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Otis Worldwide Corp. (OTIS)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Otis's First Quarter 2021 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 Stacy Laszewski, Vice President of FP&A and Investor Relations. Please go ahead.

Stacy Laszewski
Vice President-FP&A & Investor Relations, Otis Worldwide Corp.

Thank you, Stephanie, and good morning, everyone. Welcome to Otis's first 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 nonrecurring item. The company will also refer to adjusted results where adjustments were made as though Otis was a stand-alone 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's 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 different 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, Stacy, and good morning, everyone. Thank you for joining us, and we hope that everyone listening is safe and well. I'm pleased to share that Otis had an outstanding first quarter, demonstrating the power of our strategy, the global execution strength of our company, and the capability of all our colleagues. Our New Equipment business was robust, and we gained close to 2 points of New Equipment share with orders up high-teens globally in a market that was up mid-teens.

In Korea, Otis was selected to provide approximately 170 elevators, escalators, and moving walkways to support the fourth phase of the Incheon International Airport project. This addition will expand Otis's presence at the airport to over 650 units.

In China, we continue to support key infrastructure projects throughout the country, including in Xiong'an New Area, a new metropolis being built near Beijing. More than 1,000 Otis elevators and escalators have already been ordered in support of projects in the area that will be a new home to administrative services and residential communities being relocated from Beijing.

In Munich, we're continuing an over 35-year relationship with Stadtwerke München. We have been selected to install 92 escalators for the Munich Metro's modernization project, bringing the total number of Otis escalators provided to the metro system to over 500 units. Using custom-made controllers, these escalators will seamlessly integrate with the Stadtwerke mobility app to provide passengers and maintenance crews with real-time data on escalator operational status.

And finally, in New York City, we received an order to modernize 3 Times Square, the Thomson Reuters Building. We'll provide new controls, drives and Compass 360 destination dispatching on several units. This extends our long-term relationship with the building. We installed the original equipment nearly 20 years ago, and have been providing maintenance services ever since.

Our high-margin recurring Service business also grew in all lines of business, including modernization while achieving adjusted operating profit margins of 22.6%. Our strategy is based on our Service model, which drives approximately 80% of our profit. This is the model that proves our resilience year after year, including during COVID. The global Service market grows faster than the global New Equipment market, and pricing tends to be more consistent in Service.

Data- and technology-based innovations help us attract and retain customers. And in Q1, we continued to deploy Otis ONE units in the field and are shipping IoT-enabled units in both China and North America. We drove profit growth in both segments largely from the drop-through benefit of higher volume with organic growth in both segments and continued benefits from our material and service productivity initiatives.

Our strong performance allows us to create more value for our shareholders. In January, we completed the remaining $150 million of debt repayment we had committed to ahead of schedule. And just last week, we announced a 20% increase in our quarterly dividend. In addition, we're now in a position to increase our planned share repurchases for the year to $0.5 billion after completing $300 million in the first quarter. And we're equally dedicated to delivering on our commitment to the global corporate citizen.

In March, we shared additional details with you on our important ESG initiatives, including becoming a signatory of the UN Global Compact. And we continue to make progress towards our goals. Our ESG programs are integral to bringing our vision to life. This month, we completed the inaugural year of Made to Move Communities, our Signature Global Corporate Social Responsibility initiative. This pioneering program focuses on two principal goals: advancing STEM education and supporting young innovators in the development of inclusive mobility solutions for underrepresented communities.

Students from around the world put their knowledge and skills to work alongside Otis mentors to come up with many creative solutions. The winners were announced in April. We look forward to extending this program geographically and to more students and mentors in the coming years.

Turning to slide 4, Q1 results and 2021 outlook. First quarter New Equipment orders were up high-teens at constant currency with mid-teens growth in the Americas, low-single digit growth in EMEA, and double-digit growth in Asia, driven by China.

On a rolling 12 months, total Otis orders were up 1.4%. This strong order performance led to continued growth in New Equipment backlog of 8% and 2% at constant currency versus the prior year. Organic sales were up 10.3% in the first quarter, with 25.1% organic growth in the New Equipment segment and 1.3% organic growth in the Service segment.

Adjusted operating profit was up $83 million and margin expanded 40 basis points. Overall margin expansion was impacted by segment mix as the New Equipment business grew faster than the Service business. Free cash flow was robust at $541 million with 176% conversion of GAAP net income. I'm encouraged by this positive momentum, and we're confident in our revised 2021 outlook improving across all key metrics.

We now expect net sales to be in the range of $13.6 billion to $13.8 billion (sic) [$13.9 billion], up 6.5% to 8.5% (sic) [6.7% to 8.7%] versus prior year and up 4% to 6% organically. This is a 2-point improvement from the prior outlook at the midpoint, driven by faster-than-expected recovery in the New Equipment segment.

Adjusted operating profit is expected to be up $170 million to $210 million (sic) [$175 million to $215 million] at actual currency and up $120 million to $160 million at constant currency, with adjusted EPS in a range of $2.78 to $2.84, a 10% to 13% increase versus the prior year and a $0.09 improvement from the prior outlook at the midpoint. Lastly, we expect free cash flow to be robust, in a range of $1.35 billion to $1.45 billion, with approximately 120% conversion of GAAP net income.

With that, I'll turn it over to Rahul to walk through our Q1 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 first quarter results on slide 5. Net sales grew 14.9% to $3.4 billion, with organic sales up 10.3% as the growth momentum continued in New Equipment and Service returned to growth in the quarter. Adjusted operating profit was up approximately 18% or $83 million and up $57 million at constant currency, as the drop-through on higher volume, strong material and Service productivity, and favorable Service pricing more than offset the headwinds from New Equipment mix and pricing, as well as incremental public company expenses.

We maintained the focus on cost containment while continuing to invest in the business. As a percentage of sales, adjusted SG&A was down 20 basis points, despite the step-up in public company expenses and R&D

spend and other strategic investments were about flat versus prior year. This strong focus on execution drove 40 basis points of margin expansion in the quarter. First quarter adjusted EPS was up 20% or $0.12, driven by $0.13 of operating profit growth and $0.05 from lower adjusted tax rate. This was partially offset by incremental interest cost, from the full quarter impact of our external debt.

Moving to slide 6. New Equipment orders were up 18.4% at constant currency with growth in all regions. Orders rebounded strongly in Americas, up mid-teens and were up for the fourth straight quarter in Asia, including strength in China where the orders were up double digits.

Booked margin in the quarter was down 60 basis points year-over-year but improved sequentially. Organic sales were up 25.1%, with Americas and Asia up about 22% and 46%, respectively, driven by strong backlog execution. EMEA was up low-single digits, sustaining the turnaround that started in Q4 of 2020.

Despite the strong sales, there was broad-based growth in backlog that was up 8% and up 2% at constant currency, with backlog margin down slightly versus prior year and up 20 basis points sequentially from prior quarter. New Equipment adjusted operating profit was up $44 million and margin expanded 170 basis points as higher volume and strong material productivity that met our 3% target more than offset the impact of unfavorable mix and pricing.

Service segment results on slide 7. The number of units under maintenance contract increased by 2%, with growth in all regions and China up low-teens after high-single digit growth in 2020 from strong improvement in underlying operational metrics. Modernization orders were up slightly at constant currency as double-digit growth in Asia, driven by successful go-to-market strategy to leverage the mandated regulatory upgrades in certain markets, and low-single digit growth in the Americas was partially offset by lower order intake in EMEA.

Service organic sales were up 1.3% in the first quarter with continued resiliency of the contractual maintenance business and discretionary repair and modernization sales returning to growth in the quarter. Adjusted operating profit margin expanded 60 basis points and profit grew $35 million on the benefit of higher volume, strong contribution from productivity initiatives and favorable pricing. Translational FX benefit of $20 million was mostly offset by higher SG&A, including incremental public company expenses.

As we look forward to the remainder of 2021 on slide 8, we feel confident about growth across all key metrics, given the higher backlog, strength of the maintenance business and our focus on operational excellence.

Service callbacks, our proxy for repair volume, is also showing continued sequential improvement and contributed to the growth of the repair business in the first quarter after three quarters of year-over-year decline.

These encouraging trends, combined with the strong Q1 results, gives us confidence to raise the organic sales outlook to be up 4% to 6% for the year, up 2 points versus prior outlook, driven by accelerated recovery in the New Equipment business.

We now expect adjusted operating profit to grow $175 million to $215 million at actual currency, up $45 million from prior outlook at the midpoint, with sales growth, operating profit growth and margin expansion in both segments.

Adjusted EPS is expected in a range of $2.78 to $2.84, $0.09 higher than prior outlook and up 12% versus prior year at the midpoint. The year-over-year increase is driven by strong operating profit growth, a 90 basis point reduction in the adjusted tax rate to 29.5%, and reduced share count. This EPS outlook is ahead of the high-single digit medium-term growth target that we had provided at Investor Day.

Following the strong cash generation in Q1 from higher net income and more than $300 million reduction in working capital, we now expect free cash flow for the year to be in a range of $1.35 billion to $1.45 billion, $50 million higher than prior outlook at the midpoint, reflecting the improvement in net income and better working capital performance.

Given the strong Q1 free cash flow and success in repatriation of foreign cash, we raised our dividend 20% last week and are increasing the share buyback target for 2021 to $500 million.

Taking a further look at the organic sales outlook on slide 9. The New Equipment business is projected to be up between 7.5% to 8.5%, driven by accelerated backlog conversion and continued recovery in the market. This 4.5% improvement at the midpoint is driven by increased expectations in all regions and is supported by strong order intake in Q1 and demand signals from the market.

Americas is now expected to be up high-single digits; EMEA up low to mid-single digits; and Asia up approximately 10% from improved outlook in China and other markets in Asia-Pacific returning to growth.

Consistent with our prior outlook, we expect service sales to be up 2% to 4%, with maintenance and repair sales up 2% to 4% as well; and organization sales up low to mid-single digits as maintenance remains resilient and we see continued recovery in the repair and modernization businesses.

In addition to our success in Asia-Pacific, modernization growth is also driven by market growth in China and conversion of backlog in the Americas and EMEA. Overall, the organic sales growth outlook of 5% at the midpoint represents a solid turnaround after a difficult 2020 with growth across all regions and all lines of business and puts us above 2019 levels in both segments on a reported basis.

Switching to operating profit on slide 10, we now expect operating profit to be up $175 million to $215 million and up $120 million to $160 million at constant currency, reflecting the benefits of higher volume, service, and material productivity initiatives, and favorable service pricing environment, partially offset by unfavorable mix and pricing in the New Equipment segment, headwinds from commodities, and incremental stand-alone expenses.

This represents a $45 million increase versus prior expectations, driven by the improvement of outlook in both segments, lower corporate expenses, and higher translational FX benefit. New Equipment margins at the midpoint are now expected to be up 80 basis points for the year versus prior expectations of 50 basis points and above 2019 levels.

Service margins are now expected to be up 40 basis points from 30 basis points previously, building on the 110 basis point improvement in 2020. We expect overall margin expansion of approximately 40 basis points for the year. Overall, we believe that this strong outlook for the business on sales growth, margin expansion and cash flow generation reflects our focus on execution and the benefits for solid market recovery.

And with that, I will request Stephanie to please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And your first question is from the line of Nigel Coe of Wolfe Research.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning, everyone.

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

A

Good morning.

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

A

Hi, Nigel.

Nigel Coe
Analyst, Wolfe Research LLC

Q

So, the New Equipment growth in the quarter was sort of like – it took me by surprise, especially in the Americas, we're not seeing too many signs of clear strength in many of your end markets. So, I'm just wondering if you could maybe just focus perhaps a bit more on the Americas and what's driving that strength by vertical? And then on top of that the same question really is, are we seeing a higher mix of megaprojects in the mix that's driving that growth?

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

A

Yeah. Nigel, great to hear from you this morning. We were very pleased with the Americas performance this quarter and I think it goes beyond just our performance. I think we're seeing all the indicators now starting to turn, whether that's the ABI, the Architect's Billing Index (sic) [Architecture Billings Index], which is in March was at a record since the 2007 timeframe, the Dodge Momentum has turned positive as well. We're seeing that, we're experiencing that in Americas.

Our New Equipment organic sales were up almost 22% and our orders were up over 14%. We're seeing that across the volume business, as well as in some major projects. So, there continues to be recovery, especially in North America. Brazil is still suffering some of the COVID impacts. But North America, between the US and Canada, is back very strong. Again, a volume type business as well as major projects.

In terms of verticals, the commercial business, the commercial non-res in North America turned positive for us this quarter and actually did a little better than residential for us in North America. So it was a little different than we saw in 2019, but again, with the indicators and the indices heading in the right direction, and this really strong performance by our Americas team, we had growth in New Equipment orders, significant, but we also had growth in MOD orders in the Americas. So the team is executing well in local markets and then as well in national accounts.

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

A

Yeah. And the only other thing, Nigel, that I'll add is the accelerated backlog. We've been talking about it that we had substantial disruption in 2020 both because of the COVID-related issues in the factory and lack of access to job sites. And with those things not being as much of an issue in Q1 we saw a really good field execution in the Americas specifically. So that is where you saw the Americas sales being up.

And the other point, just to go back to your question on large orders, if you look at the mega orders, which is like we defined those as $10 million above, that's less than 10% of our volume in any given quarter. While those are up in the quarter, we saw really strong double-digit plus increase in the ongoing volume business as well. So it was a good performance across both the megaprojects and the volume business.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Great. That's great color. Thank you very much. I'll leave it at that. Thanks.

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

Steve Tusa
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning.

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

A

Good morning, Steve.

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

A

Good morning, Steve.

Steve Tusa
Analyst, JPMorgan Securities LLC

Q

Can you talk about what you're seeing in China, Tier 1 and 2 versus some of the other tiered cities?

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

A

Yeah. Steve, so we had this quarter our best progress in a long time in Tier 1 and Tier 2 cities. Our strategy is working and we increased our agents and distributors significantly in 2020. We added another 200 in the first quarter. But the ones we brought on in 2020 are really help yielding that access that we were looking for to grow in Tier 1 and Tier 2 cities.

The other two places we saw improvements were in our key accounts and in the infrastructure segment. They had the two largest areas of growth for us in the first Q in China. And that's important on the New Equipment side. But for us, it's even more important because our conversion rates for key accounts and infrastructure allow us to grow our Service portfolio.

Our Service portfolio grew in the low teens in China in the quarter, which beat the high-single digits from last year. So Tier 1 and 2 positive, more positive than we saw in 2010.

Steve Tusa
Analyst, JPMorgan Securities LLC

Q

And then, I guess, just thinking about the back half there and in the next year, I mean, what are some of the signs you're seeing fundamentally and how do you think the trends play out in that time period?

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

A

Yeah. For China specifically, Steve?

Steve Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah. Yes.

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

A

Yeah. So it's – listen, it's a competitive market in China. And we know that. We're also watching really the credit and liquidity situation of the major developers. We're managing effectively through that. Perry and the team are doing a really good job there. And we're deploying IoT and OTIS ONE there significantly, again, to help us on conversions.

Second half is going to be a little tougher compare for us in China, because China came back so quickly post-COVID in the second half of 2020. So we're going to watch all those factors. But the segment in China, the New Equipment segment is going to grow mid-single digits. It's the largest market in the world even despite some of the cooling measures that are still in place. We think the market is more balanced and we are going to continue to perform there.

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

A

Yeah. And Steve...

Steve Tusa
Analyst, JPMorgan Securities LLC

Q

Okay.

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

A

Yeah. Steve, just a couple of other things to add related to China. Really strong start to the year in the market. As Judy said, we expected kind of mid-single digit growing into the year. And we think that market growth could be a little bit north of that. So, a little bit positive on China than we were at the beginning of the year. And the other thing is that despite all the conversations around property market cooling down, the area under construction in China, the construction area is actually up 11%. So we're seeing strong momentum in the market in China.

Steve Tusa
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Thanks.

Operator: Your next question is from the line of Jeff Sprague of Vertical Research.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey. Two questions from me if I could. First, totally understand on kind of the accelerated execution out of the backlog, although the backlog managed to grow despite that. I just wonder if you can speak a little bit since we don't have a ton of history to go on your backlog currently relative to your forward sales expectation. Is it on the low, medium or kind of about right relative to what you'd expect as you kind of project existing backlog in the future revenue conversion?

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

A

So, good morning, Jeff. So, is the question that is our backlog sufficient to drive growth sales in the back half? Is that you're trying to go on?

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Well, yeah. I mean, clearly in dollars it is. I'm just thinking about the conversion of backlog, the revenues, right, is going to be all over the map, I would say, right, depending on the type of the project and the like.

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

A

Yeah.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

So just when you think about your revenue guidance for the year, would you say this backlog gives you kind of above or below average comfort in that revenue forecast?

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

A

Yeah. Listen, Jeff, this gives us I would say above average confidence. When we met you and everyone last February at our Investor Day, Rahul and I and the team said our goal was to end 2020 with a stronger backlog than we came in, and we did that. We've now obviously grown that backlog in 2021 in the first quarter, and we've got sufficient backlog now to see us through. And that's what gives us confidence in our outlook. What we need to do is keep growing that backlog as we end 2021 to position us for 2022. And that's where we already have the team focused.

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

A

Yeah. And typically, we expect our backlog to drive maybe two-thirds of the revenue in the year, Jeff. That's kind of our typical standard. And this year, it's going to be north of that. I mean that's part of the accelerated backlog conversion that we've been talking about is that this year we expect that revenue conversion to be higher.

And that is where it is really positive to see backlog growing in the first quarter because we did have accelerated backlog conversion over Q1 of last year, driven by better execution of the field, to Nigel's question, and higher shipments out of China. So despite that, it was really good to see the backlog growing because we did have accelerated conversion in Q1.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

And maybe just to follow on, on that. I know you probably don't want to get into detailed quarterly guidance, but given all kind of the crazy COVID comps, right, it would seem that you would have very good New Equipment growth again in the second quarter despite the fact that you pulled forward some stuff in Q1. Can you maybe just give us a little color on kind of the magnitude of revenue conversion you're thinking about for Q2 on the New Equipment side?

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

A

Yeah. So, Jeff, we always expected a strong start to the year in New Equipment because, as you pointed out, easier compares in China, but even in the Americas because Americas' revenue was down in Q1 of 2020 and we had a relatively slow start here. But as we look forward to Q2, China recovered strongly and was up high-single digits last year, but the rest of the world was still weak. So we expect New Equipment will still be strong in the second quarter, but maybe not as strong as Q1.

So that's where we think – and then Q3 should be up as well. And then compares will get tough in Q4 because Americas and the EMEA market recovered really strongly last year. So on the Service side, the flip side is true, because we got out of the gate marginally stronger than we had expected with the recovery of the repair business. But the impact to that full year is marginal. And so, we didn't change the guide there. But the fact is that we do expect Service to be up really strongly in Q2, just given the year-over-year compares were weak last year. So that's the reason we expect Service to be really strong in Q2 and then Q3 as well.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great. Thanks. I'll leave it there.

Operator: Your next question is from the line of John Walsh with Credit Suisse.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning.

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

A

Hey, John.

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

A

Good morning, John.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey. Two questions, if I may, as well. One, just curious when some of these property developers are going in and looking at upgrading HVAC or indoor air quality, just curious if that's an opportunity for you to have a modernization conversation with them or if they're also looking to maybe put some IoT? And just curious if those are actually pulling in some conversations with your product portfolio?

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

A

Yeah. There is a correlation and it is helpful, but it's not something we depend on. I mean, we have a modernization sales force that is specifically focused on modernization of both equipment in our portfolio, where we have existing customer relationships, as well as modernizing any equipment, but specifically Otis equipment that's not on our portfolio.

When someone's ready to make an investment, one of these developers, usually, it's not the developer though, it's more the building owner now or the building manager or the condominium association that are looking for these upgrades than the original developer. And so, our sales force is very focused on that.

We expect modernization to pick up. I was pleased to see modernization up in terms of orders. We were up this quarter and we saw a nice turn there. And we're going to see that pick up especially in EMEA. Our Europe performance – and we don't talk a lot about this because the Americas and China was so strong. But our EMEA performance, New Equipment sales were up over 3%, orders were up over 3%, and they had really good portfolio growth. But we see there's a pent-up demand especially in EMEA for modernization because these customers really couldn't get to us or couldn't meet to approve MOD.

So whether it's health solutions where we get integrated or standard modernization for technology, for aesthetics or for connections with Otis ONE or our eView product, we're expecting that to pick up especially in the second half of the year.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you. And then maybe a question around the Gen2 Prime product offering. Any update there on kind of contributions to orders growth or how the market is receiving that product?

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

A

Well, we launched Gen2 Prime in India out of our Bangalore factory. And as you can imagine, there're some challenges in India, not so much with our supply chain. We've mitigated that. You can see, based on the performance in Asia, we've mitigated supply chain challenges and had material productivity throughout – or over 3%.

So we're surprised – pleasantly surprised by the number of orders we have received in India, considering the current COVID and economic challenges. We have exported to Southeast Asia the Gen2 Prime already from our Bangalore factory and are getting ready to bring it to market in the Middle East as well as Africa will be after that.

So very pleased with the product reception. It's at a great price point, entry-level point for us. And I think we're going to see that continue to make a difference for us, addressing what was an area where we needed a product to bring to market. And that's where we are as an innovator.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you for the color.

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

A

Thanks, John.

Operator: Your next question is from the line of Joel Spungin of Berenberg.

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

Q

Hi. Good morning. I was just wondering if I could pick up on your comments around the books margin being down in the quarter 60 basis points, but improving sequentially in New Equipment. I was just wondering if you can elaborate a little bit on that. Is that being driven by – or was the fact that it was down year-on-year being driven by pricing pressure, per se, in the market or is it due to changes in your own mix? And we think about why it's improved sequentially. Maybe you could just elaborate, is that because there's been an easing in some of those pressures? Maybe you could just give a little bit of color around that, that'd be helpful. Thank you.

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

A

Yes. Good afternoon. So, yes, there was pricing pressure in the first quarter. And as we presented in our prepared remarks, there was headwinds from both mix and pricing. But the pricing pressure was really no surprise. I mean, we've been talking about it. Given the macro environment, we did expect pricing environment to be challenging.

As you said, previously, we focused on taking cost out of the business. And even on the field side, we're focusing on reducing the number of installation hours. So that's been our focus. And that's where you saw substantial improvement in the margins in the New Equipment segment.

The positive that we did see was that the both the backlog and the book margins improved versus Q4. And that's a positive sign because if this improvement holds through the year, that should be positive for 2022. And this is different than the trends seen especially on the backlog margin. This improvement in sequential improvement is different than the trends that we were seeing last year. So, that is a positive development and if it holds that should be a positive for 2022.

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

Q

Okay, great. That's very helpful. Maybe I can just take one more quickly, which is, I just wondered if you have any remarks, observations around raw material costs and logistics costs. And I think, obviously, it's something we discussed in the past, but you didn't really talk about it too much today. Is that something that you're able to pass on without too many challenges at the moment? Do you expect it to intensify as the year goes on? Maybe you could just provide a bit of additional color.

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

A

Yeah. Thanks, Joel. It's Judy, and good afternoon. Listen, we are, as you can see from our New Equipment, 160 basis points growth. You're seeing the drop-through and you're seeing the margin expansion offsetting competitive pricing. We have always said we will control what we can control. We can't really predict market-driven pricing but we will control what we can. And so when we started the year in our fourth quarter and our first guide, we said we had accounted in our guide for about $20 million of commodity headwinds. We're seeing about $15 to $20 million higher than that original thought than what we originally built into the guide.

So, we're doing a few things about that. We're driving material productivity even more. Again, a little over 3% in the first quarter net of inflation. Our New Equipment margins are rising. We're also targeting some pricing. Pricing is very competitive globally, but there are certain markets where we believe we can have some targeted pricing increase to offset that additional $15 million to $20 million of headwinds. In a few countries not to be named, but where we think that price will come through and we'll be able to offset that.

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

A

And that is where you see in...

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

Q

Brilliant. Thank you for the color.

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

A

...if you just look at the full-year guide, that is – as Judy said, we've offset the incremental commodity to pricing in these countries. So, we've been able to address that. And that is where you see, so if you look at our full-year guide, we've now increased the margin expansion, the New Equipment segment from 50 basis points in our previous guide to 80 basis points. So that's a good sign. And also if you look at the remaining three quarters of the year, a drop-through on higher volume at constant FX is close to 20%, so which is above our contribution margin of 18%. So clearly the fact is we're getting the benefit from volume and even a little bit from productivity that we're able to see in the 20% drop-through for the remaining three quarters of the year.

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

Q

Great. Many thanks.

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

A

Thank you.

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

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. Maybe just wanted to circle back on the New Equipment profit guide. So I think your New Equipment profits were up just under $40 million in Q1 at constant currency. And the year at the high end is guided at plus $80 million. So I suppose if we assume that Q2 is up decently off the easy comp as you mentioned, very little, no profit growth in New Equipment in the second half. Maybe just help me understand, is it the weighting of that extra cost headwind you just alluded to the tougher comp on the top line? Kind of what are those main moving pieces that mean there's very little New Equipment profit growth in the second half?

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

A

Well, let's just kind of take away the pieces, Julian. So, the New Equipment segment, the biggest driver for the earnings growth is going to be the 8% organic sales growth that we're talking about in midpoint and the drop-through from that, along with material productivity that is offsetting the commodity headwinds. The savings that we're getting from restructuring actions that we've taken in 2020, that will help us offset the incremental stand-alone costs and headwinds from some of the actions that we took last year. And we've raised the New Equipment earnings outlook primarily from the higher revenue.

But based on the drop-through – again, just to repeat what we said earlier, but based on the drop-through on incremental volume for the year is close to 20%. So we are seeing – and it's – so I don't – just the fact is we are seeing the drop when you see about 30% – $30 million improvement in earnings. So, it's – it's early in the year, so it's good to be prudent, but we are seeing good drop-through and good continued improvement in the New Equipment profit for rest of the year.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

I see. And is there any color on the weighting of that cost headwind you mentioned through the year or is it fairly even?

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

A

Well, when we started the year, we expected the commodity headwinds to be more skewed towards the first half, given we were expecting prices to come down. But as we – as where the prices are sitting right now, I think that commodity headwind is probably evenly spread out throughout the year, just given that commodity prices were hanging on a little bit longer. So, we are expecting that to continue throughout the year.

So that is where – but it's good to see, Julian, despite that, I mean, if you look at our profit guide, even for balance of the year, we're expecting close to $40 million improvement in our New Equipment earnings. So we're absorbing that. You've seen the benefit from volume. So, we see continued improvement on the New Equipment profitability.

The margins are higher in the second half. I mean, based on the guide that we provided, our margins for the remaining three quarters of the year, up 50 basis points year-over-year. So not only we saw very strong margin expansion in the first quarter given the volume increase, but even as we go through the rest of the year, second half compares do get tougher, just given the strong growth that we had in New Equipment segment especially in the fourth quarter. But despite that, we are seeing a 50-basis-point improvement in the margins in the remaining three quarters of the year, but continued profit growth.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Thank you. That's very helpful. And maybe just a very quick one on Service. You added in your profit bridge pricing as a tailwind for 2021, which wasn't there at the Q4 earnings. But you left the revenue guide for Service organically unchanged. So just wondered, does that mean that the pricing tailwind is very small or there's some slight reduction in the volume outlook offsetting it? Just wanted to try and understand that Service pricing driver a little bit better.

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

A

Yeah. I think it's still early in the year. We were – we saw both repair and modernization turned positive in terms of growth first quarter, which was better than we had seen in the former three quarters. Julian, we used revenue per unit as our proxy for pricing in Service. And the revenue per unit was up about 50 basis points. So, to us, that was a very positive and that's a global number. So, even in places that are – we can't even get to certain customers due to COVID still in a few markets, we were really – Service pricing held very nicely.

We're going to continue to monitor this. And obviously, we'll be back to you next quarter with what we know. We do expect the second half Service growth to be stronger. It's almost the counter to the New Equipment growth. And as we continue to see that trend, we'll continue to evaluate what our outlook should be and share that with you.

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

A

The other good thing that happened in the Service during – in the first quarter was our pricing concessions that we've been providing to our customers, they continue to come down. We've seen that number continue to come down over the last four quarters. So that – Q2 last year was the peak, and they've been sequentially coming down. So that was another positive. They're less than $5 million for the quarter, so it's insignificant. So, that was another really positive development. And as Judy said, pricing – overall Service pricing was favorable and that is where you saw us increased the guide.

But that part, the concessions, just given the overall COVID environment, that part we are being very careful right now just because we're not through COVID and especially if you see certain parts of the world, we're seeing some resurgence. So that part, we baked in some improvement in Service pricing. We reflected that in our guide. But we were careful not to bake in the sequential reduction of Service concessions in our outlook, just given the uncertainty in the environment. So we're being prudent on the absence of pricing concessions in our guide.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's good to hear. Thank you.

Operator: Your next question is from the line of Cai von Rumohr of Cowen.

Cai von Rumohr

Analyst, Cowen and Company

Q

Thank you very much. So help me a little bit with the quarterly pattern. If I look back at 2018-2019, the second quarter was on average up 21%- 22% from the first. And then, obviously, normally, the third and the fourth would be down sequentially. But you were so strong in this quarter is, like, if you're up close to 20% and even last year you were up 15% sequentially, you have almost a fall off the cliff. So, I mean, kind of just looking at this, the constant currency organic growth in new elevators looks like it has opportunity, am I correct?

Rahul Ghai

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

A

So let's just talk about the quarterly trend first, Cai. So the difference between 2021 and maybe some of the prior years is the COVID impact. So this year is a little bit different than the prior years, just given the slowdown in China in Q1 of last year. So we expected – and China rebounded very strongly in Q2 of 2020 just because it was a snapback. So that is where you see.

The historical trends that you mentioned, they're primarily driven by the Chinese New Year holiday. So Q1 is typically a lighter quarter in China, and then you see an improvement in Q2. So that's what a typical year is. But last year, that trend got magnified because of COVID. So, therefore, we saw a really strong snapback in Q1 of this year. And I think the improvement in China – well, we're still going to see the sequential improvement in China that we always do, but it's not going to be to the same extent. I think that's what – in response to Jeff's question, I think that's what I was trying to say earlier.

So that's what you will see. So this year, the trends are going to look a little bit different than the prior year trends just given that. So we expect Q2 to be strong. We expect Q2 New Equipment sales to be still be up strongly, just given America, then EMEA compares. And again, as we said earlier, the Service compares should be easy as well.

So we expect a snapback in Service. Compares are easy. Our repair and modernization revenue is coming back. And the snapback of the repair revenue in Q1, that was a positive, that we have not seen that year-over-year growth in the repair revenue since Q1 of 2020. So that was a positive. And we expect that trend to accelerate in Q2 of 2021.

So that's the positive that we see. So Q2 will be higher than Q1, but not to the same extent as prior years just given the COVID impact last year.

Judith F. Marks

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

A

Yeah. And, Cai, just a little more color. I mean, we're seeing especially in the US non-residential segment, in Q1, we saw a really good snapback on the commercial side and saw a tougher residential compare. So it actually flipped what a lot of other markets are seeing. So we're seeing this turned in non-res. We experienced it both on the order side, but the residential was a little tougher for us in the Americas.

Cai von Rumohr

Analyst, Cowen and Company

Q

Very helpful. And then on Otis ONE rollouts, I think you did 100,000. I think that's the target for this year. Can you update us? Can you do a little better than that? What are the main countries you expect to roll out?

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

A

We anticipate doing a lot better. Otis ONE is a key element of our strategy for portfolio growth. Any time we're connected, whether it's Otis ONE or our Compass destination dispatch system, eView, anytime we're connected, we get better conversions where people come to us for service. And then we also get improved retention. And our retention rate did maintain at 94%, which we believe is the best in the industry.

We will, at least, deliver as many as in 2020, which was 100,000. In 2021, we have started shipping all units out of our China factories and our North America factories already Otis ONE IoT enabled. And we will – beyond the six countries last year, which were China, the US, and four in Europe, we're going to be adding some in Asia-Pacific as well this year. There's great pull.

Again, this is about a focused strategy on density. So we don't want to send Otis ONE to every country simultaneously. We want to have the ability to define where we're going to put it because it's on our capital investment, so we can yield the productivity we expect from it. And then, obviously, also give our customers some additional insight beyond the productivity and the information for our mechanics to perform even better.

So, again, it's a logical strategic rollout and we'll be adding some countries in Asia-Pacific, as well as potentially another few in EMEA.

Cai von Rumohr
Analyst, Cowen and Company

Q

Very helpful. Thanks so much.

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

A

Thanks, Cai.

Operator: And your next question is from the line of Carter Copeland of Melius Research.

Carter Copeland
Analyst, Melius Research LLC

Q

Just a couple points of quick clarification. First, on the revenue per unit, the 60 bps that you mentioned, Judy, any color you can help us understand there on regional differences in that number that you're seeing. And then just on the Service portfolio growth, I know you highlighted the China number versus the 2% overall. But I wonder if you can tell us if there's any ISP share in there, if you're having any success in that front that's measurable that's worth talking about. Thanks.

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

A

Yes. So great to hear from you, Carter. It was 50 basis points on revenue per unit. So let me – let me make sure I said that correctly. We saw that up everywhere except one major country in Asia-Pacific where we had some very challenging Service pricing but not enough to obviously be material. So China was up, EMEA was up, Americas was up, and the majority of Asia-Pacific was up with the exception of one kind of mature country. So those results really stand tall. It's important for us that that happens in first quarter because that's when so many of the maintenance contracts get re-signed. That's – if we have a sense of seasonality, that's where it happens. So that's why that was so important for us.

In terms of portfolio, in China, we are taking it away from the ISPs. There's no doubt now with the pace and at the rate that we're securing that portfolio growth in China, that's exactly who we're taking it away from. And we've shared our strategy where we've expanded service depots. We've added our reach in the Tier 5 and on cities, and it's paying off. And so, again, double-digit teens in China in the first quarter, and they just have sequentially now for the past three or four quarters continue to improve their portfolio attachment rate.

Everywhere else in terms of portfolio, we had – EMEA had good growth. We had growth in the Americas. And again, the Asia growth was more driven by China.

Carter Copeland
Analyst, Melius Research LLC

Q

Great. Thank you for the color.

Operator: At this time, we have no further questions. I'll turn the call back over to Judy Marks for any closing remarks.

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

Thank you, Stephanie. On April 3, we celebrated our one-year anniversary as a stand-alone public company. I am proud of what our 69,000 colleagues accomplished in every corner of the globe, serving our customers, keeping passengers moving, and building our company at a time of global crisis. We had a very strong start to 2021, and I'm confident that our positive momentum and the continued recovery in our end markets positions us well to deliver our improved 2021 outlook. We'll remain focused on driving value for our customers, colleagues, communities, and shareholders.

Everyone, stay safe and well. Take care.

Operator: Thank you. This does conclude today's conference call. You may now disconnect.