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Otis Worldwide Corp. (OTIS)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Michael Rednor
Senior Director-Investor Relations, Otis Worldwide Corp.

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

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

OTHER PARTICIPANTS

Nigel Coe
Analyst, Wolfe Research LLC

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Julian Mitchell
Analyst, Barclays Investment Bank

Patrick Baumann
Analyst, JPMorgan Securities LLC

Cai von Rumohr
Analyst, Cowen & Co. LLC

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Miguel Borrega
Analyst, Exane SA (United Kingdom)

Nick Housden
Analyst, RBC Europe Ltd.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Otis' Third Quarter 2021 Earnings Conference Call. This call is being carried live on the Internet and recorded for replay. Presentation materials are available for download at Otis' website at www.otis.com.

I will now turn over to Michael Rednor, Senior Director of Investor Relations.

Michael Rednor
Senior Director-Investor Relations, Otis Worldwide Corp.

Thank you, Michelle. Welcome to Otis' Third quarter 2021 earnings conference call. On the call with me today are Judy Marks, President and Chief Executive Officer; and Rahul Ghai, Executive Vice President and Chief Financial Officer.

Please note except where otherwise noted, the company will speak to results from continuing operations excluding restructuring and significant non-recurring items. The company will also refer to adjusted results where adjustments were made as though Otis was a standalone company in the current period and prior year. 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.

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

Judith F. Marks

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

Thank you, Mike, and thank you, everyone, for joining us. We hope that everyone listening is safe and well. Otis continues to make significant progress driving our long-term strategic priorities as reflected in the strong financial performance year-to-date. In the third quarter, we grew organic sales and expanded margins in both segments. We gained approximately 1.5 points of New Equipment share this quarter and year-to-date on top of 60 basis points in the prior year. On a year-to-date basis, New Equipment orders were up mid-teens with growth in all regions, reflecting our continued focus on providing value for our customers and a recovery in our end markets throughout the year.

In the quarter, New Equipment orders were particularly stronger in Asia, up mid-teens, where we secured an order for the Hong Kong International Airport, extending an over 20-year relationship with this customer. We will install over 100 escalators and moving walkways to keep passengers moving across the concourse. This is further progress of our sub-strategy to win in infrastructure. In China, we're seeing traction on our new Gen3 connected elevators, re-affirming our investment in the innovation that Otis ONE provides to our customers and passengers. Just a few months after officially launching our Gen3 elevator, we secured our first repeat customer in China for the new platform. [Foreign Language] (00:02:56) property developer company ordered an additional 123 Gen3 elevator systems for four more commercial and residential projects in Northeast China. We're also making progress on deploying our Gen360 connected elevator platform in EMEA. In first few months after launch, we received several Gen360 awards, adding more than 50% to the pilot phase volumes.

Moving to Service. In the quarter, we grew our industry-leading maintenance portfolio by 3%, a goal we set for ourselves entering the year, and grew organic service sales for the third consecutive quarter. In the Americas, Otis was selected to continue a 35-year partnership with One Commerce Square in Downtown Philadelphia. Otis installed the building's original elevators in the 1980s and has been maintaining units since then. Otis will now modernize the building's elevators, including the introduction of our Compass 360 destination dispatching system. Won portfolio modernization awards are a testament to Otis' service excellence and longstanding customer relationships.

The strong year-to-date company performance and robust cash flow generation in excess of 140% of net income enabled us to complete $725 million in share repurchases. In September, we announced a tender offer for the remaining interest in Zardoya Otis, a premier elevator business in Spain, Portugal, and Morocco with a strong service presence. The transaction will simplify our corporate structure and operations while optimizing alignment of assets and debt financing in Europe. We expect this transaction to be mid-single-digit percentage-accretive in 2023.

In parallel with the strong financial performance, we made additional progress on our ESG initiatives. Focusing on sustainability has always been an integral part of our operations culture, and achieving ISO 14001 certification for all of our factories is an important part of our existing efforts. We're pleased that this quarter, we achieved this goal years ahead of schedule, adding our factories in Korea and Florence, South Carolina. We're proud to see several programs recognized at these two factories including power consumption reduction programs, robust package recycling processes and lubricant leakage prevention measures. In addition, in Florence we launched a pilot for a zero waste to landfill program that will scale to other manufacturing sites next year as we work towards our goal of having all factories eligible for zero waste to landfill certification by 2025.

We also made progress on our social initiatives, launching the second year of our Made to Move Communities signature CSR program. Participating colleagues will guide 200 student participants from 20 schools across 12 countries and territories to develop creative mobility solutions while also helping to close the STEM skills gap. This year, we aim to make a difference by helping communities adapt and leverage better design and newer technologies to address the mobility, health and safety concerns of older populations. We look forward to sharing these solutions and highlights of the program with you during our Lift Our Communities Month in April of next year.

Now turning to slide 4, Q3 results and 2021 outlook. New Equipment orders were up 3.8% in Q3 and up 10.3% on a rolling 12-month basis. Organic sales were up 8.1% in the third quarter with 14.1% organic growth in the New Equipment segment and 3.6% organic growth in the Service segment. Adjusted operating profit was up $63 million and margin expanded 20 basis points despite a 50-basis point impact from segment mix as the New Equipment business grew faster than the Service business. Year-to-date, we generated robust free cash flow of $1.4 billion or 141% conversion of GAAP net income.

This positive momentum and our progress on our long-term strategy gives us the confidence to improve our 2021 outlook and positions us well to build upon this strong performance in 2022. We now expect sales for the year to be approximately $14.3 billion, up 11.8% to 12.3% versus the prior year and up 8.5% to 9% organically. Adjusted operating profit is expected to be in the range of $2.18 billion to $2.19 billion, up $260 million to $270 million at actual currency and up $195 million to $205 million at constant currency. We're improving adjusted EPS from the prior outlook by $0.04 at the midpoint and $0.06 from the low end and now expect it to be approximately $2.95, a 17% increase versus the prior year. Lastly, we're improving our free cash flow outlook to approximately $1.5 billion to $1.55 billion with 125% conversion of GAAP net income.

With that, I'll turn it over to Rahul to walk through our Q3 results and 2021 outlook in more detail.

Rahul Ghai

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

Thank you, Judy, and good morning, everyone. Starting with third quarter results on slide 5, net sales grew 10.8% to $3.6 billion as the strong growth momentum continued in New Equipment, and Service grew for the third consecutive quarter. Adjusted operating profit was up 12.5% or $63 million and up $52 million at constant currency, primarily from the benefit of higher volume in both segments. Installation productivity initiatives in New Equipment and favorable Service pricing and productivity helped to offset the headwinds from commodity inflation and the absence of temporary cost actions taken last year to alleviate the impact from COVID 19.

We maintained the focus on cost containment while continuing to invest in the business. Adjusted SG&A was down 70 basis points as a percentage of sales despite the step up in public company expenses. R&D and other strategic investments were up slightly versus prior year and were about flat as a percentage of sales. This strong focus on execution resulted in 20 basis points of margin expansion in the quarter and 70 basis points of margin expansion at constant segment mix. Third quarter adjusted EPS was up 11.6% or $0.08 driven by $0.11 of operating profit growth partially offset by $0.04 from a higher adjusted tax rate due to the absence of accumulative year-to-date tax benefit in the third quarter of 2020. On a year-to-date basis, the adjusted tax rate is down by 180 basis points.

Moving to slide 6. New Equipment orders were up 3.8% at constant currency. Orders momentum remains strong in Asia up, mid-teens, including six consecutive quarters of growth in China. As expected, after 47% growth in the second quarter, orders declined year-over-year in the Americas primarily due to timing as awards which precede order booking in North America were up approximately 24% versus the prior year. EMEA was down 1.8% from the timing of major project orders. Proposal volumes in the quarter also continue to show signs of strong demand globally, up double digits. Total company backlog increased 4% and 1% at constant currency from strong growth in China. Pricing on new orders declined by over 1 point and backlog margin was down about 1 point versus prior year. Both pricing on new orders and backlog margin were about flat sequentially.

Year-to-date, New Equipment orders were up 15%, including 13% growth in the Americas, mid-single-digit growth in EMEA, and approximately 20% growth in Asia. Organic sales were up 14.1%, with growth in all regions. Americas was up mid-teens driven by strong backlog execution as the business surpassed pre-COVID levels. EMEA was up low single digits and Asia grew high teens driven by China where organic sales were up double digits. New Equipment adjusted operating profit was up $33 million from higher volume. Pricing was marginally unfavorable in the quarter and higher commodity prices were a headwind of $35 million, but we more than mitigated these impacts through strong installation execution, including favorable project closeouts leading to 80 basis points of adjusted operating profit margin expansion.

Service segment results on slide 7. Maintenance portfolio units were up 3% versus the prior year with global improvements in retention, recapture and conversion rates. The number of units increased in all regions and China was up high teens, accelerating from the mid-teens growth in the second quarter. There was pressure on modernization demand in the third quarter and modernization orders were down 4.1% at constant currency as growth in EMEA and Asia was offset by decline in the Americas primarily driven by timing of orders as the market is recovering strongly in 2021. Overall, modernization backlog was up 2% at constant currency.

Service organic sales were up 3.6% with growth for the third consecutive quarter as the business continues to recover from the impact of COVID. Maintenance and repair grew 4.7% with strong recovery in repair and low single-digit growth in contractual maintenance sales. Modernization sales were down 1.2% as growth in Europe and China more than offset declines in Asia Pacific from lingering COVID-related lockdowns and in the Americas from supply chain shortages. Adjusted operating profit grew $27 million as higher volume, productivity initiatives, and improved pricing and mix more than offset the absence of favorability from COVID-related cost containment actions taken in the prior year. Adjusted operating profit margin expanded for the seventh consecutive quarter and was up 30 basis points.

Overall, year-to-date results reflect solid performance with approximately 1.5 points of New Equipment share gain, our best portfolio growth in the last decade; 11% organic sales growth and $261 million of adjusted operating profit growth, with margin expansion in both segments. We also generated close to $1.4 billion in free cash flow, enabling us to complete $725 million in share repurchases, raise dividends earlier this year, continue with bolt-on acquisitions, and announce the tender offer for the remainder remaining stake in Zardoya Otis.

Looking forward to the balance of the year on slide 8, we feel confident about strong growth across all key metrics for the year. We now expect organic sales to be up 8.5% to 9%, up 1 point from the prior outlook with improvement in New Equipment segment. We now expect operating profit to grow between $260 million to $270 million, up $15 million from prior outlook at the midpoint with sales growth, operating profit growth and margin expansion in both segments. Adjusted EPS is now expected to be approximately $2.95, $0.04 higher than prior outlook at the midpoint and up 17% versus the prior year. The year-over-year EPS increase is driven by strong operating profit growth, a reduction in the adjusted tax rate, and a reduced share count.

The adjusted tax rate is now expected to be in the range of 28.5% to 29%, more than a 150-basis point reduction versus the prior year and a 25-basis point improvement from the prior outlook at the midpoint. Following strong year-to-date cash generation from net income growth and over $300 million reduction in working capital from the end of last year, we now expect free cash flow for the year to be between $1.5 billion to $1.55 billion. This is up $50 million from the prior outlook from improved net income and reduced working capital.

Taking a further look at the organic sales outlook on slide 9. New Equipment is now projected to be up 15% to 15.5% driven by accelerated backlog conversion and a 15% year-to-date orders growth. This is an increase of more than 250 basis points from the prior outlook and over 11-point improvement from our expectations at the beginning of the year. This broad-based improvement in expectations is supported by robust market growth in all regions, strong year-to-date performance and continued backlog growth. Americas is now up high teens, sorry, up mid-teens, EMEA up high single digits and Asia up high teens driven by China.

In Service, we're adjusting our outlook to approximately 4% growth, the lower end of the prior range reflecting slower than expected recovery on modernization in the second half of the year. Modernization is now expected to be up approximately 4% for the year from up mid-single-digit previously driven by COVID-related job site restrictions in Asia Pacific, slower decision-making in EMEA, and some parts shortages in the Americas. Despite the resurgence of COVID in Asia Pacific, there is no change to the maintenance and repair outlook that is still expected to be up approximately 4% for the year driven by continued maintenance portfolio growth and recovery in discretionary repair.

Overall, the organic sales growth outlook of 8.5% to 9% reflects a strong year-to-date performance and good momentum, positioning us well to deliver growth across all regions and all lines of business while building backlog to support continued growth in 2022.

Switching to operating profit on slide 10. We now expect operating profit to be up between $260 million to $270 million versus the prior year with margin expansion of 30 basis points. At constant currency, operating profit is expected to be up between $195 million to $205 million. This represents an improvement of $15 million versus the prior outlook from the impact of updated volume expectations in both segments and actions taken to reduce the corporate expenses. FX tailwind is now expected to be approximately $65 million from $70 million that we were expecting previously primarily due to recent strengthening of the US dollar against the euro impacting the profit growth in the Service business.

The year-over-year growth in operating profit reflects the benefits of higher volume, service productivity initiatives, favorable service pricing and strong installation execution. It is partially offset by unfavorable New Equipment price mix, headwinds from the absence of prior-year cost containment actions related to COVID-19, and higher commodity prices. The headwind from commodity is now expected to be between $80 million to $90 million for the year, at the higher end of what we communicated in July driven partially by higher New Equipment volume in the year. The broader price increases announced last quarter have been rolled out and will help to alleviate the impact from higher commodity prices in 2022.

Overall, this strong outlook puts us more than $1 billion ahead of our 2019 reported revenue, with 100 basis points of margin expansion. 2021 sales, earnings and margin in both segments are expected to be higher than 2019. And adjusted EPS is expected to be up more than 30% versus 2019, reflecting broad-based improvement in performance driven by the ability to execute, implementation of the long-term strategy, and the benefits of a solid end market recovery.

And with that, I'll request Michelle to please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Nigel Coe with Wolfe Research. Your line is open. Please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning. Hope everyone is well. So, I hate to start off with the obvious question, but maybe if we just talk about China; obviously, a lot of noise in that country. I note in the appendix, there's a useful chart around sort of risky developers. But just curious what you're seeing on the ground real-time and then maybe just how share, price, and mix is evolving in China.

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

A

Sure. Good morning, Nigel. Good to hear from you. So, let me try to put China into context, and we hope that chart was helpful. As we entered this year, we were expecting mid-single-digit growth in China. We have actually seen stronger growth year-to-date and the segment itself, we believe, will end the year at high single digits. Through the first nine months, all sectors in China have been strong, residential, commercial, and infrastructure. We've seen increased activity in Tier 1 and 2 cities as well as in infrastructure and with our key accounts. The third quarter segment we believe grew mid-single-digit, and we anticipate in the plan for the fourth quarter to be down correspondingly mid-single-digit.

So, if we go back to 2020, we thought it was going to be mid-single-digit growth; we've seen that. 2021, we've seen high single-digit growth. We're still seeing healthy demand. This is the sixth quarter in a row that we've had New Equipment growth in China, but we're trying to be prudent for 2022 and we've actually planned for a flattish market there, and we're going to control what we can and what we know how to control. There's clearly heightened possibilities there could be declines next year given the macro environment in the property sector, but we believe that the strategy we've put in place and the initiatives we've put for sales coverage, for share gains and for price are really all paying off. We've added agents and distributors, so now we're at 2,300. We've added another 150 A&Ds in the third quarter. As Rahul shared in his operating comments, our portfolio growth is in the high teens, so our service strategy is paying off with more coverage and more service depots, and our proposal volume was up significantly this quarter.

So again, we're being prudent. We're watching what's going on, but we have put in place price increases. Those will yield in 2022; they won't yield quicker than that because of our long cycle business. But we're managing that as well, and I just will call your attention to that chart in the appendix and just put that as well into context. We did tens of millions of dollars of revenue across approximately 10 customers that have breached either the two or three red lines with their liquidity issues. And we share that those 10 customers are less than 3% of our China sales through the third quarter and less than 1% of Otis sales through the third quarter, but we've been mitigating this since the three red line policy has come into play. And for any of these customers that cross these red lines, we've moved to an advance cash basis. So, we're working this on an account-by-account basis. We do not believe, and we've shared that the exposure is not large, and we're going to continue to managing this effectively and executing our strategy.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks, Judy. That's really helpful. And then obviously, supply chain is another key issue. One of your competitors called out some impacts from that but also called out some product delays which – behind some of the new equipment weakness that they saw. I'm just curious; are you seeing any – it doesn't seem like it, but are you seeing any weaknesses caused by delays on construction projects? And are we seeing inflationary impacts on steel causing some delays to tendering activities out there?

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

A

Well, let me start with the steel and Rahul, please add. We're not seeing delays due to steel. Obviously, steel, again, in our New Equipment business about $300 million a year of commodities that we purchase. We've been able to purchase it. But obviously, with the steel prices it fairly escalated prices. And Rahul shared we've increased to $80 million, $90 million our impact on commodities this year primarily driven by our volumes being up versus what we shared with you in July. So steel is not causing delays, we're not seeing significant delays on job sites in terms of labor. We're all watching installation subcontract labor especially in Europe. But in terms of Otis labor, we have not had any delays in any of our job sites, and we've put plans in place. Our supply chain team has been dealing with this extremely effectively now for almost two years, whether it's semiconductors, ocean freight. We have not had delays in delivering to job sites from our New Equipment. Some of that's the benefit of our factories being local and our supply chains being local with global agreements. But we have done everything from spot buys and redesigning some of our chipsets from an engineering perspective to use more common chips to make sure there was no impact to our customers. So, we've not seen that but Rahul, I'll let you add.

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

Q

The only place, and I'm sure we'll get there during the call, Nigel, is on modernization it does impact our revenue because as Judy said, on New Equipment we can manage the shortages wherever we see them because we can have multiple shipments to the jobsite. Elevator doesn't go in one box or it is a completed unit; we actually assemble the elevator as you guys know on the job site, so it goes in a couple of dozen crates, right? So whatever parts are short, we can ship them later. But on modernization jobs, it's a little bit harder because they're shorter in duration. So on modernization, we've seen some impact from raw material shortages. And there's a little bit of a construction delay. It's not – as Judy said, we are not experiencing delays from our factories; we can manage that. But there is a little bit of construction slowdown or other shortages, and that's impacting some revenue on the New Equipment side especially here in the US. But other than that, I think we're okay overall.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Perfect. I'll leave it there. Thank you very much.

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

A

Thanks, Nigel.

Operator: Thank you. And our next question comes from the line of Jeff Sprague with Vertical Research. Your line is open. Please go ahead.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Yeah. Thank you. Good morning, everyone.

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

A

Good morning, Jeff.

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

A

Good morning, Jeff.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Good morning. Could we just talk about price a little bit first, I guess? Rahul, I think that price was down 1 but also flat sequentially. Is that correct? But really, the larger question is a little bit of color on kind of the competitive environment as you see it. It does appear you're taking some share. Is there a competitive price response that you're dealing with there? And maybe a little bit of color on the price that you do have in the market currently when you do expect it to show up in the P&L.

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

A

Yeah. Let me start with the pricing and I'll hand it to Judy to add some color on the competitive dynamics here. So overall, I think the numbers you quoted, Jeff, are exactly right. Pricing, our overall pricing was down maybe slightly more than 1 point in Q3 here and was consistent with the booked margins in Q2. And on a regional basis, EMEA was better year-over-year and pricing trends in both Asia Pacific and China was largely consistent with the first half, and Americas pricing was slightly worse than first half and it's more to mix of customers is where we saw the pressure. The distribution was a smaller share of orders, and that comes with a little bit better pricing. But pricing in Americas and the volume of business was consistent with first half.

So you put all that in context, the fact is the pricing trends, basically what we saw in first half is continuing into Q3, so no sequential change from the first half into Q3. And the price increases that we've put in place, we've rolled them out pretty much across the board at this point. And where you will see that impact is those quotes have not yet converted to orders, which is fairly typical because that's the cycle from quotation to orders and they'll probably start up, maybe showing up in late Q4, early Q1. And the benefit of that, as Judy said in response to Nigel's question, would probably show up in 2022. Let me pause there and Judy, if you want to add something on competitive dynamics.

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

A

And listen, Jeff, we're seeing strong competition I think across the board and we're seeing varying levels of price increase. And we have rolled out – we shared with you in our second quarter earnings that we had rolled out some limited price increases early in the year And then we went, right after our second quarter earnings call ended, global price increases at varying levels to understand and see what we could get in the market because we have, obviously, cost increases in terms of inflationary labor cost as well as input cost and commodities. Rahul hit it right on and the only thing I would tell you is we are seeing some headwinds on pricing, but our New

Equipment margins are up 150 basis points year-to-date, so we're able to, as we've always said, try to get it with price but we understand the lag time, increase our installation efficiency which we did very well in the third quarter globally, as well as continue to control what we can in terms of productivity in our factories, material productivity and every lever we have. So it's going to be competitive, it's going to continue to be, but the end markets are growing across the globe, so strong demand and we're going to continue to try and get price everywhere we can.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great, and then just a follow-up on China for me. Maybe just a little bit more color on what you're seeing on kind of bid and proposal and forward pipeline. And really, the nature of my question is it seems like there's some government pressure on these developers to complete projects, right, which may give us some forward momentum. But in terms of kind of the what you can see on the horizon, the visibility that you have, just any other color there I think would be interesting.

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

A

Yeah. So Jeff, what I'll say there is A, I think I said in my prepared remarks our proposal volume was up very strongly across the board and it was very, very strong in China. Our proposal volume was up close to 40% in China. I think that goes back to what Judy said earlier, is it's driven by all the things that we have done, our increase in our channel partners, increase in our sales force. Our sales force is up by more than 10% in addition to the growth in the channel partners, so we have invested a ton to increase our reach in China which is up close to 10 points as well. So, all the things that we are doing is driving incremental activity on our side.

But if you step back and even look at the market overall, if you look at the floor space under construction, it's up 8% year-to-date and 10%-plus over 2019, the real estate investment is up 9% year-over-year. And historically, there has been a very, very strong correlation between these two metrics and the elevator growth. But the reality is the situation is fluid today and after a very strong start in the first half, the start has slowed down in the last couple of months. So we're watching it very, very carefully. But again, I think if you want to grow the overall economy next year, even if you say the Chinese government doesn't set a target of 6% but they set a target of 5%, with 30% of GDP coming from the property market, it'll be hard for them to achieve 5% to 6% growth next year with the property marketing being down. So this is where I think, going back to what Judy said earlier, we expect the market to be more stable for next year. But again, we'll keep watching it and keep doing what we can control which is driving incremental effort on our side, and the healthy proposal activity is a good sign for us to come.

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

A

Yeah, Jeff, let me just add one or two other things. As we said, our share gain on New Equipment share both for the quarter and for the year so far is 150 basis points. It's at least that in China, so including in the third quarter, so our strategy really is working there. Second, we've already been approached by people other than these developers in local governments to finish some job sites on an advance cash basis. So, we believe the work-in-progress is going to continue even with the developers that are experiencing two or three red lines. And so, we're – but again, we're being prudent. We're planning for a flattish 2022 and we're going to continue to execute our strategies to gain share in that flattish 2022.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great. Thanks for the color.

Operator: Thank you. And our next question comes from the line of Julian Mitchell with Barclays. Your line is open. Please go ahead.

Julian Mitchell
Analyst, Barclays Investment Bank

Q

Hi, good morning. Just wanted to follow-up on the backlog margin because I thought that maybe would be sort of filtering through more quickly, but I think the backlog margin is down 100 points and it was down I think 50 points in Q2. So how should we think about the backlog margin sort of from here looking out over the next two or three quarters?

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

A

Yeah, no. I think Julian, you're exactly right. The numbers you quoted are exactly right. Backlog margin was down about 1 point and last quarter, we did say kind of 0.5 point, so you're exactly right. So, it got slightly worse. And again, I think going back to what we said earlier, what you will see is the pricing that we have put out in the market, that should start showing up in late Q4, early Q1, and that is where you'll see it start seeking improvement in both our booked margin and backlog margin. So that is when we expect the trends to turn. But in the meanwhile, going back to our earlier response, we are just continuing to execute really, really well on the installation side, and that is what's driving our increase in year-to-date margin, and that is offsetting both the pricing pressure and the commodity headwinds.

I mean, despite both those headwinds between incremental volumes drives higher absorption and the installation execution which we've said was always a priority, between those two things that's what's helping us continue to grow our New Equipment margin. And if you look at even the full year guide, last quarter we said maybe it's 90 basis points. In this quarter, it's up 90 basis points for the year margin expansion, and this guide we think we can get between 90 to 100 basis points. But despite everything, we are actually improving our margin outlook on the New Equipment segment for the year.

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

A

Yeah, Julian. We've really pivoted to grow off our service productivity, process changes, technology changes to really, we've always believed there is opportunity on installation, and that's where we've been focused again. Especially, we're trying to overcome both the backlog margin and the commodity pressures on New Equipment, and that's what you're seeing come through.

Julian Mitchell
Analyst, Barclays Investment Bank

Q

That's helpful, and then maybe just on the New Equipment orders by region. So clearly, people are very focused on the China and Asia numbers, but in Q3 those were very good still, so what was more interesting for me was Americas and EMEA. I realize it's lumpy, but you had the down orders there on New Equipment. I just wondered when you compare this upcycle in non-residential with the one 12 years ago, this upcycle has recovered far more quickly out of the recession than coming out 2009. So the slope of it from here, are you sort of thinking that we had an exceptionally strong V-shape and now the growth from here is fairly muted? Again, this is sort of ex-Asia and ex-China.

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

A

Yeah, let me talk to the Americas first. I mean, if you look at our guide, first of all, we've seen a faster sustained recovery in the Americas whether you go back to the GFC or 12 years ago, Julian. It's at the end of the GFC which is really when we felt it more in the Americas, and our guide has us going up mid-teens from the low teens. We've got a strong backlog execution. And year-to-date in the Americas, if you take out the lumpiness and just go year-to-date, we're at 13.3% growth in the Americas and a 12-month roll of the healthy number as well. So, we see the Americas doing, coming back strong. The Dodge Momentum Index was up 164.9 and the Architects Billing Index was at 56.6, so the industries are trending in the right way and we're doing well. Again, it's no one quarter makes an orders book. We don't control all the timing on those orders. But year-to-date, the Americas has done tremendously, incredible second quarter and now again in the third quarter.

EMEA, 6.3% year-to-date, down a little in the third quarter but that's kind of timing, and we think we'll see both of those nicely accelerate in Q4. And that's important for us. We want to end the year with higher than the 1% backlog we're sitting at today, and our entire team understands that. We believe we can do that in the Americas because the awards are up as Rahul said in his opening remarks, and that is a leading indicator where we've got the awards already and we've got the LOIs and now we have to move it to a booking and get everything finished. But we expect a strong fourth quarter and plan to end the year with a backlog of 2%-plus, hopefully closer to 3%. We'll have to see where that comes out so that we start 2022 strong.

Julian Mitchell
Analyst, Barclays Investment Bank

Q

That's great. Thank you.

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

A

Thanks, Julian.

Operator: Thank you. And our next question comes from the line of Patrick Baumann with JPMorgan. Your line is open. Please go ahead.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning, Judy. Good morning, Rahul. Thanks for taking my questions. First one, just on the China exposure you detailed in the appendix. Just wanted to test the sensitivity on that versus the macro stats. So, when you said planning for a flattish market, does the assumption for a flattish market there embed any decline in floor starts? Just trying to understand how much your initiatives there and your exposures there could help mitigate a decline in floor starts.

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

A

Yeah. It's an interesting question, Patrick. Again, it's hard to draw a direct correlation between any of these metrics into the elevator markets because it depends on what's going on in the market, how many buildings are under construction which are obviously declining. And the floor starts have been down just the last couple of months after a very, very strong first half. So we've seen them the last couple of months but again, the first half was very strong. So that is where if you come back and if you look at the other metrics which I won't repeat because you've gone through those, like the construction and the real estate investment, historically they've had a pretty high correlation with the elevator market, so that is where we still believe the market is going to be more flattish for next year.

And keep in mind, that flat level is at more than 600,000 units and comes after two very strong years of growth, high single digits this year and mid-single digits last year. So we think if the market stabilizes at this level, that's a very healthy demand for the market, and driven by all the self-help initiatives that we're driving gives us an opportunity to continue to drive gains in our China business.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Okay. So it's not as simple taking 20% of sales and saying okay, floor starts are down 10; that's what we should attribute to Otis. It's more complex than that, it sounds.

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

A

Well, for sure. Yes.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

And then, if you could – this is a follow-up. Can you help bridge that 20% of sales from China down to earnings? I mean, how big a percentage of earnings is that when we take into account like the impacts from joint ventures, etcetera? And then within that, how much of that earnings is aftermarket or service versus kind of direct residential OE exposure?

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

A

Well, we haven't – we typically do not report that way, Patrick, but let me see what we can do here on the call. So, if you take our China business, year-to-date sales of about $2.1 billion or so, so that's our revenue for China year-to-date. Now, it's typically 80%/20%, 80% New Equipment and 20% Service, and the Service business is accelerating very, very nicely as well driven by the portfolio growth that we've been talking about. And what we've said historically is that China is one of our more profitable New Equipment businesses, in fact the most profitable of all regions in terms of how we report. And on the Service side, it is the least profitable of our regions. And then you put the mix on top of it so that the mix, the New Equipment/Service mix also works against the overall growth in China. So that's where – so the overall, I mean, you put all that together, the China profitability is maybe overall lower than where Otis reports, so that's kind of where we are. And then obviously, the JV share; we've got two JVs in China. And we've not disclosed our ownership, but obviously it's somewhere between 50% to 100%, so it's somewhere in there. But you're right; I mean, obviously, the profit that we earn in China gets shared with our JV partners.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Right. So without giving any specific number on that, obviously less than 20% of earnings but maybe even less than 10% of earnings? I don't want an exact number. Just kind of curious as a follow-up.

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

A

Patrick, I just want to stay away from that on the call. I think that's – we report via segments. I think I've provided enough color here and I think you guys can – you're more than smart, all of you guys to do the math, so we'll leave it there. Thank you, though.

Patrick Baumann
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks so much. I appreciate the time.

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

A

Thanks, Patrick.

Operator: Thank you. And our next question comes from the line of Cai von Rumohr with Cowen. Your line is open. Please go ahead.

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

A

Good morning, Cai.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Yeah. Thanks so much for taking – yes, good morning, Rahul.

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

A

Good morning.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

So first, Q4 cash flow, it looks like you're guiding to $170 million. Maybe refresh my memory in terms of what you have that kind of depresses that number.

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

A

So first, Cai, a really great year on cash. I mean, if you think about the working capital reduction that we've been able to drive, we've had our third consecutive quarter of negative working capital. It's down, as I said in my prepared remarks, more than $300 million from where we ended the year, so very, very strong performance on cash. Now, the two things that kind of, or I would say three things that work as you go sequentially from 3Q to 4Q, the first is that there is historically a buildup of working capital between third quarter and fourth quarter. So, if you look at the last couple of years where cash flow is available, you'll see an increase in working capital from the third quarter to the fourth quarter, so that's one driver

The second is based on the guide that we've provided, there's lower net income in the fourth quarter than in the third quarter, so that's the second piece. And we still have that tax payment in one of the European countries that we've alluded to before that's a longstanding tax matter that predates spin that we still need to make in the fourth quarter here and that we sized previously between tens of millions of dollars. So those are the kind of the three big levers I would say as you go from third quarter to fourth quarter cash flow. So that is why fourth quarter cash flow is less but still $50 million higher than where we were three months ago, and it's driven by improvement in net income and better working capital performance and a very, very healthy number for the year. I think it's close to 125%.

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

A

Yeah. We're going to be past our mid-term guidance we gave in Investor Day in terms of cash flow for the second year.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Yeah. So the big, abnormal thing is the tax payment. And then on the Zardoya purchase, I mean, if you took that cash and bought back stock, it looks like Zardoya is modestly maybe 1% accretive to full year basis and you already control it, so maybe walk us through some of the potential opportunities. For example, I think we've discussed this offline, but Spain has a tax rate of 25%. I mean, do you – and I assume you're going to issue Eurobond debt. And so, are you able to [ph] expense (00:47:30) that at a higher tax rate? So what are some of the benefits from the consolidation?

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

A

Well, let me talk about the financial piece...

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

A

And I'll talk about the operational.

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

A

And then – yeah. Then Judy, I'll handle it over to Judy to kind of talk about the operational opportunities that we have. So from a financial standpoint, Cai, it's very, very straightforward. I mean, you look at our – and I think we said this in a press release, about $80 million of net cash outflow that we make to our JV partners there, both minority and the family, the small individual shareowners and institutional shareowners and the family combined, so that's about $80 million. Now, obviously that's something that we don't have to make once we have full ownership of Zardoya. And then, we will borrow. As you said, our intention is to borrow in Europe, so we'll do the borrowing in Europe. And so that is where if you net the two out, we expect mid-single-digit percentage accretion in 2023.

Now, in 2022 it's going to be less than that because the fact is it's going to take us a few months here. We just filed the prospectus. It's going to take three to four months for that filing to get approved. Then, we launch the tender. Then, there's a delisting period and it may take us time to wrap up to the full ownership. So there's going to be a staggered increase in our ownership, and that is where I think we said in the press release we expect maybe $0.04 to $0.05 of accretion in 2022 just given the timing of the close and the timing of acquisition of shares. So those two things will get us to $0.04 to $0.05 – I think we said $0.04 to $0.06 in the press release, so somewhere in that range for 2022 and then mid-single-digit percentage accretion in 2023. Hopefully that answers the question, Cai. And then maybe Judy, you want to talk about the operational, yeah.

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

Yeah, I'll just make it simple because of the time. I mean, first, Cai, this is going to simplify our corporate structure. It'll allow us to eliminate the only remaining listed subsidiary we have and we'll save the public company costs that go with that as well. But it really will allow us to streamline our operations in Europe which gives us the launching point in the future for some strategic growth opportunities. It's a great service portfolio. We have three factories there. We love this business and we think it's just – yes, we control it which is why we're not worried about any implementation risks because we have operational control right now. But as we think about some future strategic growth opportunities across the continent, this is going to give us just that full capability to optimize everything from our talent to our operations in our facilities.

Cai von Rumohr
Analyst, Cowen & Co. LLC
Q

Terrific. Thank you very much.

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

Thanks, Cai.

Operator: Thank you. And our next question comes from the line of John Walsh with Credit Suisse. Your line is open. Please go ahead.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC
Q

Hi. Good morning, everyone.

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

Good morning, John.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC
Q

Hi. So a lot of ground covered around pricing and commodities. But I'm just curious if you can help us think about maybe 2022, or maybe I'll even broaden it and just say a deflationary environment if we start to get some relief around commodities if we've kind of hit the peak pain so to say this year. How do we think about your ability to kind of capture positive price/cost spread? Are there certain things in your contracts or just some of those escalators maybe go away? Just trying to understand the price/cost dynamics as we think into next year if we are starting to see some relief in commodities.

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

So yeah, that's a great question, John. And we have escalation capabilities in our service contracts in most of Europe and the Americas that are primarily indexed to labor, and most of those tend to renew, the majority in the first quarter of the year, so we believe that will be to our benefit. Those clauses are resident in those contracts and have been there for many, many years; we just haven't been able to exercise them. So we will certainly try to flow through service price increases and we'll see what the market will bear there. But we have the ability to do that and the majority of them are indexed to labor, but there's some small portions that are indexed to material or commodities. Again, we haven't had that opportunity; it is a customer negotiation point. But we think that will at least start off 2022 stronger in terms of service pricing.

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

A

Yeah. And on New Equipment, again, I think we've said kind of before we expect some commodity headwinds next year, John, on the New Equipment side. Given where the commodity prices were in the first half of this year, we expect first half of next year to kind of be in the same range as where we were in the second half of this year, so call it $30 million to $35 million a quarter, so maybe $70 million for the first half. And then beyond that, if you look at the commodity forwards today, they will start going the other way starting May, June of 2022 and we start – right now, the forwards would project that they will be tailwinds in the second half of next year, but it's early too to call that.

But again, go back to our thesis is it's going to be that for next year, we can continue driving earnings expansion in both segments, New Equipment coming from higher volume given where Judy said we are planning to ending the backlog, kind of in that low single-digit growth range. So we'll continue to drive revenue growth in the New Equipment segment with incremental, some help from pricing that we already put in place, and of our continued execution in installation. We think we can use all that to offset any commodity headwinds in the first half and drive earnings expansion. And on Service, I think pricing should be a tailwind for next given where prices are, and the volume should accelerate to kind of more mid-single-digit growth which is what we expect.

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

A

Yeah. We've seen really good year-to-date snapback on repair, John, and we expect that to continue in the fourth quarter and into next year globally and then if we can get some of these maintenance escalators. But service pricing has been – held up really strong.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah, no, appreciate the details there. And then maybe just a follow-up here on China. A lot of ground covered already, but as I think about Otis' opportunity within China, there's kind of the market piece but also the share gains. And was just curious as you look in a flat market, if that does prove to be the case, how should we think about Otis' ability to gain share in a flat market? Is this 1.5 points kind of the right bogie? Could it be better? Should we temper ourselves a little bit? Just would love to get your thoughts on that.

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

A

Yeah. We'll share more obviously as we give guidance in 2022. But our China team has taken on the challenge to grow share and grow portfolio, and they've done those robustly this year. And we've lived through declining markets. If you go back to 2015 to 2018, we were the first to emerge really in 2018 and 2019 and to drive price increases there even when others didn't want to follow. And now, we've really I think proven share gain for two straight years and, again, sixth consecutive quarter of New Equipment growth while we're getting that share gain and driving profitability. So whether it's flat or up, we intend to gain share.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thanks for taking the questions.

Operator: Thank you. And our next question comes from the line of Miguel Borrega with Exane BNP Paribas. Your line is open. Please go ahead.

Miguel Borrega
Analyst, Exane SA (United Kingdom)

Q

Hi. Good morning, everyone. I've got a couple of questions if I may. The first one, again coming back on China. Can you comment on how are your clients reacting to these prepayments that you're asking for that you mentioned on slide 16? Is this something you just started asking or are you now rolling over to all-new orders instead of a select few?

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

A

Yeah. So we have been – the three red lines came into effect, if I get the month right, August of 2020, but certainly sometime during the 23rd quarter, and we've been monitoring this closely. And if we have clients who are not going to go to this cash payment, then we stop taking orders from them to be candid. We're managing it effectively in what we think is prudently in a risk mitigation perspective so that we don't get out ahead of their liquidity issues or become the holder of their liquidity issues. So they understand it, we've been very upfront with them. Again, we go account-by-account; that's why you have these relationships and we have these open discussions.

Miguel Borrega
Analyst, Exane SA (United Kingdom)

Q

Thank you. And I would be interested in understanding the 10% increase that you mentioned on your sales force in China. Can you shed some color on where are you investing? Are these Tier 1 cities or are you expanding more into Tier 3 cities? And can you remind us your exposure in terms of segments in China, resi, commercial, and infrastructure?

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

A

Yeah. So our sales force, I mean, obviously it's pretty broad-based, Miguel, and it's both in Tier 1 and Tier 2 cities. I mean, that is something we've done so that as we're adding more channel partners, we need our sales force to support the channel partners that we're hiring and gain our fair share of wallet from those agents and distributors. So that is where our incremental sales force is going, and it's split between both New Equipment and Service because that's what we need to do to drive our service portfolio growth. And in terms of our overall mix, I think we do very fairly well in every segment, both residential, commercial, infrastructure, so we have a fairly strong presence across all verticals. Now obviously, it depends on where the market is. And we've been focused a lot more on the infrastructure recently, and that is where if you look back at what we shared on our Investor Day, that is where we obtain a few points of share. So we continue to do well across all segments and I think our share gain is fairly broad-based.

Miguel Borrega
Analyst, Exane SA (United Kingdom)

Q

Thank you very much.

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

A

Thanks, Miguel.

Operator: Thank you. And our next question comes from the line of Nick Housden with RBC Capital. Your line is open. Please go ahead.

Nick Housden
Analyst, RBC Europe Ltd.

Q

Yeah. Hi, everyone. Thank you for taking my questions. Just a couple of quick ones from me. You've mentioned productivity gain a few times as a driver of the pretty good margin result. I'm just wondering if you can maybe quantify that a little bit more and also tell us to what extent there's still potential here going forward in the next few quarters.

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

A

So our productivity gain is coming from both segments, Nick. It's coming from New Equipment. We spoke about the material productivity when we did our first Investor Day, so we've been talking about that's a key driver for us, so we continue to push really, really hard on that. In addition, we've been driving installation efficiency, so that means better project closeouts and ending the project at a higher margin than what we booked at, and that includes both using fewer hours to install the product and taking cost out of the material because not the entire material cost comes from the factory; there's incremental material procurement that happens in the field. So we've been spending a lot of time and effort to understand where the supply base is and how we can take cost out of that, so that has been the major push here and that is where you're seeing. And again, we're in early stages of that; we just started it. We saw good results in Q2, we saw good results in Q3, so we're in early stages of that and we need that installation efficiency to continue to get better as we get into 2022. So that will be a push for us.

And on service productivity which again has been a tailwind for us despite catch-up of maintenance hours and all the COVID-related headwinds that we're absorbing, our Q3 hours are still down year-over-year to maintain an elevator. So that comes from the push that we have on Otis ONE and some of the other productivity things that we're doing. So that is what is driving our service productivity which continues to be strong in Q2.

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

A

And that's obviously what drives our profitability.

Nick Housden
Analyst, RBC Europe Ltd.

Q

That's great, and then just very quickly on the tax rate. You mentioned 28.5% to 29% this year. Is that about the right number going forward or should we expect something a bit different?

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

A

So we guided at Investor Day, and after that actually, that we expect that to continue to go down and to get to about 26.5%. Really, that's what we're expecting over the midterm, really two strong years in a row, Nick. We brought it down to about 30.4% last year from over 34% in our first year and then another, as we said, 180 basis points this year to get us to the midpoint between 28.5% and 29%. So, really good focus and it's now, what we have to do is operationalize a lot of it. But we know the path, we know the trajectory and we're going to continue down that path to get us closer to that 26.5%.

Nick Housden
Analyst, RBC Europe Ltd.
Q

That's great. Thank you very much.

Operator: Thank you. And our last question comes from the line of Joel Spungin with Berenberg. Your line is open. Please go ahead.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)
Q

Yeah, good morning. Obviously covered a lot, so just hopefully quickly maybe looking just on China again on slide 16. Just help me understand when you talk about this 3% of China sales, is that both your direct and indirect total exposure to those property developers, so including sales via third party distributors or whenever it might be? I guess the reason I'm asking just maybe to open up because I'm interested to hear your thoughts is that the risk here might not just be with potentially an Evergrande or whoever going bust but actually causes distress in the distribution network in China, and that you have exposure to distributors who might be put at risk if some of these guys go under. So yeah, just wondering if you could talk a little bit more about that in terms of what this 3% number is just to clarify that.

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

Well, the 3% we present are sales to these customers, both direct and indirect, yeah. So, that's a total exposure to these customers. I think your question, Joel, is right and I think it goes to a broader contagion issue which obviously is not represented on this chart. And again, that goes back, I mean, to all the discussions, Joel, that we've had on this call around our expectations for the China market. So not to rehash all of that, but we do expect that this is going to be – we do expect the China elevator and escalator market to be more flattish next year. So that's our current expectation, but this 3% is our total exposure to these customers...

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

All-in.

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

...all-in.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)
Q

Okay. Thank you. And then maybe just one final one quickly which was just on your comments around modernization which I thought were interesting. I mean, it sounds like you're slightly tempering your expectations for the fourth quarter in terms of modernization. Do you think that there's sort of bottlenecks here, like some of these issues are likely to result in some pent-up demand being released in 2022? I'm just interested, for example your comments about EMEA being sort of delayed decision-making, whether or not going back [indiscernible] (01:04:21) to sort of come through faster maybe next year.

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

A

Yeah. [indiscernible] (01:04:25) Joel, we think it really is demand delay versus disruption – versus elimination actually or destruction. The challenge on mod is somewhat more bespoke in New Equipment and custom, and that at least in the Americas has created a little bit of a supply chain challenge for us. So we're dealing with it. I think we've appropriately tempered the fourth quarter to the low end of the service guidance for that reason, but we don't see this or the EMEA demand or the Asia Pacific demand going away by any point. Modernization is going to continue to grow and we know what we need to do. If you look all-in year-to-date, our orders are up 4.3% and our sales are up 2.7%. So we think the fourth quarter reflects that kind of knowledge as well as what we're experiencing, and 2022 should be stronger.

Joel Spungin
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Okay. Thanks very much.

Operator: Thank you. And that concludes our question-and-answer session. I would like to turn the conference back over to Judy Marks for any further remarks.

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

Yeah. Thanks, Michelle. This solid year-to-date performance, positive momentum, and our ability to execute on our long-term strategy gives us confidence we'll deliver a strong close to 2021 with high single-digit organic sales growth, $260 million to $270 million in operating profit growth, and high teens EPS growth. While the external environment remains fluid, I'm confident the investments we've made over the last few years and our progress as an independent company have set a new path and will position us well for 2022. As always, we remain focused on driving value for our customers, our colleagues, our communities, and our shareholders. Thank you for joining us today and stay safe and well.

Operator: This concludes today's conference call. You may now disconnect. Everyone, have a great day.