Corrected Transcript

25-Apr-2022

Otis Worldwide Corp. (OTIS)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Otis' First Quarter 2022 Earnings Conference Call. This call is being carried live on the Internet and recorded for replay. Presentation materials are available for download from Otis' website at www.otis.com.

I'll now turn it over to Michael Rednor, Senior Director of Investor Relations. You may begin.

Michael Rednor

Senior Director, Investor Relations, Otis Worldwide Corp.

Thank you, Latanya. Welcome to Otis' First quarter 2022 earnings conference call. On the call with me today are Judy Marks, Chair, CEO and President; and Rahul Ghai, Executive Vice President and CFO. Please note, except where otherwise noted, the company will speak to results from continuing operations, excluding restructuring and significant non-recurring items. A reconciliation of these measures can be found in the appendix of the webcast. We also remind listeners that the presentation contains forward-looking statements which are subject to risks and uncertainties. Otis' SEC filings including our Form 10-K and Quarterly Reports on Form 10-Q provide details on important factors that could cause actual results to differ materially.

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

Judith F. Marks

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

Thank you Mike and thank you everyone for joining us. We hope that everyone listening is safe and well. We had a strong start to the year, reflected in our financial results and in the progress made on our balanced capital allocation strategy. We grew organic sales, expanded margins and achieved high single-digit adjusted EPS growth, while driving growth in all regions in New Equipment orders and our Maintenance portfolio. Our Service business experienced favorable pricing and grew revenue, margins and adjusted operating profit. In addition, we generated nearly $0.5 billion in free cash flow, while continuing to return the majority of our cash generated to shareholders.

In Q1, we completed $200 million in share repurchases and received board approval of $1 billion share repurchase authorization. In April, we announced a 20.8% increase to our quarterly dividend while acquiring the remaining interest in Zardoya Otis. After settlement of the tender offer in mid-April, we now have over 95% ownership of Zardoya Otis and expect to automatically delist it in early May. Timing was better than our prior expectations and is expected to add another $0.02 of EPS accretion in 2022. This progress sets us up well for the remainder of 2022 and beyond.

New Equipment orders were up 8.8% in the quarter with growth in all regions, leading to approximately 1 point of New Equipment share gain on top of close to 2 points of share gain since 2020. In Korea, Otis was selected to provide more than 70 Gen2 units to the Yonghyun Xi Crest apartment complex in Incheon, Korea. Otis Gen2 elevators equipped with ReGen drive technology that can deliver substantial energy savings will serve more than 2,200 apartment units. This is our latest project in the region with GS Engineering & Construction, and further strengthens our 20-year collaboration with them.

In China, we received an order to support the next phase of the Shenzhen Metro project extending more than two decades of collaboration with the installation of nearly 1,000 units to date. In this phase we'll provide more than 350 IoT enabled elevators and escalators. This award marks another milestone in our digitalization journey in China, and allows us to continue delivering the benefits of Otis ONE's predictive maintenance to our customers. In addition to executing on our financial priorities, we remain committed to advancing our ESG initiatives and published our inaugural ESG report in Q1. This report reflects the focus we've placed and progress we've made on reducing our carbon footprint, creating a safe, equitable and inclusive work environment, supporting the communities around us and maintaining best-in-class governance practices.

Moving to slide 4, Q1 results and 2022 outlook, New Equipment orders in the first quarter were up 8.8% at constant currency, and up 10.9% on a rolling 12-months basis, contributing to backlog growth of 6% versus prior year. Organic sales were up 3.1% due to the strength in our Service business which was up 5.8%. Adjusted operating profit was up $29 million at constant currency and up $9 million at actual currency, with margin expansion of 30 basis points, driven by strong performance in the Service business, as well as some benefit from segment mix. Free cash flow was robust at $474 million at 152% conversion of GAAP net income.

A few additional updates before I begin our revised 2022 outlook. In April, the agreement between the National Elevator Bargaining Association and the International Union of Elevator Constructors was ratified. This collective bargaining agreement covers the majority of Otis' US fueled colleagues, and will become effective this July with wage increases taking effect in January of 2023. We believe this five-year agreement is fair and equitable to both parties, with the annual increases generally in line with historical trends. And like in private years, we expect to fully offset this cost to increase productivity as we upscale and continue to develop this essential workforce.

In addition, we're disheartened to see the escalation of the crisis in Ukraine. We have growing concerns about the long-term sustainability of Otis' operations in Russia, especially with mounting regulations and supply chain disruptions. As a result, we are motivated to find solutions and explore alternatives for our Russia business that are in the best interest of all of our stakeholders. We remain hopeful for return to peace and stability in the region, and we will continue to contribute to the ongoing relief and humanitarian efforts necessary for those most impacted by this crisis.

Looking ahead to our 2022 outlook, given the wide range of outcomes and the process that we are undergoing, we have removed Otis' Russian operations from the current outlook as well as in the prior year compares. This adjustment will largely impact the New Equipment business. Rahul will walk through this in more detail, and a reconciliation of Otis' results excluding Russia for the last five quarters can be found in the appendix of this webcast. For the year, excluding Russia, we expect organic sales growth of 3% to 4%, with net sales in a range of $14.1 billion to $14.3 billion. Adjusted operating profit is expected to be in a range of $2.2 billion to $2.25 billion, up $105 million to $155 million, excluding the impacts from foreign exchange.

At actual currency, adjusted operating profit is expected to be in the $40 million to $90 million. Adjusted EPS is expected in the range of $3.22 to $3.27, up 9% to 11% versus the prior year. Lastly we still expect free cash flow to be robust at approximately $1.6 billion or approximately 120% conversion of GAAP net income. We remain disciplined in our capital allocation strategy, and in addition to increasing our ownership in Zardoya Otis, we will continue to return cash to shareholders through dividends and share repurchases, and advance our bolt-on M&A strategy where it makes sense and adds to the density of our growing Service portfolio.

With that, I'll turn it over to Rahul, to walk through our Q1 results and 2022 outlook in more detail.

Rahul Ghai

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

Thank you Judy and good morning, everyone. Starting with first quarter results on slide 5. Net sales were up 0.2% to $3.4 billion. Organic sales grew for the sixth consecutive quarter, up 3.1% driven by Service sales which increased nearly 6%. Adjusted operating profit was up $9 million, and up $29 million at constant currency, as a drop-through on higher Service volume, favorable Service pricing, productivity in both segments, and lower bad debt expense was partially offset by commodity headwinds and annual labor cost increases.

We also maintained our unrelenting focus on cost containment. And adjusted SG&A expense was down $17 million versus the prior year, and down 60 basis points as a percentage of sales, despite the inflationary trends in the economy. R&D trend and other strategic investments were flat versus the prior year. Given the strong cash flow and progress on repatriation, we completed our deleveraging and repurchased $200 million of shares in the quarter. Overall, growth in operating profit, reduction in share count and continued progress on reducing the tax rate resulted in first quarter adjusted EPS growth of 6.9%.

Moving to slide 6. New Equipment orders were up 8.8% at constant currency with growth in all regions. Orders momentum remained strong in Asia, up mid single-digits, with about 10% growth in Asia, ex-China. China orders were up 3%, the eighth consecutive quarter of orders growth in the country, and outgrew the market that was down mid single-digits. Orders in America were up high single-digit, and awards which proceed order booking were up nearly 25% in North America signaling continued strong demand. EMEA orders were up 17% with growth in both Europe and the Middle East. Strong orders growth contributed to total company backlog increasing 4% and 6% at constant currency with growth in all regions, including approximately 6% growth in Asia.

In addition, global proposal volume was up low teens with more than 25% growth in China, demonstrating robust market activity and the benefits of increased sales coverage. Globally, pricing on New Equipment orders was about flat in the quarter on a year-over-year basis. New Equipment organic sales were down 0.5% in the quarter. EMEA was up mid single-digits, but this was offset by low single-digit decline in both Americas and Asia. Americas declined due to a tough compare from COVID recovery in the prior year, and in Asia, China was impacted by jobsite closures towards the end of the quarter. Adjusted operating profit was down $12 million, partially from the impact of lower volume. Commodity inflation of $38 million that was in line with prior expectations was largely mitigated by installation and material productivity and lower bad debt expense.

Service segment results on slide 7. Maintenance portfolio units were up more than 3% from broad-based improvements in retention, recapture and conversion rates, with recaptured units more than offsetting cancellations in the quarter. In China, conversion rates continued to improve and contributed to third consecutive quarter of high teens portfolio growth. Modernization orders were down about 6% in the quarter, but are up close to 6% on a rolling 12-month basis, driving backlog growth of 3% versus the prior year. Service organic sales grew for the fifth consecutive quarter, up 5.8%, with growth in all lines of business.

Maintenance and repair grew 5.6% with mid single-digit growth in contractual Maintenance sales, above our unit growth due to improved pricing that was up approximately 2.5% adjusted for geographical mix, and the benefits of strong repair volumes. Modernization sales were up 6.9% with strong growth in Americas, EMEA and China. Modernization sales declined in Asia Pacific on a tough compare after a strong demand in Southeast Asia in the prior year. Service adjusted operating profit was up $17 million with 30 basis points of margin expansion, the ninth consecutive quarter of margin improvement. Profit at constant FX was up $40 million driven by benefit of higher volume, favorable pricing and productivity, and partially offset by annual labor cost increases.

As you look forward to the balance of the year on slide 8, we are excluding Russia both in the current outlook for 2022 and in prior year comparisons. Overall, organic growth expectations of 3% to 4% are unchanged at the midpoint, with the improvement in Service offset a lower New Equipment growth expectations. Total company margin expansion of approximately 30 basis points is also consistent with prior expectations. We're raising our outlook for Service margin improvement to 70 basis points from 50 basis points previously from better Maintenance pricing and drop-through from higher volume.

However, this is getting offset by reduced margin expectations in the New Equipment segment from increased headwinds on commodities and higher freight cost, and the impact from lower volume growth. Overall, adjusted EPS is expected to be in a range of $3.22 to $3.27, up 9% to 11% versus the prior year after adjusting for Russia. This strong growth is driven by an increase in operating profit, accretion from the Zardoya transaction and progress on reducing our tax rate and share count.

Taking a further look at the organic sales outlook on slide 9. The New Equipment business is projected to be flat to up 1.5%. This is a 1 point decrease from the prior outlook at the midpoint, driven by adjustment in sales growth expectations for EMEA and Asia. While the backlog in EMEA is up more than 5%, our customers are requesting postponement of deliveries due to a broader slowdown in building construction activity, pushing shipments from 2022 to 2023. As a result, we now expect EMEA sales to be up low to mid single-digits for 2022. In China, our backlog at the end of Q1 was up 4% from strong orders growth. The current lockdowns are not only impacting shipments but also disrupting the supply chain.

While we expect deliveries to pick up starting May, given the supply chain challenges, we are adjusting our 2022 China outlook to be down low single-digits from flat to down 3% previously, as some sales move to the right. Given the lowered volume expectations in China, Asia is now expected to be down slightly for the year. Outlook on New Equipment organic sales in Americas remains unchanged and is expected to be up low single-digits in 2022. Turning to Service, we now expect organic sales to be up 5% to 6%, an improvement from the prior outlook of 4% to 6% driven by better-than-expected Maintenance pricing and repair orders in the first quarter, and higher confidence to execute our modernization backlog from the steps we have taken to resolve the supply chain challenges.

Switching to adjusted EPS bridge on slide 10. We now expect adjusted EPS growth of 9% to 11% with operating profit growth of $105 million to $155 million at constant currency. This increase of $0.17 to $0.26 versus prior year is driven a strong operational execution, higher volume and favorable pricing. This is partially offset by commodity headwinds which we now expect to be $110 million for the year, $20 million higher than in the prior outlook and incremental freight cost. We're absorbing the higher commodity and freight cost through increases in productivity and better Maintenance pricing, and the midpoint of profit growth expectation at constant FX remains unchanged.

Foreign exchange translation is now expected to be an $0.11 headwind versus the prior year, and $0.04 worse than the prior outlook, primarily from strengthening of the US dollar against the euro and the yen. The euro is now expected to be $1.10 for the year implying $1.09 for the balance of the year. The $0.11 FX headwind is more than offset by $0.12 of in-year accretion expected from the Zardoya transaction. This estimate is $0.02 better than the prior outlook from a faster pace of acquisition of shares. The balance of the EPS growth is driven by progress on reducing the adjusted tax rate now expected to be approximately 27.7% for the year and a lower share count.

We have completed $200 million in share repurchases for the year and plan on completing an additional $300 million in the balance of the year at the high end of the prior outlook. This guidance clearly reflects the acceleration of both sales and profit trajectory of the Service business and the benefits of investments, and our sustained focus on driving productivity. And while the New Equipment business is challenged this year due to the current macro-economic environment, a robust backlog, pricing actions and over $100 million of EMEA productivity to ensure that the business recovers sharply once the commodity and the freight headwinds abate.

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

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] And our first question comes from Nigel Coe of Wolfe Research. Your line is open.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Good morning, everyone. Thanks for taking the question. So a lot to talk about. Maybe just to start up with China, what we're seeing right now in China, obviously lots of headlines about potentially Beijing locking down. So curious, what impact you're seeing and what we might expect for 2Q.

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

A

Yeah. Good morning, Nigel. It's Judy. So we had a really strong start to the year, and I've got to just applaud our China team for their tenacity and resilience, really good start, New Equipment orders up low single-digits, backlog up mid single-digits and their portfolio up high teens for the third straight quarter. Our elevator factories are open in China, including our one in Hangzhou, which is outside of Beijing, confirmed that as well as recent as today. But we've seen some challenges with shipments and obviously slight access.

So what we've done is, we really expect the second quarter to be lighter due to the COVID lockdowns, and we've really adjusted the rest of the year to be down low single-digits mainly from our suppliers needing to restart their operations as well. So this is of kind of full supply chain impact where we manufacture in China, mainly for China. We think it's a reasonable approach. We're going to continue to monitor how things come back in China. But again, our elevator factories are open, and the timing of the reopening could push some performance into 2023, and that's why we think it's a prudent guide. We revised China New Equipment to low single-digits down, and took our full guide down on New Equipment mainly because of this.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks Judy. That's great. And then on pricing. We're seeing obviously very strong pricing in Service, I think 2.6% if I'm not mistaken. Equipment orders still flat on pricing. So the two questions here is, any reason why we shouldn't expect that kind of cadence on Service pricing to continue? And then are we electing to not get pricing in equipment to maybe gain share, or is there still a lag impact on the pricing recovery?

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

A

So pricing, let me start with Service, Nigel. We're seeing pleased we're seeing good Service pricing, increased more than 2 points in Q1 and we expect that to continue. Very strong start on Service pricing in the Americas followed by EMEA. So we still have a mix as China is growing at the high teens in terms of the portfolio, but really pleased that between the volume and the portfolio and the Service pricing, that's why we're seeing such a nice guide in Service, and we raised our outlook 5% to 6% growth there. We expect that to continue as the year goes on, we see no reason not to.

We're exercising our clauses that give us that ability to up our Service pricing because of inflation, and our sales folks are being able to realize that price. So very pleased with that. In terms of New Equipment, overall, we're flat globally. Good performance in Asia Pacific and EMEA, Americas is flat. We expect Americas New Equipment pricing to improve throughout the year, continuing the second half of 2021 trend they had. China is under pressure on pricing, and their pricing is down, but overall, we expect to end the year with flat pricing on New Equipment.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thanks Judy.

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

A

So Nigel, just maybe a point or two to add on China. First thing, what we're seeing in China is, as Judy said, the pricing was a little bit under pressure, but what we're seeing is that the volume business is doing well. That is where we've actually gained a little bit of pricing, flattish to up on the volume side. The larger projects is where we are seeing the pressure. So that is where the pressure is coming through. The flipside on China is that, the commodity prices in China, unlike the rest of the world are also coming down. So if you look at the rebar steel, that was down close to 10% in Q1.

And the hot rolled coil which is another commodity that impacts the steel prices, down close to 5% in the second quarter. So the China commodity market is behaving a little bit differently than the rest of the world. So that is why maybe the China pricing trends are little bit different. But overall, as Judy said, we are kind of flat for the quarter. And for the year we're largely expecting that we will mitigate the backlog pricing headwind that we inherited from last year by in-year price increases. So largely we'll be kind of flattish on price for the year.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. Thank you.

Operator: And our next question comes from Steve Tusa of JPMorgan. Steve, your line is open.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hey, guys, good morning.

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

A

Good morning, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So on the Services business, some of the key stats that you talked about as being pretty positive, the whole attrition recapture. Can you just give a little more detail on those, just a little bit more or like maybe rolling averages on those metrics, those KPIs?

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

A

So we typically don't provide those quarterly, Steve, as you know. But overall, the trends were fairly robust across all three, retention to recapture and conversion. I think we saw global improvements in all three metrics. Retention continues to be our – as we've discussed previously, continues to be our focus, and that improved year-over-year in the quarter, kind of in line with the full year improvement we saw for all of 2021. So that trend is good. Recaptures are very strong, especially in China, and as I've said in my prepared remarks, recapture units exceeded the cancellations in the quarter. So that contributed to our portfolio growth.

And conversion trends look really good. I mean, again, with China, where we see the maximum opportunity driving the way, and that was a big contributor to the portfolio of growth here. So overall, listen, we are very, very pleased with the way things progressed. We have, as we said previously, a really, really strong focus on that, and there was a subtle change in what we said, but that's, our portfolio grew more than 3%. So it's actually that the continued traction that we said we grew, 3% last year and in Q1 it's more than 3%. So that's, we feel good about the full year growth on Service portfolio growth.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

I think Schindler said something about a big difference in order volume versus order price in, specifically in North America, like a double-digit difference. Anything going on there with regards to timing of price increases? Sid you guys see that, a pretty significant between orders, the volume and price in current developed markets, North America?

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

Yeah. As we said, our pricing in North America was flattish. So North America pricing was flattish. I mean, the only part in New Equipment where we, to respond to Nigel's question, Steve, the only place where we saw little bit of pressure on price was China. So that's where the rest of the world kind of behaved, and we expected North America to improve starting Q1, because the cycle time from proposals through actually booking the order is really long in North America. So we expected, Q4 our pricing was down in the Americas, and we always expected that Q1 we will see the sequential improvement, and we did. So that is good, and hopefully it continues to gain traction as we go through the rest of the year. But in China, the pricing was under a little bit of pressure as we previously discussed, and there was a difference between our units booked and the overall revenue growth in China.

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

Yeah. Steve, we're seeing a really strong market in North America. Our orders were up 9.1%, the awards as Rahul said, we're up nearly 25% which is our leading indicator. Resi, non-resi, but especially multi-family in North America is just really coming in very strong. 12 months roll in the Americas is 13%. So the market is strong, we're seeing – obviously we have a lag from the time we book till the time we recognize that revenue, but we think that bodes very well for the rest of 2022 and 2023.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Okay. Great. Thanks a lot.

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

Thanks Steve.

Operator: And our next question comes from Jeff Sprague of Vertical Research. Your line is open.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Thank you. Good morning, everyone. First, just kind of on housekeeping on Russia. Would you have kind of been anticipating something similar to that $0.06 for 2022 in your original guide, and maybe you could just elaborate on what the plan is there, are you unwinding the business, you are trying to find somebody to acquire it, just a little unclear on what the plan is there actually.

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

A

Yeah. So let me answer the first part of your question, Jeff, and then I'll hand it over to Judy for the second part. So we were expecting a little bit of growth in Russia. The markets were strong getting into the year. So we're expecting a little bit of growth in Russia as we got into the year. But for the sake of ease, we've kind of took [indiscernible] (29:18) because we can size the number. But in our original guide we had a little bit of growth coming from Russia. Judy, maybe you want to take the second part of the question.

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

A

Yeah. Thanks. Good morning, Jeff. So I think everyone is aware that we stopped taking New Equipment orders and making new investments. We've been very public about that, in Russia. And really, we are right now evaluating the best ownership structure for the business, whether that's with us or somewhere else, and that's why we removed it from the outlook. We really wanted to be able to have a useful comparison. We're working through our backlog in Russia to try and meet existing customer commitments. Candidly, it is very challenging due to supply chain issues and sanctions, and really against that backdrop that we're evaluating options to provide a more certain future for the business. I can't comment on potential future transactions, but we will update you in due course.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great. Thanks. And then just coming back to Service, it's nice to see the uptick in the margin outlook, and I'm sure some of it's explained by price. So I just wonder if you could unpack a little bit more what you're seeing as it relates to mix and adoption of the IoT offerings across the geographies. You've had this outgrowth in China which would technically be mix negative, right, and the margins are looking better in spite of that. So just wondered if you could unpack that a little bit more for us. Thank you.

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

A

Yes. So on Otis ONE we had a strong start to the year, especially versus last year first quarter, and probably 21st quarter. So we're picking up nice momentum there, and we are headed towards our medium-term outlook of 60% of the portfolio covered. We also had some really nice progress in eView bookings which gives us another connected product, as we exited the quarter, we had significant eView bookings as well. But we're really starting to see both the volume pick up, and as Rahul said, all three categories are doing better conversion, retention as well as really bringing portfolios, bringing items back to our portfolio.

Productivity is strong. It is taking care of any labor increases we're seeing. And even our apps that we don't talk about as much anymore, Jeff, have really seen sustained uptick. We're still rolling them out in some of our Southeast Asia countries as recent as last month. And if you look at the apps, we saw a 20% increase in repair sales booked through the upgrade app year-over-year, the Tune app which really gives our mechanics just that ability to use their iPhones to do vibration checking is up more than double same period last year, and we had a 50,000 parts ordered which is up mid single-digit plus over the year before all using technology.

So our mechanics are getting more productive. Otis ONE is adding that ability to be predictive, they've got the ability to see what's happening with transparency with our customers, and we're seeing actually Otis ONE make a difference in our recaptures when customers come to us, put us back on Maintenance because of Otis ONE. So all-in-all everything is trending, and that's why we've got confidence in the Service, not just in the revenue side, but it will with volume it's going to fall through and the incrementals are going to be strong.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great. Thanks for the color.

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

Nick Housden
Analyst, RBC Capital Markets

Q

Yes. Hi everyone. Thank you for taking my questions. My first one is on China, and if I heard you correctly, you said that you grew orders 3% against the market that was down mid single-digits which seems like a pretty significant outperformance. So I'm just wondering what exactly the components are, is it partly because when you talk about the market you're including the lower tier cities where maybe the declines have been sharper, whereas your focus is more higher tier cities, where my understanding is demand has been holding up a bit better, or just any color you could give would be helpful there.

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

A

Yeah. Let me start Rahul, and I'll let you add. But we saw share gain of about a point globally but we saw a share gain clearly in China. We came into the year and we expected our backlog to cover 60% or so of the revenue and the rest – for the in-year revenue, and the rest would be kind of book-to-bill. We thought that book-to-bill, Nick, would be down 5% to 10%, but what we saw in the first quarter was it was only down 5%. So that was fairly positive. As you look at the first quarter though, we did well Tier 1 through Tier 4 cities. So it wasn't just the big Tier 1s, we really did well in Tier 1 to 4, and we grew share there, and we grew share in every vertical, residential, commercial, high-rise and infrastructure. So it was an across-the-board gain in terms of share from our China team. And I think that's what really led to the up 3% in New Equipment orders and the backlog of mid-single now.

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

A

And Nick, not a lot to add. I think Judy has kind of covered it. I think we covered verticals, we had share gain in all verticals, and what we saw in the market was, the market was down about 5% in the quarter. Where we saw the growth, we saw growth in industrial and on the infrastructure side, and residential as you would expect was down in the quarter just given the [indiscernible] (35:10) that we had. And the minus 5% that we saw in the market was actually little bit better than what would have thought going into the year.

We still expect the market to be down 5% to 10% for the year. That estimate has not changed, even though some of the metrics have moved around. The construction was up kind of 1% in the quarter, investment was down a couple of points, the new starts were down maybe 20-plus-percent in the quarter but that was a tough compare, and then obviously you had the impact from COVID. But the inventory is kind of holding in China. So inventory is still at that 3.5 months of inventory. So our estimates for the year on China market growth have not changed. So we're expecting minus 5% to minus 10%, and with Q1 being down about minus 5%.

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

Yeah. I think it's just execution of strategy, Nick. Our sales coverage is there. We kept A&Ds, our agents and distributors around 2,200. There has been some churn in them as the lower performers are exiting, we bring on new for coverage. But our sales coverage actually globally went up about 150, by 4%, and even though our SG&A went down significantly. So we're driving everything, and it's all about executing our strategy.

Nick Housden
Analyst, RBC Capital Markets
Q

That's great. And then just one more on China and looking up working capital. So you're expecting the market to be down 5% to 10% this year, and I'm just wondering what the potential impact could be on working capital, and specifically in terms of the prepayment position. Should we expect this to be down with at all or will it just increase at a slower rate?

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

Yeah. Our business in China did really well on cash last year, Nick. I mean, we were up more than 20% over 2020 levels in 2021. And for the year, for 2022, we kind of expect similar level of improvement in free cash flow in China. So last year, if you look at 2021, our receivables were up slightly less than 10% on revenue that was up more than 25%. So we did really well on cash management in China. But obviously, the situation is volatile. We're looking at our payable situation. We're extending some advances to our customers to ensure supply. But at the same time, we're also looking at, okay, where we can, we are stretching the payable terms. So we're kind of going both ways, managing it on a supplier-by-supplier basis. But overall, listen, the situation on cash in China was good last year, and we expect similar level of performance in 2022.

Nick Housden
Analyst, RBC Capital Markets
Q

That's great. Thank you very much.

Operator: And our next question comes from Julian Mitchell of Barclays. Your line is open.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Hi, good morning.

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

Hi, Julian.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi, good morning, Judy. Maybe just switching away from China perhaps to Europe, little was interestingly talked about the kind of push-outs there into 2023. So maybe just a little bit more color I suppose on, was that the Europe-wide comment, or there's just particular markets that are being affected? And you had very, very strong New Equipment orders growth in EMEA in Q1. Just wondered how you're expecting those European orders to play over the balance of the year. And when you think about the broader Europe market, the last time they had some kind of GDP downturn, obviously, Service price [indiscernible] (38:45) was under pressure. How you feel the market structure is different today, if at all?

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

A

Yeah. So as you said, our orders were strong in Europe, and we are seeing – so the backlog was up as I said in my prepared remarks, it was up more than 5%, and it was up more than that clearly. But what we're seeing, Julian, is we are seeing delays in construction activity, and that's pretty much all the major European or mostly major Western European markets. So we are seeing that slowdown which is extending our delivery times from our factories. So that is what we are seeing, and that is the reason we kind of looked at our revenue expectations for the year in EMEA and we took them down slightly. We were up kind of mid single-digit levels last time, and we took them to mid-to-high this time or low-to-mid this time.

And part of that was obviously Russia coming out, because Russia was a faster growing market, so some of that impact was just Russia getting pulled out and some of that was construction, and now we think it's low-to-mid. But as you look at the overall construction activity in EMEA, that is kind of holding. So if you look at the building permit activity, that was up 2% to 3% over last year, I think they're expecting that to continue. And so that is where we expect that our orders growth in Europe should be okay for the year. We're not expecting any big slowdown at this point. So the business seems to be holding up, and all we're seeing is this delay in revenue recognition and the pricing was good as well. So we saw, we picked up pricing up low single-digits in EMEA. So overall, the business is doing well, except for the slowdown in construction that is impacting us.

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

A

Yeah. It's not a demand issue, Julian. It's just a delay in the delivery and the recognition of revenue.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Understood. Thank you. And then just on the operating profit line, so I think your adjusted op profit at constant currency was up $29 million in Q1 year-on-year, and the year as a whole you're guiding up around $130 million. So you're sort of just taking it, looks like that the Q1 increase and then sort of times it by four across the quarters. Wondering if there was any kind of cadence on that profit development to call out or it really is as simple as sort of $30 million, $35 million increase every quarter? And then specifically on that point, you mentioned the cost inflation headwind of $110 million for the year. What was that in Q1? How do we think about that in the second half, the $110 million?

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

A

Yeah. So let me start with the second part of your question first, Julian, then I'll get to the first part of the question. So overall, commodity headwind is about $110 million for the year, about $38 million in the first quarter. Similar levels expected in second quarter. And what has shifted from the last estimate is clearly we're expecting a little bit of headwind in the second half of the year which was not in our prior expectation, and that's driven by the higher energy prices in Europe that are driving up aluminum cost and also some of steel prices in Europe have gone up. And same thing in North America. We're seeing commodity pricing moving higher in North America as well offset to some extent by lower prices in China. So commodity headwinds is one tenth for the year, about $76 million in the first half, the balance in the second half of the year.

Now in terms of cadence, you're right. I mean, what we saw, you can think it's kind of a run rate, but what you're seeing obviously, the earnings in New Equipment were pressured in the first quarter because of the higher commodity headwinds. And we're expecting kind of similar level of pressure on New Equipment earnings in the second quarter. So the margins in New Equipment on an year-over-year basis are going to look very similar in the second quarter as they did in the first quarter. So the margin expectations in New Equipment first quarter, second quarter are going to be similar. And if you look at our full-year margin guide, that is more or less in-line with the first quarter margin guide. So we're not expecting a huge acceleration in New Equipment margins, and maybe that's a little bit conservative as we get into the second half, maybe there is a little bit of tailwind. But given all the uncertainty, we felt that, okay, holding the margins kind of at sequentially flat to Q1 levels was appropriate.

Now, as you move to Service store on the other side, we do expect acceleration of margins on the Service segment. And the biggest driver of that, A, obviously sequential revenue growth in Service that comes with a high drop through. But also, if you go back to Q1 of last year, we still had the impact from COVID. So in Q1 of this year we had some of the cost coming back that were not there in Q1 of last year. So we absorbed that incremental cost and yet grew margins. So as we get into the second to the fourth quarter, that headwind is not there, and that helps us drive higher Service margins. So that's the underlying cover. But as you look, overall, obviously good start to the year. And we expect Q2, same, we expect to grow revenue in the second quarter, and then EPS on a year-over-year basis and on a sequential basis should be up as well in the second quarter.

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

Hey Julian, the only other thing I would add is, what we saw in repair in the first quarter was very positive, which shows even in the regions where people are concerned about office populations, we're seeing elevator usage pick up in the really, in the commercial side of the business as well. And our repair business certainly indicated that in Q1. That's going to help drive again this margin expansion in Service as we go through Q2 through Q4.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

That's very helpful. Thank you.

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

Thanks Julian.

Operator: And our next question comes from, Joe O'Dea of Wells Fargo. Joe your line is open.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC
Q

Hi, good morning. Thanks for taking my questions. I wanted to go back to a comment I think last quarter just talking about the cadence around Americas, and I think Judy you had mentioned that there were some larger projects in Americas that you're kind of scheduled for back half of the year. Just wanted to kind of check-in on that, see if those timelines are still kind of going according to plan.

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

A

Yeah. Joe, good morning. They are, I mean, we had secured some large projects in 2021 that will actually not just be second half of this year, it will be more strong in early 2023. And that's still consistent, those projects are all on schedule. So what we said last quarter still holds.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Got it. And then it looks like there was a $20 million cut to CapEx guide. How much of that is Russia-related, how much of that is other factors?

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

A

Some impact from Russia. But we are just looking and calibrating the full-year, so that's what we did. So just, nothing major, things move around all the time. There's not a big cut in any one line. But there is definitely some impact from lower investments in Russia. But overall, it's just kind of minor tweaking in different lines.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

And then maybe just a clarification on Service price. The pricing you got in the quarter, how much of that was contractual just on kind of escalators, how much of that was maybe a little bit more proactive on activity levels?

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

A

Well, it all takes activity. So even though we have those clauses in the contract, they don't automatically happen at a renewal unless we can enforce it and sell the value of what we're doing. So our sales force had to go out and basically make all of that happen. So there was nothing that would just happen automatically, mechanically or commercially. So it was all make happen, and the team did a great job explaining how we had additional costs, and how it's appropriate for those to flow through on price.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Got it. Thanks very much.

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

A

Yeah. Thanks Joe.

Operator: And our next question comes from Cai von Rumohr of Cowen. Your line is open.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Terrific. Thank you very much and nice results.

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

A

Thanks Cai.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

So to follow up on Jeff's question, I mean, we have terrible relations with Russia. The numbers weren't bad, but presumably going forward, are you concerned that basically there will be any sort of penalties put on you or operating difficulties as a result of being a US company? And what should we think about the ultimate exit, I mean, are you going to be able to get your bait back, or are they basically going to squeeze you so it ends up being a loss?

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

A

Well, Cai, I think it's important to reinforce that we are following all sanctions that have been imposed by the US, the UK and the EU. So we are following all of those rules. We provide an important life safety service everywhere in the world, especially in our Service business. So obviously, we are evaluating who should be or could be the rightful owner of this asset. And that's the evaluation we're under. We'll share more as we learn more, but we'll have to see where that evolves.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Got it. Thank you. And then turning to your Service population, so you were up obviously. I think you said high teens in China, which looks like it suggests the rest of the world was up 1.5%, 1.8%. Could you give us some color on the Service population growth in each of the other three areas, as well as some comment in terms of the growth versus how much from conversion, what was the retention was, and what was the recapture in M&A? Thanks.

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

A

Yeah. No, so as we said overall, Cai, good growth globally, obviously strong growth in China. And the other emerging markets in Asia did well as well, but we did grow our portfolio in both Europe and the Americas as well. Obviously, they are lower growth economies, and so they contribute a lower amount because the growth is clearly happening in Asia, but it was global improvement with improvement in all four regions. And then your second question on conversion, I think the conversion rates obviously moved up a lot overall throughout the world, but especially with the improvement in China kind of driving that. And that is where we expect most of the improvement to come.

And the cancellation rate is good, I mean, we keep making progress, and the fact is that we may – and especially and where that is really important is in the more mature markets in the US and in the Western European economies. And that is where, if you look at our improvement this year, that is where we saw the maximum improvement in our retention rates. Both Europe and US did really well, or Europe and the Americas did really well on improving their retention rates. And that is what we really need to see because that also drives price, because losing that portfolio hurts us the most. And by improving our retention rate, that drives incremental price and incremental margin. But overall, really pleased with the progress we're making globally.

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

A

Yeah. And Cai, we were 1% two years ago, actually in 2020 we were 2% of portfolio growth – 1% in 2019, 2% in 2020, 3% last year. We said we'd be 3% plus. That's what's driving, again, everything, we've said that to drive that portfolio is the key to our Service success, and we just had our fifth consecutive quarter of Service organic sales growth and our ninth consecutive quarter of adjusted operating profit growth in our Service segment, and growth in every region this quarter on the portfolio. So that's what we need to continue to see going forward. That's what our team is focused on.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Yeah. No, I get that. But you give projections for everything else, obviously you mentioned how well China is doing. If China continues at upper-teens even at mid-teens as it's getting bigger, that has some leverage on the rest. So what's the potential that you could be close to the 3.5% for the full year?

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

A

Definitely. I mean, our expectation, I think, we said it just post Investor Day, Cai, that we see portfolio growth edging – continue to improve, and there is a clear line of sight at some point to this portfolio growth starting with maybe a 4% and then maybe even going up from there. But we take this in small steps. And every quarter is a dart point on the board, and all these dart points make up a trend. So I think that's what Judy kind of alluded to, just kind of a sequential improvements. And I think we're putting another dart point on the board with this quarter. And we are hoping that by the time we end the year, this number starts with a 4%, but we're not there yet. So we'll keep marching forward.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Terrific. Thank you.

Operator: And our next question comes from John Walsh of Credit Suisse. Your line is open.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, good morning, and I appreciate you taking the questions.

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

A

Thanks, John.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Maybe just first on pricing. Can you just remind us kind of historical cycles, the ability to hold on to the pricing you've been pushing through? And I guess, the question really focuses around, is this all still strategic or is some portion of this kind of a surcharge that, as we get may be some lack of inflation at some point, gets given back to the customer?

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

So most of our price increases are structural. There are surcharges kind of built into that number, because as we've discussed previously, we have escalator clauses which are tied to overall inflation in the economy. So that gets captured on the Maintenance side. So nothing unusual in the quarter, we should be keeping this entire price increase. Obviously, it's all market dependent, and a large portion of our portfolio comes up for renewal in the first quarter, but not all of it. So we'll keep kind of guiding to you guys as the year goes on and how this moves forward. So that's point number one.

And the second part is, and then obviously on the New Equipment side it is, once you kind of sign the contract, it's there. So I think on both sides there is no reason to give any of this price increase back. On repair, where we kind of do more brake-fix work, there are some surcharges that we add based on the travel that we need to do. So that is where we do add a surcharge based on travel. But on Maintenance and New Equipment there is nothing unusual about the price increases. We're just kind of pushing through and we should be retaining all of it.

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

Great. And then maybe as a follow on to that, just thinking about capital allocation, every once in a while you get some noise around the larger asset either in Asia or Europe. Can you just remind us kind of where doing something larger kind of fits within your cap allocation strategy of share repurchase dividend, smaller bolt-ons?

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

Sure. So we talk about the smaller bolt-ons at about the $50 million-ish kind of level a year. As you can see, when something is attractive, like Zardoya Otis, we didn't hesitate, and kudos to our team for just executing that with excellence with the squeeze out occurring. So we will be the full owner and delist in the next week or two. So we're always looking for an opportunity. We think we're at a really good leverage point right now, we're still investment grade. We were able to keep that, as well as repaying. We repaid a $0.5 billion of debt in the first quarter, after $350 million in 2020 and $450 million in debt in 2021. So we're keeping the debt kind of where we want it. Our gross debt is at about $6.75 billion right now, and we think that's a good place.

And if a large strategic opportunity comes up, whether it's in Europe or Asia or the Americans, we're obviously interested, and we're going to evaluate it, because the large generation type opportunities don't happen that often in this industry. So we're making sure we've got the flexibility on the balance sheet to do that. In the interim, the cash we generate in year, we plan on returning to our shareholders. We raised our dividend late last week, little over 20%, and now that's 45% over two years, and already bought back $200 million of shares in the first quarter, as Rahul said, we're going to do another $300 million, so we'll be at $500 million for this year. And our board reauthorized $1 billion cap for us to do that. So we're going to share with our shareholders and keep our ability to do strategic acquisitions when they arise.

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

Great. Thank you very much.

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

Thank you.

Operator: And our last question comes from Joel Spungin of Berenberg. Your line is open.

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

Q

Hi, there. Good morning.

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

A

Hi, Joel.

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

Q

Hi. On Russia, if I could start there, I just wondered, I can't see the number in the presentation or the release, maybe I've missed it. [indiscernible] (56:37) said what your operating assets in Russia is, and if there's level of any outstanding receivables or working capital there.

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

A

Yeah. Overall, we did not disclose that, Joel, but overall, our asset base in Russia is not huge. We typically do get advances from our customers everywhere in the world before we get a New Equipment order, and Russia is, call it, 80% New Equipment. So we are actually in a negative working capital position in Russia. So as and when something happens, obviously, we'll update the accounting, but we don't expect a big asset write-off. There could be some other charges that we'll have to evaluate as time goes on, but we don't expect a big asset write-off to come from anything that Judy mentioned earlier.

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

Q

Great. Okay. Thank you for that. And then can I just ask about, I was just looking at the numbers on slide 28, that [indiscernible] (57:29) the adjusted operating profit margin in Russia on New Equipment was 18%, I'm not seeing, is incredibly high.

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

A

So just keep in mind, Joel, yes, it is high and the reason for that is two-fold. One, obviously, the biggest reason for that is that, we don't do a lot of installation in Russia. We sell the equipment through our factory to people who actually install it. So therefore, that just rise higher margins because if you look at our industry, we make more money on selling the equipment and the installation part is lower profit. So that is what you see in Russia because we don't do a lot of installation that comes through, and obviously if there is some other adjustments that go through as well any time you try and pull a business out. But the biggest driver of that is just that nature of our business in Russia.

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

Q

Got it. That's helpful. Thank you. And then maybe just one quick question on China, and thank you for the detail on how you're doing there and of the outlook there. I was just wondering, to what extent, I think you talked about the market being down mid single, sort of now your current thinking. Are you able to say implicitly within what your assumptions are about sort of normalization of some of the challenges you're seeing in Russia. Are you seeing things get back together, back to something approaching normality by the middle of the year, or do you just assume that they stay roughly as they are?

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

Joel, the question is when China where we see, the market is getting back to normal in China?

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

Well, actually, more like when you see supply chains and some of the disruptions that you've seen there normalizing.

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

Yeah. So we are, obviously Q2 is going to be tough, I mean, obviously we were expecting the lockdowns to kind of end mid-April, but they've now extended. So we will see, so Q2, we're still expecting to resume deliveries starting May. So that's still part of the expectation, but obviously, we'll keep monitoring that. We think from our own delivery standpoint, we should be able to catch up as we get into Q2 and Q4, because we saw that just post-COVID after the lockdowns, we had a really, really strong Q2 in Russia in 2019 – sorry, in China, we saw really strong bounce back in China in Q2 of 2019. And we expect that as soon as the lockdowns lift, we should be able to recover. But the supply chain part is a little bit more uncertain for us because that we don't control directly, and that was the reason for taking down our guide as Judy said earlier. So we've adjusted our guide, reflecting more the supply chain issues and potential some conversion challenges with job sites and other places. But from our own factory standpoint, we are pretty confident that as soon as the lockdowns lift, we're ready to go.

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

Understood. Thank you very much for that.

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

Thank you.

Operator: I would now like to turn the conference back to Judy Marks for closing remarks.

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

Thank you, Latanya. So to summarize, we had a strong first quarter and continue to make progress on our strategic priorities while weathering macroeconomic challenges. We recognize the work left to be done to continue building on our track record of resiliency and strong execution. We're confident we'll do just that and deliver 10% adjusted EPS growth in 2022 with continued momentum in 2023 and beyond. Thank you for joining our call, and please stay safe and well.

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