice sequential growth quarter after quarter and we're really seeing more new equipment market stability.

Some of the – and again, we get this from our sales teams as they're talking to customers, the sentiment has gotten a lot better after the Fed changed the rates. We've got a really strong backlog in the Americas, a good 18-month plus line of sight to perform, even though our backlog's down because our sales have been up significantly. Our New Equipment sales in the Americas came in 6% for the quarter, it was hotter than the prior low-single digit and mid-single digit for the full year. We expect the fourth quarter to be mid-single digit as well.

Service sales in the America portfolio is up low-single digit, repairs were great in the third quarter, about 10%, they're there year-to-date, and we anticipate that continuing into the fourth quarter. Mod orders for the Americas were up mid-single digit both in the quarter and year-to-date, we expect that to continue. And mod sales were up low-teens for the quarter, and year-to-date they're up high-single digit. So, we believe the Americas market, the market itself has stabilized and our performance is doing much better.

And when we look at – this is a little different commentary than you heard last quarter. When we look at the different verticals, this quarter we still had the best verticals were infrastructure and industrial buildings, but all of the verticals were up this quarter in North America, which to us is there is a real inflection point. If I go to EMEA, what we're seeing in the market itself is it's challenging, but we're performing very well. Middle East is doing very well. South Europe is strong. North Europe is a little weaker. Spain and Africa are doing very well. And even Central Europe for us this quarter did very well, despite the market uncertainty and environment in Germany. We're seeing pressure in France, but our backlog in EMEA is solid. New equipment year-to-date is up 8%.

So, even though the quarter was down in orders, strong first half by EMEA, the team is performing very well. Our 12-month roll in EMEA orders is up 7.8% and I really believe we're outperforming the market there. Our backlog is up over last year in EMEA and our Gen360 product is rolling out very well. So, a little different commentary this quarter. Inflection we're seeing in the Americas and I think we're outperforming in EMEA in a challenging environment.

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**Joseph O'Dea**

*Analyst, Wells Fargo Securities LLC*

Q

And that's really helpful commentary. Obviously sort of mixed trends that we see in some of the leading indicators, so appreciate it. And then just wanted to ask on cost structure as it relates to China and thinking about that



market sizing moving forward. Obviously, some of the build-out that you did there to serve that market. But as you think about it today and the potential for volumes in this range for a while, how do you think about costs or those things we could hear more about as we get into next year?

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**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

You will definitely hear more about costs coming out in China. And listen, this is for two reasons. One, we would do this based on the market, but second with our UpLift program, where we're changing the way we work to be more customer centric, to have common processes everywhere, to have the ability to actually continue to drive significant growth. But in China, we're looking at everything from our operational footprint. We have moved our modernization into our new equipment factories. So, any facilities that used to do modernization don't do that anymore.

And we we're obviously looking at our workforce. I have to give Sally and the team incredible credit for operating under some pretty tough economic times right now. As I'd said, when I think in my first answer, we're trying to balance rational volume with pricing and with our customer's abilities to pay. That's what's really driving our cash guide coming down. We're not going to take business just for the sake of volume to fill factories or to keep the field gainfully employed. We're taking what we believe is smart business that will put us in a strong position to continue to grow our Service business in China and get ready for that nascent mod business to really take off.

When I think about mod and new equipment, I can't tell you where that crossover is going to happen yet. But when you think about what we – the price of a unit in mod is about the same price of a unit in new equipment everywhere in the globe, including China, where our mod margins are highest. And so, as that picks up, right now we have 415,000 units in the New Equipment segment this year in China. As that mod market picks up, we will hit 415,000 units sometime this decade. Just as the mod segment, I can't peg when that's going to be, but we're actually going to have a larger market to serve in China and around the world than we have today.

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**Joseph O' Dea**

*Analyst, Wells Fargo Securities LLC*

Q

That's very interesting. Thank you.

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**Operator:** Your next question comes from the line of Chris Snyder with Morgan Stanley. Please go ahead.

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**Chris Snyder**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you. I mean, I appreciate all the color on China potential range of outcomes next year. But Judy, I would just be interested in your perspective on the stimulus actions we've seen in China so far. Anything more that you're watching that could come here in the coming weeks or months, and ultimately just kind of what it means for China construction? Thank you.

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**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah. Thanks, Chris. Listen, we are encouraged by what's been announced to date. The key is going to be the implementation methods, the regulations. You know we're in a regulated environment and how the local governments use the potential liquidity, debt relief, all of that. The announcements that were made are positive. To us it's now the how. We believe the first indication of this, and we've talked to the party secretaries because we're focused on economic development. We want to grow in China, and we will grow in China. Despite this \$0.5

billion of revenue, you will watch our Service and our mod business continue to grow and we'll stabilize this New Equipment business.

Our early look is, with the stimulus, with the aging population, we think this is going to actually accelerate modernization more. It's going to allow with the 5,100 white projects for projects to get finished, which will give us more confidence and liquidity with some of our customers as well and our key accounts. But the first time I think we're going to know more, Chris, is there's a special meeting of the National People's Congress, the most senior members next week with a read out next Friday, November 8. So, we'll see what happens there. I will be on the ground in China in November. I think it's important to be able to talk to our customers, to be able to talk to our colleagues and thank them for their dedication under this distressful time. And they are delivering, when you think about the decline we've had in the top line and yet our focus on continuing to deliver for our customers and grow our Service business. So, I think we'll all know more.

We do not anticipate that impacting fourth quarter financials, even if rules come out. If it does, I'll be happy to share that with you in our fourth quarter earnings. We see this more as a potential for 2025. But in all the color Cristina and I have given you today, because we're not going to guide for 2025 yet, we have not anticipated any positive impact of the stimulus on China. So, when we say down 5% to 10% next year for China New Equipment at the segment level for units available in the market, that does not anticipate any stimulus. Same with the modernization market. And there's 10 million units available for service. We added mid – our Service growth this quarter was high teens. So, now in China we're up to 425,000 units in our Service portfolio. That's still 4% share. We got plenty more we can recapture, plenty more to convert.

So, we are hopeful, but we need to understand the implementation rules. And most importantly, our customers and the local governments need to do that.

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**Chris Snyder**

*Analyst, Morgan Stanley & Co. LLC*

Q

Appreciate that. And if I could just follow-up on the Americas. You talked customer – better demand signals from customers. If we look at the orders in Americas, obviously, very sharp rate of change Q3, up 20%, first half down 20%. Were you starting to see that better customer demand in Q3 or is that a Q3 order number really just a function of comps? And then that improvement is really maybe a Q4 into 2025 driver? Thank you.

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**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

There were certainly some comps. Look, I want to be clear about that. But now we are seeing between proposal activity, and we had a lot and Chris, we get a down payment when we sign an order everywhere in the world, but especially in the Americas. And it's not something that is really negotiable or that we give back if a project gets canceled. So, our customers have to have that conviction that their project is going to go. And we had a lot that we're just really close. But I think waiting to hear what the Fed was doing, waiting to see what the economy was doing.

But as I said, for all the segments, we're talking commercial, office, residential, infrastructure and industrial, to have turned positive in the market in the third quarter, it's more than comps. Our team is performing and you can expect that kind of positive performance regardless of comps fourth quarter and into next year.

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**Chris Snyder**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you.

**Operator:** Our final question comes from Patrick Baumann with JPMorgan Chase. Please go ahead.

**Patrick Baumann**

*Analyst, JPMorgan Securities LLC*

Hi. Good morning, Judy, Cristina, thanks for letting me squeeze in here.

Q

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

Sure.

A

**Patrick Baumann**

*Analyst, JPMorgan Securities LLC*

Just had one, maybe two, but first one on free cash flow, the \$1.4 billion to \$1.5 billion this year. Can you talk about what working capital drag is embedded in that and parse that out in terms of drivers, maybe size the China down payment drag you called out or anything else unusual depressing this year that should flip around next year to give you a better growth? Because I'd assume, and you could correct me if I'm wrong, that free cash flow growth next year should be better than kind of the mid-single-digit you expect on operating profits? So, I just wanted to check on the dynamics there.

Q

**Cristina Méndez**

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

Hi, Pat, this is Cristina. So, yeah, you are right, the reduction of the guide to \$1.4 billion to \$1.5 billion is related to the down payments on the new equipment order situation in China. But overall, when you see our cash flow performance year-to-date, we have generated an adjusted net income of \$1.1 billion, \$1.2 billion and \$900 million year-to-date cash flow. That means that year-to-date, we have built up approximately \$250 million working capital. And there are two reasons for that. One is the business mix. On the one side, New equipment declining, especially because of China, and we don't get the down payments. But on the other side we are growing in Service and the collection time in Service is later, because we collect when we execute the job, for example, on repair.

A

We also have some payables impact because of the ramp up of modernization, because of payments to suppliers when we execute the projects, but we expect these business mix to stabilize now in Q4. We'll start collecting the good ramp up of top line in Q3, now in Q4. And overall, the \$200 million working capital is going to be unwound. So, the expectation in the guide is to deliver in Q4 approximately \$550 million cash flow. That is more or less the same level of cash flow we delivered last year in Q3.

And then to your question into 2025, yeah, you are right. We should expect that as we have stabilize the business mix, cash flow should pick up at a faster pace than operating profit growth.

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

And Patrick, from a capital allocation perspective, if you think about it, we're going to do \$1 billion of share buybacks and \$600 million roughly of dividend versus this \$1.4 billion to \$1.5 billion. We have the ability to do that because the team has done a great job bringing our cash balance down, probably since first time significantly

A

since spin from \$1 billion to almost \$800 million. So, we're working every element of this to be able to share, to obviously share this cash back with our shareholders.

**Patrick Baumann**

*Analyst, JPMorgan Securities LLC*

Q

Makes sense. And so, conversion next year should be back above 100% of adjusted earnings?

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

At least 100%. We'll guide in January.

**Patrick Baumann**

*Analyst, JPMorgan Securities LLC*

Q

That makes sense. And then last one, just on Service margins. I mean, if you could talk about just the factors around why the margin expansion for next year would slow to something less than 50 basis points relative to the 75 you're guiding for this year. Just any color on the factors that were better than expected this year that will reverse, I guess, next year to make it closer to that 50 over the two-year period?

**Cristina Méndez**

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

A

We are, yes. At the end, we are not guiding now. We are just providing some color of the trends and the 50 basis points is what we committed back in the Investor's Day. And this is going to come on, of course, on top of that we continue working on the same actions we have implemented this year in terms of price, productivity and UpLift. And we will target to overdrive. But for the time being, this is what we can mention.

**Patrick Baumann**

*Analyst, JPMorgan Securities LLC*

Q

Understood and modernization business, those margins are expected to continue expanding as part of that guide for next year?

**Judith F. Marks**

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

A

Yeah, you'll see that in January. Yes.

**Patrick Baumann**

*Analyst, JPMorgan Securities LLC*

Q

Okay. Thanks so much for the color, best of luck.

**Cristina Méndez**

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

A

Thank you.

**Operator:** And ladies and gentlemen, that does conclude today's question-and-answer session. And I would now like to turn the call over to Judy Marks for closing remarks.

## Judith F. Marks

*Chair, President & Chief Executive Officer, Otis Worldwide Corp.*

Thank you, Krista. Our solid results in the first nine months of the year demonstrate the resiliency of our service-driven business model. We remain focused on mitigating macro headwinds and further driving shareholder value in order to deliver a strong final quarter and beyond. Our growth and modernization, maintenance and repair and the overall Service portfolio validates that our flywheel continues to fuel profitable growth.

As I close the call, I'd like to take this opportunity to thank Mike for his many contributions to Otis and wish him success in his new role. Stay safe and well, everyone. Thank you for joining.

**Operator:** Ladies and gentlemen, that does conclude today's conference call. Thank you for your participation and you may now disconnect.

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