KONE Q2 INTERIM REPORT FOR JANUARY - JUNE 2015

July 17, 2015
3:45 EEST

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Katri Saarenheimo: Good afternoon everybody and welcome to KONE's Q2 Results Webcast. In Espoo, Finland today we have our CEO Henrik Ehrnrooth and CFO Eriikka Söderström. I am Katri Saarenheimo from the Investor Relations Team.

As usual we will start with an overview by Henrik of our key figures and development during the second quarter. After this we will again have plenty of time for Q&A and discussion. Henrik, please.

Henrik Ehrnrooth: Ok, thank you Katri. It's also my great pleasure to welcome you to our Q2 webcast because we have good news to share with you. I must say that I'm very happy about the strong performance that we had in the second quarter that again shows the good execution and the breadth of our performance that we are able to achieve at the moment.

I will as usual start with our key figures, go more in detail into orders received, sales and EBIT. After that I'll talk about our businesses and the markets and then how we have strengthened our competitiveness and finish up with markets and our guidance for the year.

Starting with Q2 and our key numbers, as the heading also says we had a very strong performance on a broad base. This we can see starting with our orders received. Our orders received were €2.2 billion, growth of 21.7% compared to last year or 6.3% in comparable currencies. Our order book reached an all-time high, €8.6 billion, a growth of 32% or 15% in comparable currencies. Our sales grew also to €2.2 billion, growth of 15% or 6.8 in comparable currencies. What is important with our growth is that it continues to be profitable and that we can see from the development of our operating income which was now €325 million in the quarter, a growth of 23.5% compared to last year. The profitable growth can also be seen from our operating income margins which now improved from 14.2% to 14.7%. We also had a very strong cash flow. We can say it was exceptionally strong for Q2, now €426 million and our earnings per share grew at a little bit over 30% compared to last year, now €0.51.

So a very strong overall and broad-based performance in Q2, but also if we take a little bit of a longer perspective and look at the first half of the year we can also see a similar performance – good growth in our orders received which were €4.2 billion, growth of 20.3% or 5.9% in comparable currencies. Also solid sales growth in the first half, total sales of €3.9 billion, growth of 18.6% or 6.9% in comparable currencies. We also see that our growth was profitable if we look at over a six month period with an EBIT of €537 million, a growth of a little bit over 21% and an improvement in our operating income margin from 13.5% to 13.8%.

Our cash flow from operations, a very solid and strong €638 million for the first six months. I'm very pleased now that we had a very good performance in Q2 because we can see now on a six month basis we had a solid cash flow. We had a slightly slower start to the year in terms of cash flow but I think we can see if we look on a six month perspective that even in a challenging market environment we have been able to maintain good and healthy business practices which can be seen from our cash flow. Earnings per share €0.80 compared to €0.67 in the comparative period. Again what has been the key enabler of this development that we have had, I would say it's very good engagement we have amongst 48,000 people and all of our employees' commitments to continue to achieve good results and profitable growth, so of course a very big thank you to all of our employees for the great work done in the first half of the year.

If we look a little bit more closer at the numbers and start with orders received which grew at 21.7% or 6.3% in comparable currency, here we had growth in orders received in all geographic areas and in both new equipment and modernisation business. I think the highlights on our orders received is that we had a solid growth in our volume of new equipment business with a good growth in both Europe and North America. The growth in Asia Pacific was now somewhat slower due to also very high comparison points, particularly major projects last year. In the important China market we continue to grow fast in the market. We grew at close to 5% in volume terms when the market declined slightly, so a continued strong outperformance as well in China. So I would say overall I am very pleased with our performance on orders received, how broad-based it was and how well we were able to continue a strong growth in North America and accelerate our growth in Europe.

If we then look at pricing and the overall market environment, what we can see is that the price for market share has continued to be very intense and we can see that that has had some impact on pricing, but what I would say here is that in an environment where a fight for market share and the impact on pricing has been such, we have been able to for example in China growth continuously faster than the market without sacrificing our margins and this I think shows the strength of our performance. In an environment where market prices have come down slightly but we have been able to maintain a solid level of margins for orders received, this has been achieved through a continuous improvement in our overall competitiveness and through a very good performance of our teams overall, so I would say overall broad-based a good performance.

If we then look at sales, here the good news is that we had growth in all geographic regions and all of our businesses. We will start geographically. The fastest growth was in North America where our growth was about 14% in comparable currencies. Our growth in Asia Pacific continued to be a solid 7% and in Europe, Middle East and Africa we grew at 4%. If we look at our businesses what I'm pleased about is that our growth in our services business accelerated slightly. Our growth in services overall was 7.1%, maintenance was 6.4% and in our modernisation business 8.8%, so a clear acceleration and growth in our modernisation business. Also new equipment business continued to grow and was 6.6% overall. Here you can see the solid broad-based growth that we achieve also in sales.

Then finally turning to operating income, the main reason behind the broad-based positive development was what we achieved in sales on many fronts, so we were able to have a good development in both our services business as well as new equipment business and in each of our geographic regions, so I'm very happy about this underlying performance that we had. Translation exchange rates also had a significant positive impact on our operating income and they now contributed a little bit more than 40 million to our operating income, but even taking out that we can see that the underlying growth was solid. We continued to increase our investments in areas that support our future growth such as our investments in R&D, process development and IT and expanding our footprint in key growth markets in Asia Pacific. Also we continued to strengthen our resources in North America to cater to strong growth that we are experiencing in that market. Again also in operating income, a very broad-based and positive development.

Then finally on our numbers, looking at our business mix and if we start business mix by various business lines, you can see that the trends that we have seen already for a while which is that our new equipment business continued to increase its share of our sales, that continued. New equipment was now already 56% of total sales. Here the main reason for the increase in the share of new equipment was translation exchange rates because we have in new equipment business we have more sales in other currencies than the euro than we would have in for example maintenance and modernisation, so the change in mix was mainly a foreign exchange driven mix change. The same very much comes when we look at it by market, here Asia Pacific was now 44% of total sales; Europe, Middle East and Africa 40%, but if you look at Americas it has increased from 14% to 16%, that is both due to the strong underlying growth in Americas and comparable currency as well as for translation exchange rates.

That's about our numbers. Let me next go into our various business lines. We start with new equipment business and first about our performance. As I mentioned I think the most important point is that our orders received in the volume business grew yearly. In the major project business there was slight growth as a result of a very significant comparison period last year. The growth as I mentioned was strong in North America and also accelerated Europe, Middle East and Africa. In Asia Pacific we were able to grow in China, in Australia and in India. Percentage-wise the growth was the fastest in Australia and India but as I mentioned in China we grew at close to 5% in a market that declined slightly, so a very strong performance overall.

If we then look at the various markets and we start with the Europe, Middle East and Africa region. First of all markets in Central and Northern Europe were rather stable but the positive thing is that we saw a stabilisation now of the market in South Europe. Here a continued recovery although from a low level in Spain but also we saw markets such as France start to stabilise and that’s of course positive. But if we look at Europe overall I would say that we are seeing a slightly more positive overall sentiment than in previous quarters – it’s not significant but at least slightly in the right direction. Also what has developed slightly better than we expected is the overall market in the Middle East that grew from a good level last year. In North America the market continued to grow, the previous trends continued there and Asia Pacific, their market volumes weakened marginally because of the slight decline in new equipment markets in China. Markets continued to grow in Australia and the recovery continued in India – those were both positive.

Now let me address China again a little bit more in detail because I know there’s a lot of questions relating to that so I can try to address some of them up front. The first message related to China is that we had a good performance. We continued to outperform markets and grew faster than the market at close to 5% when the markets declined slightly. If we look at the market overall one of the important points to remember is that the market is not one homogenous market. The market actually has many different environments within it. If you look at a Tier 1 city the market development continues to be positive. There’s growth in the market, the overall real estate markets are quite strong and our customers in those markets are developing well and growing. If you on the other hand look at some of the lower tier cities we see a clearly more challenging situation and we can see that our customers have challenges in getting financing and also inventory levels are at quite a high level in some of the cities.

If you look at the overall market, we can also see that the area where we see most growth is infrastructure and that is of course driven by stimulus measures. Other than that we don't see a significant impact from stimulus as of yet but I'll return to that. If we then look at the overall pricing environment in China, as I mentioned earlier that the competition for market share particularly in China is very intense but in particular in China I would say that we have been able to grow in a declining market without sacrificing our margin and that we have been able to achieve as a result of a very good development in our overall product competitiveness, the strength of our team on the ground and our good and broad distribution in the market. I would say if we look at the overall pricing trends they have continued to be challenging and we can expect also that situation continues but of course our objective is to continue to improve our competitiveness as we have very successfully done in the past as well.

Now going forward we expect the market for this full year this year to be stable or slightly down. If we look at the impact of government stimulus in the market, that is not significant and we can't really see it as of yet other than in the infrastructure segment, so the market remains uncertain and in some places very challenging. But I think also we see that there are some good news also coming out of the markets. In the second quarter for example real estate transactions increased quite solidly throughout the market and we could see in the past few months that pricing improved in the top 100 cities now on a sequential basis. So I think that these positive developments gives us again confidence in our longer term view in the Chinese market of the continued strong urbanisation on the improving quality of urbanisation. So we can say despite a challenging market we can see that if competiveness is strong, it's a big market with a lot of opportunities, it's also possible to as we have shown to perform strongly in that market environment. That's again a little bit more in detail about the Chinese market and our performance there.

Let me then go to our services business and start with maintenance. As all of you know one of our most important strategic objectives is to accelerate the growth in our maintenance business and I'm happy to say that our maintenance sales developed positively in all geographic regions on earlier trends, in fact a slight acceleration even and our sales growth in Asia Pacific continued to be strong, so a good overall performance in the maintenance business. If you look at the market we can say first of all that Europe and North American market continued to grow although before there continued to be differences in the market environment overall and competition, the competitive environment continues to be tough in many markets. Asia Pacific, here we've continued to see very good trends in the market. The market has continued to grow and that's of course a good thing for us given the very strong market position we have in Asia Pacific overall and that we can see how we are able to turn that into strong sales growth in that region.

Then if we look at our modernisation business, here our orders received grew slightly. Also our objective here is to accelerate the growth so this is an area where I think we can do better. Modernisation sales grew strongly in North America – here we are doing quite well but in Europe, Middle East and Africa I believe we have good potential to improve our growth rates. If you look at the markets overall, in North America the markets continued to grow somewhat and also markets in Central and North Europe grew, but in South Europe they remained at weak levels.

In South Europe I would also like to highlight one positive market which is Spain and here we can see again from Spain that when the overall market economic environment improves then we can also see a clear correlation to the modernisation market. As we know the Spanish economy is recovering and we can see that clearly in the modernisation market, but overall as I said many other South European markets still remain challenging.

So that's about our businesses and our market development. If we then go to our development programme, as you know we have always three year cycles in our development programmes and we are now halfway through them. I would say first of all that I think we have had solid development in them overall and we can see that we have strengthened our competitiveness in many areas. Today we always highlight one of the areas, I want to highlight what we've done in what we call our most competitive People Flow solutions where our objective is to have the most competitive elevator and escalator offering and develop solutions for smart buildings, so first of all here the focus is again on how we can strengthen our competitiveness in the key growth markets and that we have done again during the first half of the year. In the first quarter we launched the KONE MonoSpace Elevator that is specifically designed for the Indian residential market. It brings all of KONE's strength in this product with ride comfort, with energy efficiency and what is new what we are bringing to the Indian residential market is a much more attractive visual design and options on that side, so I think that the attractiveness the elevators will bring into the residential market in India, we are clearly taking to new levels with this product. I must say that I'm very pleased how this has been received by our customers since it has been launched.

Another important growth market at the moment is the overall infrastructure and public transport market. For this we have launched a new version of our infrastructure escalator, the KONE TravelMaster 140 to make sure we have a stronger competitiveness in this key growth segment. Also when we look at smart buildings we have strengthened our offering in North America with our People Flow Intelligence Solutions and related to that we have also launched our turnstile 100 product in that market. So again you can see many different improvements in our competitiveness in growth markets of the world.

Then finally a market outlook which we have slightly specified and starting with the new equipment market. First of all Asia Pacific, the market is expected to be rather stable in 2015 and the Chinese market as I mentioned already, we expect that to remain stable or decline slightly this year. In Europe, Middle East and Africa we expect the market to grow slightly. In Central and North Europe markets expect to be stable or grow slightly and in South Europe we expect to start to see a recovery also from a low level but at least we can start to see a recovery and this we can see through the recovery we're seeing already in Spain and the stabilisation of the markets in France. In the Middle East we now expect the market to grow slightly this year. In North America we expect the good trend to continue and the market to continue to grow. In the maintenance market the overall outlook is the market environment will remain very much similar to what it has been so far for the market to grow overall but with variations from market to market and we expect that the development in Asia Pacific will continue to be positive.

Modernisation market, rather stable in Europe but continue to grow in North America and Asia Pacific and given the weight of Europe we expect the market overall to be rather stable or grow slightly. So I would say that's on the positive side the most important changes are that we are seeing a slightly better environment in Europe.

Then finally KONE's business outlook, we have now six months of the year behind us so we have specified our outlook and on sales we have now narrowed our range a little bit. We expect sales to be between 6-8% in comparable currencies, previously we expected it to be between 6-9%. In the first half year we've grown at about 7% so I think that this range is very much in line with that; and if you look at our operating income, here we now expect it to be €1,090 million to €1,250 million and here we assume that translation exchange rates now remain at the average level of January to June 2015. Previously we expected the range to be from €1,140 million to €1,230 million assuming exchange rates at the level of January to March. Previously we expected that translation exchange rates would bring about €100 million positive to our results. Now we're saying we expect with these translation exchange rates that it will be positive of about €100-120 million, so we look at the specification of our range, we can see that actually most of it is because of good underlying performance but also because of improvements in translation exchange rates.

So I would say if we look at this outlook, if we look at the strong order book we have and the broad-based strong execution we have, I think we have quite a good confidence for our performance for the rest of the year.

So with that I think we have now a good time again for questions.

Katri Saarenheimo: Thank you Henrik. Let's start with questions from people present here in Espoo, Finland.

Question: On the strong modernisation phase, it was negative Q1, is it kind of lumpy or is the underlying sales growth?

Henrik Ehrnrooth: If you look at our performance over the past quarters, we have had better performance in orders received than in sales. Now we just had more of the sales coming through from the order book. There is some seasonality but it's particularly good performance in North America where our order book is stronger and we have grown our orders received over the past couple of years quite strongly where they start to come more through now.

Question: And on the Middle East you're expecting some growth now versus Q1. Could you talk a bit about what's happened in the market?

Henrik Ehrnrooth: We see actually the Middle East is interesting, we see quite a broad based good market in many different countries in the Middle East and many different sectors, so there's quite a lot of infrastructure happening, quite often the residential market is quite good, so it's not one specific market, it's actually quite broad based.

Katri Saarenheimo: Ok, and we are now ready to take questions from the line, so handing over to the operator please.

Operator: Thank you. If you would like to ask a question at this time please press *1 on your telephone keypad. We will just pause for a couple of seconds to allow everyone to signal. We can now take our first question, it comes from Andre Kukhnin of Credit Suisse. Your line is open, please go ahead.

Andre Kukhnin: Yes, good afternoon. Thanks for taking my questions. Can I start with just a couple of questions on China? Could you tell us or could you confirm that in a backlog the margins that you're booking right now, that they're comparable to the current backlog or the sales level given what you've said on the pricing environment and on your ability to compete in a falling market without sacrificing profitability?

Henrik Ehrnrooth: So as I mentioned there's strong competition in the market but I think if you look at how we've been able to strengthen our competitiveness in this market environment, we have been able to compensate the pressure in the market overall, so yes, you're right on the margins. We're booking consistent with the margins in our backlog.

Andre Kukhnin: Got it, thank you. Could you tell us in terms of your two brands in China, KONE and GiantKONE, how are they performing against each other and against the market? Are both growing at a similar pace, one outgrowing the other versus the market?

Henrik Ehrnrooth: First of all we look at our China market as one whole and it's important to have the two different brands because when the market environment is different, at some point one grows more than the other, in this current specific environment given that the performance is stronger in the higher tier cities, the larger customers, then we see a better development overall for the KONE brand given the overall market, so in this we can also see a slight difference between the two. This situation varies between the two so I think really that's the strength we have is that we can really see the difference in the market and cater to different market environments.

Andre Kukhnin: Got it. Just on Europe, it's nice to see the improvement in sentiment but could you help us just thinking about the gearing of that impact on KONE, should we think about it as sort of a turning point but in terms of actual meaningful or tangible improvement or impact on your bottom line, it will be somewhat later on once that's translating into high additions to the install base and therefore maybe pricing pressure easing on service or would you anticipate actually any early impact from this already from the new equipment piece, just being aware of the very low profitability of that segment, just how should we think about the impact from Europe getting better on your bottom line?

Henrik Ehrnrooth: I would say first of all let's put it in perspective as I said, at least in Europe it's going in the right direction. If you look at Europe, Middle East and Africa, it's about 40% of our gross sales, so of course it's important. I think what's important here is that now that we had an Asian market that was somewhat slower than we've seen in the past years, we were able to actually grow well because we were able to accelerate our growth in Europe and continue to have a strong growth in North America. So of course it has some impact when we start delivering these orders. I think we have to remember that our revenue streams come from a broad set of concrete projects and different businesses in those countries. There's usually not one single market that is driving profitability but as we saw again it was broad-based. I don't think it's going to be much more in detail into that but of course always a growing market is more favourable to profitability development overall.

Andre Kukhnin: Great. Thank you Henrik, appreciate it.

Henrik Ehrnrooth: Thank you.

Operator: Thank you. We can now take our next question. It comes from Manu Rimpela of Nordea. Your line is open, please go ahead.

Manu Rimpela: Ok, good afternoon. Two questions from me, firstly continuing on China, so you mentioned that you have been outperforming the market and we know that you've been doing that for quite some time already and you say that improved distribution and improved competitiveness are the main reasons for that and also why you're able to keep prices higher. I was just wondering if you would be able to kind of give some more concrete examples of what this exactly means? Then secondly on the outlook you gave for the group and especially for areas outside of China, you sound cautiously optimistic on Europe and fairly upbeat on the US. Then if I look at the order intake on an organic basis excluding China I think it was up 8% in Q2 compared with last year so I think that's a pretty strong number, so should we read into that that 8% is a cautious growth number you think or how should we think about that 8% in the context of your comments? Thanks.

Henrik Ehrnrooth: OK. Can I ask going on to take one question at a time because I must say that your second question was so long that I must say I'm not sure I quite understood your second question, so if you could…I will start with the first one if you see if I can give something specific on China. I think the point is that it's a very broad market. We have a broad and I would say a very strong team in China. It's a very broad customer base, so in a market where you have both strong and weaker situations it's all about who has the best team on the ground with a strong product competiveness, a good distribution who finds these opportunities. I don't think I can give you any more specifics behind it. It's about even in a challenging environment there are a lot of good opportunities to market: how do you find them, how do you make sure that you have a product that is competitive against it and a salesforce that knows where the opportunities are and how you price them. That's what it's all about. It's not about individual situations. It's about having a broad-based structure to be able to deliver that and I must say your second question…

Manu Rimpela: I will repeat that one. If you look at the orders in Q2 on an organic basis, so take out China so I get to a number of something like 8% growth in organic order intake outside of China. You sound still fairly cautious on the kind of European recovery and upbeat on the US, so I'm just trying to understand how should I think about the cautious comments still on the kind of outlook but then a pretty strong organic growth outside of China, so should we see that if Europe starts picking up then that number should be a lot higher going forward or just how should I think about that?

Henrik Ehrnrooth: First of all as you know we don't guide our orders received so we don't give an outlook on that and as you know orders received can fluctuate. We have to remember this is one quarter, they can fluctuate quarter to quarter. I would say that our messages is that we are slightly – and I would underline the word slightly – more optimistic on Europe when we see the trends in there and we continue to see a good market in North America, so overall if you have a growing market and if you have your competitiveness in shape then you can of course find good growth opportunities. I don't know how much more I would comment on that.

Manu Rimpela: Ok, thank you.

Henrik Ehrnrooth: Thank you.

Operator: We can now take our next question. It comes from Jonathan Hanks of GS. Your line is open, please go ahead.

Jonathan Hanks: Hi there Henrik, just one on China again, sorry about that, just on payment terms specifically. We just have a number of peers comment on worsening payment terms in China specifically. I'm just wondering if you'd seen any impact there at all? Thanks.

Henrik Ehrnrooth: Thanks. Eriikka, do you want to address that?

Eriikka Söderström: I can comment about the payment terms in China. Yes, it has been a slightly together situation due to competition but we have been able to fall into our good payment terms, so nothing dramatic there. So good cash flow from China.

Jonathan Hanks: Ok, thank you very much.

Henrik Ehrnrooth: I think the key point is you can see our continued strong cash flow, I think that shows how we've been able to run our business.

Jonathan Hanks: Thanks, very clear.

Operator: Thank you. We can now take our next question. It comes from Michael Hagmann of HSBC. Your line is open, please go ahead.

Michael Hagmann: Good afternoon, several questions if I may. The first one, if we now look at the fact that you have 45% of your orders from China, 40% of sales, if you look at it from a risk controlling perspective I was wondering have you been increasing your controls or change the way that you manage the cash, how you get the cash out of the country just in order to make sure that if we see a precipitous decline in demand in China the company is safeguarded? Second question then would be what is the risk that as you are now seeing…

Henrik Ehrnrooth: Michael, let's take one question at a time, that would be appreciated. First of all always when a certain market gets more challenging or a specific area in a market is more challenging, clearly you take a deeper look at that, put focus and controls in place to make sure you strengthen your resourcing in areas to make sure that you collect your money and you maintain your payment terms and also as you know we have been able to repatriate our cash from China, so from that perspective we are in a pretty good situation.

Michael Hagmann: Ok. Then if you now look at the order trends, obviously you have been saying that the market is now down in the second quarter. We've seen as you know very weak housing starts and obviously also weak completions. I see that we are seeing a sequential improvement in pricing, nevertheless there is this overbuild that we have particularly in the lower tiered cities, so how big do you think is the risk that we actually see a meaningful decline in the market for the rest of the year and in 2016?

Henrik Ehrnrooth: As always the outlook that we give for the market, that is our best and transparent outlook for the market, so we don't believe that we will see a situation that you are describing. We expect the market to slightly decline or be stable year over year. Of course we continue to see…you again have to remember that the market is not one homogenous market. There are many different situations and there are a lot of higher tiered cities that are actually in pretty good shape where inventory levels are improving and are not being higher than where they've been on average over the past several years and we continue to see good urbanisation in a lot of cities. Then you have others where the situation is more challenging, so I think when we look at this net net, that's how we come to our outlook and based on customer activity and the activity on the ground that we see. That's our best and most transparent outlook for the market.

Michael Hagmann: Would you dare to look into 2016?

Henrik Ehrnrooth: As you know Michael we don't at this stage of the year give an outlook for 2016. I think what's important as I mentioned that we still are confident that urbanisation will continue to be strong in China and the quality of urbanisation will continue to improve and that is driving the density of elevators and escalators in the market, driving higher standards of living all of which are positive so I think what I mentioned is that when we start to see now again transaction volumes improving quite strongly in Q2, that gives us confidence that longer term the market has good opportunities even though we see the clear uncertainty at the moment.

Michael Hagmann: Thank you. Can I also ask about net working capital trends? Obviously we had not quite a regular pattern if we look at the second half of last year, Q1 this year and Q2 this year. Can you give us your expectation for net working capital development in the second half? Thank you.

Eriikka Söderström: First of all we don't give guidance to our balance sheet items and cash flow either, but yes, we have seen fluctuations but that is like mostly related to payables but I would say that net working capital is negative €950 million so we are very pleased with that level.

Michael Hagmann: Thank you very much.

Operator: Thank you. We can now take our next question. It comes from San Fang of Summit View. Please go ahead sir.

San Fang: Hi there. Congratulations on the very good, very solid result for the second quarter. One thing I want to further understand is your EBIT margin in the second quarter actually advanced a lot, so could you help me to understand what kind of major reason that drives EBIT margin growth?

Henrik Ehrnrooth: I would say that there are two main reasons behind it. One is the overall solid performance we had on a broad basis – that brought us good, profitable growth and good profitability. Also when we have favourable translation exchange rates at this level, that little bit also helps our margin because if you look at costs such as research and development and process development, those are more euro weighted so therefore a shift in exchange rates a little bit helps our margin as well but I would say it's a combination of…it's not one specific area, I would say it's a broad-based solid execution, plus then a little bit of exchange rates.

San Fang: Thank you. The low material cost and also part supply also helps to that?

Henrik Ehrnrooth: That has helped a little bit. Our raw material impact for the quarter was about €5 million. Remember that one of the areas we said and we have strengthened the competitiveness of our offering, we have slightly benefited, not much from raw materials but there has been a design change and a sourcing impact and so forth. There are many different areas that contribute to that and that's the reason we have been able to maintain a good and healthy level of our order proceeds.

San Fang: Could you help me to understand the cost structure of your new equipment production?

Henrik Ehrnrooth: In which way?

San Fang: Like how much is from raw materials and parts, how much is from labour, things like that?

Henrik Ehrnrooth: So first of all raw materials is not that significant of a part of it. You have to remember that we don't buy really raw materials directly, it's embedded in components that we acquire, so most of the standard components for elevators we buy from our suppliers. We then assemble some of the parts ourselves, so I would say most of the costs come from buying components from our suppliers and of course they have all of the components…

San Fang: So in cost structure, what's the breakdown of the component supply outsourced from the third parties?

Henrik Ehrnrooth: That's a very significant part of our cost base and new equipment is what we buy from suppliers.

San Fang: Do we see price decline from those component suppliers?

Henrik Ehrnrooth: You always have to look at…the answer is yes and you have to look at where does it come from and it comes from of course working with suppliers on improving designs. We have to remember that with the very significant volumes we have, we have a good benefit in the market of getting benefit from that volume, so it comes from many different sources.

San Fang: I see. The other thing I want to understand is you just confirmed that the margin for the backlog is pretty much consistent from previous years. If you look at the new order intake from China, would you say on an apples to apples basis the ASP also maintained at pretty much the same level or ASP probably also slightly declined a little bit which kind of like offset by the cost decline. How would you comment on that?

Henrik Ehrnrooth: As I mentioned because of the fight for market share there has been price pressures in the market and prices have been declining slightly, so yes, prices have declined slightly but we have been able to compensate that with improvements in our competitiveness and as a result been able to defend good margins in our business.

San Fang: Thank you. If I use your full year guidance on the EBIT and back out the second half EBIT which is comparable to the second half of last year?

Henrik Ehrnrooth: I would say if you look at our outlook I think the point is that we expect a continuous solid performance.

San Fang: Yes, it's quite solid because the second half of last year's EBIT margin was…if it's not historically high it should be close to a historical high. So I'm not sure if my calculation is right, if I just use your EBIT, full year EBIT guidance and then back out the second half EBIT margin for this year which is quite comparable to last year.

Henrik Ehrnrooth: Ok, well we don't guide our margin. We give a range for sales in comparable currencies and we give a range for operating income and from that we expect to continue to have a good and solid development in the second quarter. That's the point.

San Fang: Ok, thank you very much, clear.

Henrik Ehrnrooth: Thank you.

Operator: Thank you. We can now take our next question. It comes from Guillermo Peigneux of UBS. Your line is open, please go ahead.

Guillermo Peigneux: Hi, it's Guillermo Peigneux from UBS. Two questions if I may, could you comment a bit on how the price declines in China actually compare to the price declines that you saw in Q1 and is it fair to assume that as order declines for the market, not so much for you, the price competition is probably going to increase going forward?

Henrik Ehrnrooth: I would say that the overall trend I don't think has changed that much from Q1 so in that sense it's not a big surprise and let's see. I think we continue to expect a very competitive environment but also we expect that we can continue to perform strongly if we look over a period of time in that market as we have done so far, so I wouldn't expect any significant change to that overall equation.

Guillermo Peigneux: The second question is regarding a comment you mentioned earlier about density of elevators. I'm just baffled a little bit because if total floor space under construction at the moment is roughly flat, just growing a bit, but actually on your statement you say that order intake, orders for elevators are actually going down, that would imply that inventories are declining rather than increasing. So how can we read that comment from you? Thank you.

Henrik Ehrnrooth: I think when you look at density you have to look at it over a period because when you look at orders and you look at floor space, they don't go exactly in sync, so you can't compare them exactly but if you look at it over some period of years then you can see a continued improvement in the density, what the improvement is exactly right now, that's why it's difficult to say because you're going to have to average over a number of years. The two data points, they are not quite apples for apples.

Guillermo Peigneux: That's interesting because I was doing that…theoretically I can agree with you on the density comment when you compare elevator installations and new starts, then I can see an increasing amount of elevators per total billion square metres added, but then if I compare the total elevator installations to the total floor space under construction, it's actually a very, very let's say one-to-one relationship, almost 90% correlated so I'm puzzled because new starts is a very early indicator. It takes three years to build in China, 2-3 years, so I just wonder whether this density increases at all over the last five years for the Chinese market?

Henrik Ehrnrooth: We would expect there has been. I don't have the exact numbers here with me but that's based on our understand that there has been a continued improvement in density when you look at what types of buildings and how many elevators they have and what regulation requires.

Guillermo Peigneux: Ok, thank you.

Operator: Thank you. We can now take our next question. It comes from Max Lewis of JP Morgan. Your line is open, please go ahead.

Max Lewis: Hello, thanks for taking my question. I wanted to ask a little bit more about what you're doing with suppliers in order to lower your cost base moving forward, so if you could tell me more about that and more about supplier policy not only in Europe but also in China, that would be interesting. Staying on the topic of suppliers, one of your key suppliers recently announced that they were starting production of elevators or elevator components in South America in order to service not only the South American but also the North American market. What kind of opportunity do you see there and did you view that as an opportunity to secure more components from one of your larger suppliers at a slightly lower rate than you may have done historically?

Henrik Ehrnrooth: First of all and the first question you had, I can't give you an exact answer because if there will be one specific area where you could get a very significant improvement, that you haven't done a good job in the past, so this comes from many different streams. It's really a combination of continued development of your offering, of your product, of the materials and components you used, how you apply them, how you can reduce the number of components and of course there is some also actions on the sourcing side how you can benefit from increasing volumes you have and standardisation and so forth. It's just such a broad plethora of areas you need to look at when you talk about the overall strength of your competitiveness. South America supplying to the US, we have many suppliers. I don't know exactly what…maybe it could give us some opportunities. As you know we are not in South America, maybe it could help our suppliers in North America – I don't know. We have good suppliers there, there's a good competitive situation so I think that…I don't think that that's such a big individual factor for us.

Max Lewis: Ok, thank you very much.

Operator: Thank you. We can now take our next question. It comes from Jiahuan Wang of Exane BNP Paribas. Your line is open, please go ahead.

Jiahuan Wang: Hi, thank you for taking my question, it's Jiahuan from Exane. I have a question regarding the service business in China, could you give us an update on the conversation rate in China in Q2 please and maybe the sales split between service and new equipment and the growth rate in service? Thank you.

Henrik Ehrnrooth: We continued from a growth perspective, we continued strong growth in our service business in China. We've said that it has been compounding reasonably at about 25% and it continues to do at that good level, so it continues still to be less than 10% of our sales, so not much use on that front and overall still conversion rates, it's not a big change, so for the KONE brand we continue to operate at around 60% and then if you include GiantKONE, for the whole of KONE it's a bit lower.

Jiahuan Wang: That's very clear, thanks. I have a follow-up, you have increased your workforce in China last year by about 20%. I guess many of them therefore your investment in the service team…how is the head count development in China for this year, for now or you have a general target for the end of the year?

Henrik Ehrnrooth: We haven't set a specific target but we continue to increase our head count in China particularly as you said on the service side. That's I would say a more labour intensive part of the business and I think there when you grow one of the important areas is you continue to get more skilled technicians into your workforce to make sure that you can have a good service delivery, so we have very active training programmes ongoing in China and we will continue to expand our service workforce in the market. That's I guess how specific we can be there.

Jiahuan Wang: Ok, thank you. Maybe one last question about your American business. We see the order accelerated this quarter. It seems the biggest driver is the volume product and maybe I'm wrong because I was just reconciling your comments with volume product growth, so can you give a little bit more colour on this? Are you getting more market share in the US or if the general online market is rebounding more faster?

Henrik Ehrnrooth: We believe that we would have grown in the first half of the year faster than the market in the United States. The market is growing but I believe we are growing faster than the market.

Jiahuan Wang: And the key driver behind this, any reasons? Any segments or it's growing faster…?

Henrik Ehrnrooth: The segments that are growing are both commercial and residential and if you look at the trends in the North American market they are favourable for us because the machine room segment overall continues to take market share from the hydraulic segment and we are a very strong player in the machine room led market, so we have a good overall competitiveness in the market. We have strengthened our team so I think in that sense…you have to remember it's not only product, it's the team you have on the ground, it's a combination of that and I think we have been able to improve on both sides.

Jiahuan Wang: Ok, very clear. Thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: Thank you. We can now move on to our next question. It comes from Glen Liddy of JP Morgan. Please go ahead.

Glen Liddy: Good afternoon. In terms of the margins for original equipment, I think in the past you've suggested that China is around the group average but in developed markets it's below the group average – is that still the case?

Henrik Ehrnrooth: Our best new equipment margins are in China, that's correct.

Glen Liddy: So going forward if we've got no growth in China and stronger growth in the rest of the world, do you think you can keep the margin and the order backlog at the current level?

Henrik Ehrnrooth: I wouldn’t start speculating on that. I think Glen our objective is to continue to grow profitably if we can continue to improve our competitiveness we can also improve our profitability in each of the markets. That’s how we look at it. The most important point is that when we grow, we grow profitably. There are slight differences in the profitability but that’s the most important point and that’s the way we continue to generate good cash flow and returns in this business.

Glen Liddy: And for China, are you seeing any cancellations of orders?

Henrik Ehrnrooth: No, not really. Our cancellations overall have continued to be at a very low level as they have been in the past. The answer to that is no.

Glen Liddy: In terms of the delivery profile, I know you don’t give us an average delivery time but the order backlog today particularly for China stretching over the next 12 months, is it the same percentage of the backlog that will be delivered over the next 12 months as you had over the last 12 months or is the time getting longer?

Henrik Ehrnrooth: Do you want to comment on our delivery backlog?

Eriikka Söderström: I would say that the fluctuation has remained at approximately at the same level as in the previous years.

Glen Liddy: Ok then. Thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: Thank you. We can now take our next question from Bill Wilson of Redburn. Please go ahead sir.

Bill Wilson: Yes, good afternoon everyone. I've got two questions please. Firstly on your pricing, thanks for the comments on China. Can you give some commentary on what pricing developments you've seen in Europe and North America? I know there was commentary in the press release that perhaps some quantifications of what pricing trends you're seeing there. Thanks.

Henrik Ehrnrooth: First of all if we start in the most positive area, so in North America our pricing is improving, so that's good. In Europe overall not a significant change. We have to remember that many European markets are still quite weak even though we see slight positiveness and positive development we have. I think in China as we said that pricing is slightly down given the strong competition for market share there.

Bill Wilson: I think in the past you said that your Chinese market pricing is down 2-5%. Can you say where European pricing is versus that and where North America pricing is versus that?

Henrik Ehrnrooth: We don't usually open up to such detail. You have to remember Europe has so many different markets as well and a little bit of a different development there but I think overall as I said positive trends in the US, Europe more mixed but more stable and China I think we discussed already.

Bill Wilson: Ok, thank you. Just coming back on Chinese maintenance, growth rates are still growing at 25% but I think you said the conversion rates haven't really changed much and I'm just curious as to why you're not seeing the conversion rates move up either for GiantKONE or for your KONE brand given the investment you're doing in maintenance, so why conversion rates have soared.

Henrik Ehrnrooth: As you know the overall market structure is such that there are lots of independent players that also continue to grow their…I think what's important is that we continue to grow at a very good rate in China and we have a good performance. I think it's clear that over the coming years our objective is to increase the conversion rate but given the market structure it's not something you change overnight but I think our clear objective over the coming years is to improve that.

Bill Wilson: The conversion rates has been rising though from 2007, 2011 also and then they appear to have lulled a bit over the last few years. Do you think it's fair that we've hit kind of a level at which they can't really rise much further?

Henrik Ehrnrooth: I don't think so. I think that as the market develops I think the focus on quality of service and productivity of service will become more important and I think then we will have a good positive. I'm confident that over time there will be a favourable development but it's not something that will change overnight I would say. The good thing is that particularly with the KONE brand our performance continues to be solid and we are a very significant presence in the market.

Bill Wilson: Have you started to take share yet from the competitive install base in China or are you still very much focusing on your own install base for now?

Henrik Ehrnrooth: The China basis is predominantly KONE equipment and GiantKONE.

Bill Wilson: Ok, thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: Our final question today comes from Martin Flückiger from Kepler. Please go ahead sir.

Martin Flückiger: Yes, good afternoon. This is Martin Flückiger from Kepler Cheuvreux. Two questions if I may: just coming back to your outlook on new equipment and market growth in China. Looking at the recent statistics coming from the National Bureau of Statistics of China, by the way I'm aware of the statements you made on the heterogeneity of the market, but just looking at those statistics, particularly looking at land purchases and looking at new construction areas, looking at inventory levels overall, the outlook is of a slightly declining market particularly given the fact that Q2 was already slightly declining seems to be somewhat overly optimistic. How would you respond to such a claim? That's my first question. Then secondly coming back to…

Henrik Ehrnrooth: Let's take again one question at a time, we can provide more clarity that way. I would say just remember that we have a very…I think first of all we have a very good team on the ground in China. We have a very broad team on the ground in China. We follow the market very closely there, of course have a close reaction with our customers. Based on everything we see in development of the market in China this is what we believe at the moment and also when we look at overall real estate investment in the market, this is our best and most transparent view and what we of course are committed to stick to.

Martin Flückiger: Ok, thank you very much. Then second question, coming back to the EMEA, particularly Europe, if I remember correctly the statement in the Q2 report was Europe overall was flattish to slightly up and if I remember also correctly the statement on your own order intake growth in Europe was looking for clearly growing in Europe – I think those were the words. So if there's a discrepancy are you gaining market share and if yes from whom?

Henrik Ehrnrooth: I would say that we had overall a good performance and did we grow faster than the market? We probably did. Were we taking market share? I don't know, probably. I can't exactly say but I would say overall I would say that I think the key message and the key takeaway from the quarter is that our performance was very strong on a broad basis including Europe and I think that's important and that's why I'm very happy about how strong the execution we had on a broad basis.

Martin Flückiger: Ok, thank you very much.

Henrik Ehrnrooth: Thank you.

Operator: We have one final question from Norbert Kretlow of Commerzbank. Please go ahead sir.

Norbert Kretlow: Good afternoon ladies and gentlemen. One follow-up on China if I may. Could you share your view with us on the effect of the stock market drop? It looks like in particular private investors have been hurt and could there be any spill over effect to developers offering and a low return for their properties they sold?

Henrik Ehrnrooth: I think there are better experts to assess the impact of the stock market volatility we've seen in China. I think the best understand we have is if they can keep it more stable at these levels or if the market stays more stable at these levels the wealth effect should be limited and in the end the number of private individuals active in the stock market is not that high so at least based on the intelligence and understand we have so far, it has not had a significant impact on either investments in real estate…in fact investments in real estate are going up at the moment; and also consumptions seems to be pretty solid.

Norbert Kretlow: So you're hearing no complaints from the real estate developers?

Henrik Ehrnrooth: We don't see any significant impact on our developer customers in this.

Norbert Kretlow: Good to know. Thanks.

Henrik Ehrnrooth: Thank you.

Operator: As we have no further questions at this time I'd now like to turn the call back to the speakers for any additional or concluding remarks. Thank you.

Katri Saarenheimo: Thank you. We are then ready to conclude the call from today, so thank you everybody for your participation and we would like to wish you a very nice rest of the day. Thank you.

Henrik Ehrnrooth: Thank you.