15-Feb-2022

Otis Worldwide Corp. (OTIS)

Investor Day

Copyright © 2001-2022 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

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

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

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.

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

OTHER PARTICIPANTS

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Nigel Coe
Analyst, Wolfe Research LLC

Julian Mitchell
Analyst, Barclays Capital, Inc.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Miguel Borrega
Analyst, Exane SA (United Kingdom)

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Cai von Rumohr
Analyst, Cowen & Co. LLC

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Nick Housden
Analyst, RBC Capital Markets

MANAGEMENT DISCUSSION SECTION

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

Good morning, everyone. Welcome to Otis' 2022 Investor Day. I'm Mike Rednor and I lead Investor Relations for Otis. We're happy to have you here with us today. Before we get started, just a few reminders. This presentation is being carried live on the internet and is being recorded for replay. Presentation materials are available for download at otisinvestors.com. Please note, except or otherwise noted, the company will speak to results from continuing operations, excluding restructuring and significant non-recurring items. The company will also refer to adjusted results where adjustments were made as though Otis was a standalone company in prior periods. A reconciliation of these measures can be found in the appendix of the presentation.

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.

Okay. With that, let's start the agenda for today. I'm joined by several members of Otis' leadership team. We'll start with Judy Marks, our Chair, President and CEO, who will give us an overview of the industry and Otis. Next, Robin Fiala, who leads Sales and Marketing at Otis, will discuss our global growth strategy before Rahul Ghai, our CFO, finishes with a financial overview. After prepared remarks, there will be dial-in instructions for about an hour of Q&A.

Copyright © 2001-2022 FactSet CallStreet, LLC

With that, I'd like to welcome Judy Marks.

Judith F. Marks

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

Thanks, Mike, and thank you, everyone, for joining us virtually today. We're excited to share the progress we've made since you joined us in Freedom Hall in February of 2020. Since then, we've delivered on our long-term strategy, proving that it's sound and that our team can execute at a high level. Today, and that our team can execute at a high level. Today, I'm pleased to be joined by Rahul and Robin to share our vision for the future and to update you on our progress creating long-term sustainable value for all stakeholders.

Before I begin, let me thank our team we wish could be here in person, but know that the team that leads Otis is with us today and every day, creating value for our shareholders, customers, colleagues and communities.

Starting on slide 5 with the elevator and escalator industry. Our industry that Otis began nearly 170 years ago is large and expanding at approximately $80 billion. The industry has strong fundamentals that are backed by global growth trends, including urbanization, which is expected to cover approximately 60% of the global population by 2030. And that population is aging, increasing the demand for elevators.

This industry is highly regulated. Many of you use our product every day, and this happens in cities across the globe, not just in high rises, but in schools, hospitals, airports and anywhere that people are on the move. Above all, it's important that elevators and escalators provide safe movement for passengers everywhere. The top five E&E participants represent approximately 70% of the $80 billion industry. Because of code and other regulations there are not many new entrants in the $35 billion New Equipment market, and the New Equipment business is stable.

Although the $45 billion Service market is fragmented, today the top five OEMs make up about 40% of the total Service market. Service is the profit and growth driver of this industry. This growth is built on maintenance of the compounding installed base, shown on slide 6, and supplemented with both repair and modernization business. The New Equipment market has been growing steadily at a low-single-digit CAGR, adding about 1 million units annually. This steady stream of units results in compounding growth for the Service installed base expected to grow at a mid-single-digit CAGR globally with growth in all regions. This growing Service base is the highlight of our industry and provides resilient and recurring growth and profitability opportunities for Otis.

Moving to slide 7. Otis is the leader in this industry with $14.3 billion in 2021 sales, over 2.1 million units under maintenance and industry-leading adjusted operating margins of approximately 15.3%. We do that through 1,400 branches and offices, leveraging our local knowledge, presence and customer relationships at a global scale and driving a margin premium through the density and size of our Service portfolio, pricing and productivity initiatives.

Similar to the industry as a whole, Otis' business is driven by Service, with about 55% of sales coming from Service. While the New Equipment business is profitable, the margins in Service are about 3 times that of New Equipment, and the Service business contributes about 80% of our adjusted operating profit. New Equipment margins were 7.5% in 2021 and Service margins were 22.8%.

Next on slide 8, you'll see that Otis benefits from strong geographic diversity in addition to a broad customer base. Starting with New Equipment, while the China market is about 60% of overall global units, it is less by value. For Otis, the Americas and EMEA represent about a quarter each of our New Equipment sales in 2021, Asia Pacific about 10% and China approximately 35%. From a New Equipment profitability standpoint, both the Americas and

Copyright © 2001-2022 FactSet CallStreet, LLC

China are above average and similar, while EMEA and Asia Pacific are below company average New Equipment margins.

On Service, EMEA were about half of our 2.1 million portfolio units operate, represents the largest share, with 2021 sales still roughly split a third each by region: Americas, EMEA and Asia. Otis' Service business in EMEA benefits from density and the higher-than-average Service margins. But Service revenue in each region is accretive to overall Otis margins.

On slide 9, we have an integrated approach to achieving our strategic vision and ESG commitments. Our business strategy supports sustained New Equipment growth, accelerated Service portfolio growth, advancing digitalization and empowering our organization to drive sales, earnings and cash flow growth to create sustainable shareholder value. At the same time, we're focused on fostering a strong foundation and culture that embraces many voices and points of view and proactively engages the communities we serve. We strive to reduce the environmental impacts of our products, operations and services, and uphold the highest standards for strong governance, ethics and integrity. And above all, we are committed to the health and safety of our colleagues and passengers in Otis Absolutes.

On slide 10, we're continuing to invest in innovation, a driving force behind sustained New Equipment growth. We have made enhancements to our bestselling Gen2 platform to address specific customer needs, including our entry tier, low cost offering Gen2 Prime. Our future is the connected elevator. And in 2021, we launched Gen3 and Gen360, two platforms with built-in Otis ONE connectivity and digital options. Gen3 is being sold in China and North America currently, while Gen360, our next generation platform, is currently being sold in Europe. These platforms address the growing customer needs for space optimal options, improved aesthetics and digital services that improve uptime, simplify elevator management, and enhance the passenger experience. These introductions are a direct result of our focus-product strategy and investments in research, development and other strategic investments.

Moving to Slide 11. This sustained New Equipment growth supports acceleration in our Service portfolio. Over the last several years, we've driven growth of the Service portfolio from 1% to 2%, and in 2021 to 3%. We plan to accelerate this growth to faster to 3% CAGR over the medium-term period. How will we do this? Through focused improvements in each of the key service metrics: retention, conversion, and recapture, each of which improved year-over-year basis in 2021. Robin will elaborate more on how we plan to achieve this.

On slide 12, digitalization is foundational to everything we're doing to drive productivity in the field, enhance the passenger and customer experience and optimize our back office functions. Enabling connectivity will drive step function change in how we manage our portfolio, changing how we address customer and passenger needs and allowing us to do this far more remotely. At the end of 2021, approximately one-third of our global units were connected, including 200,000 Otis ONE units. We plan to accelerate deployment over the medium-term to connect over 60% of units under our maintenance. This technology improved service provided to our customers, resulting in improved conversion out of warranty and stickiness with existing maintenance customers. Connectivity also provides major benefits to Otis, improving the productivity of our service technicians and allowing us to capitalize on incremental subscription service sales. Put simply, Otis ONE drive Service growth, pricing and customer loyalty while making Otis more competitive against the independent service providers.

More on slide 13, where we highlight how the digitalization of Otis is improving the experience for our mechanics. In addition to Otis ONE, we've deployed several proprietary iPhone apps that allow mechanics to optimize their time, reduce unnecessary travel and arrive to the customer site with all the information and tools required. One app example is our Tune App that allows a service mechanic to place his or her iPhone on the floor of the

Copyright © 2001-2022 FactSet CallStreet, LLC

elevator and diagnose severe vibration sensing. This saves time and effort where the mechanic would otherwise have to access the top of the car to diagnose.

Another example is our Upgrade App, which facilitates repair sales while the mechanic is on site, allowing him or her to execute a contract for incremental work if needed. And you can see this reflected in the productivity of our service technicians who are generating 9% more revenue per technician as well as the favorable survey results and reduction in attrition that we've driven since 2019.

On the next slide, you'll see our meaningful progress on our ESG journey in a relatively short timeframe. This journey is continuous. We laid the foundational framework and made progress on our long-term goals this year, including 100% ISO 14001 certification of all our factories. We also advanced new products and modernization offerings that have lower power consumption needs and include technology to generate and redistribute power within the building.

This year, we'll continue to make progress on our long term goals to reduce Scope 1 and 2 greenhouse gas emissions and achieve gender parity in our executive ranks. These two metrics are now included in the 2022 executive compensation plan, reflecting the emphasis we place on progressing our ESG initiatives. There will be more details on all our progress in our first ESG report that will be published next month.

Moving to slide 15. Otis has delivered strong financial results over the last two years, despite facing a challenging environment. In February of 2020, we gave our first medium-term outlook as an independent company, just before the COVID-19 pandemic began to affect the way we live and work. I am very proud of the results that this team has delivered over the past two years, reaching some of our medium-term objectives ahead of schedule.

We drove 3% organic sales growth while expanding margins 100 basis points and taking cost out of the business in response to COVID and we made strong progress on below-the-line items, resulting in a adjusted EPS CAGR of 16% from 2019 to 2021. Cash generation remains strong, over 130% of net income, and we were focused on capital deployment that benefits all stakeholders, including $725 million in share repurchases, approximately $135 million in bolt-on M&A transactions, a solid dividend payout and the announcement of our tender offer for the remaining stake in Zardoya Otis.

Despite fluid market dynamics, we expect this strong performance to continue in 2022, on slide 16. The New Equipment market is expected to be up mid- to high-single digits in the Americas, low-single digits in EMEA, and down mid- to high-single digits in Asia, driven by uncertainty in China, where we expect the market to be down 5% to 10%. While the China New Equipment market faces headwinds, this will not detract from solid growth in the Service installed base, where approximately 1 million units are added each year globally, a mid-single digit growth rate annually. Industry installed base in the Americas and EMEA are expected to grow low-single digits; and in Asia, we're expecting high-single digit growth driven by China.

In 2022, for Otis, we expect to deliver organic sales growth of 2.5% to 4.5%, with net sales in the range of $14.4 billion to $14.7 billion. Adjusted operating profit is expected to be in the range of $2.24 billion to $2.3 billion, up $95 million to $165 million, excluding the impacts of foreign exchange. At actual currency, adjusted operating profit is expected to be in the $50 million to $120 million range. Adjusted EPS is expected to be in the range of $3.20 to $3.30, up 6% to 10% versus the prior year and $0.24 at the midpoint. Lastly, we expect free cash flow to be robust at about $1.6 billion or approximately 115% to 120% conversion of GAAP net income.

Finally, on slide 17, Otis' medium-term outlook. We're targeting organic sales growth of low- to mid-single digits, with low-single-digit growth in the New Equipment segment and mid-single-digit growth in the Service segment.

Copyright © 2001-2022 FactSet CallStreet, LLC

We expect to continue building on our best-in-class margins that on average will be up about 40 basis points annually over the medium-term. We expect modest expansion in the New Equipment segment about 10 basis points to 20 basis points, with continued expansion in Service of about 40 basis points to 50 basis points. This operating profit growth and progress on reducing our adjusted tax rate will drive the 10%-plus adjusted EPS CAGR and 100% to 110% free cash flow conversion. It's an exciting time to be part of Otis and exciting time for investors as well. Strong topline growth, margin expansion and robust cash flow generation, supporting a disciplined capital allocation strategy focused on creating value for all stakeholders.

Just before turning over the stage to Robin, let me take a brief moment to recognize our 70,000 colleagues who delivered strong results, including our 41,000 field professionals who kept the world's elevators working every day through the pandemic in good times and hard times. Everyone at Otis is grateful to all our extraordinary and essential people in the field.

With that, I'd like to turn it over to Robin to talk through our strategy in more detail.

Robin Fiala

Vice President-Sales & Marketing, Otis Worldwide Corp.

Thanks, Judy, and hello, everyone. I'm Robin c, the Vice President of Sales and Marketing at Otis. And I'm very excited to be here with you today to share our growth strategy that's well underway in both our New Equipment and Service segments. The focus of our organization on executing our strategy has never been stronger. And I'll share with you our progress over the last two years. But just as importantly, I'm going to highlight for you the runway for future growth.

Starting on slide 19, as you heard from Judy, our Service portfolio, the more than 2.1 million units we have under maintenance is really at the core of our business model. The reoccurring revenue stream generated from these units is a significant portion of our approximately $8 billion in service revenue. And given that service generates roughly 80% of Otis' profit, the size of our Service portfolio clearly matters. Our Service portfolio is 25% larger than our closest competitor, and we're well-positioned to continue to accelerate its growth.

Today, I'll share with you our strategy and how we're doing this, focusing in four key areas. It starts with selling more New Equipment units, giving us the opportunity to convert these units into our Service portfolio. The second area is increasing our conversion rate itself, particularly in China. And finally, further improving our retention and recapture rates, keeping units under our service while also adding units from the market that we don't currently maintain. Over the last few years, we've accelerated our portfolio growth from hovering between 1% and 2% to finishing last year at a 3% growth rate. With the drivers we'll discuss today we're confident that we can accelerate to greater than 3% creating an even larger portfolio to drive our sales and earnings growth from going forward.

Let's turn now to discuss the first lever on slide 20. This begins with expanding our share in the New Equipment market. The greater our share in this segment, the more units we have to convert from the warranty period into our Service portfolio. To fuel our New Equipment growth above the market, we remain focused on the three strategic areas that I laid out for you at Investor Day two years ago: Enhancing our sales coverage; expanding the addressable market of our industry-leading suite of products; and finally, introducing innovative new solutions focused on meeting emerging customer demands.

If we start with sales coverage on slide 21, first, I'll point out that we start from a position of strength as the only OEM that operates in the top eight countries, which represents about 85% of the global market. To understand our opportunity, we regularly assess each country looking at both our bid coverage and our share. Higher bid coverage means that we're proposing more projects and this drives share performance, and you can see this

Copyright © 2001-2022 FactSet CallStreet, LLC

clearly with the chart on the left. At the bottom of this chart, we've identified six large countries where we have opportunity to grow share by improving bid coverage.

In fact, you see on the right that over the last two years we've increased our coverage by 10 points, allowing us to capture two additional points of share in these markets. To close these gaps, we've been expanding our sales force and channel partners where needed. For example, in China, we've doubled our A&D network over the last two years, adding over 1,000 additional agents and distributors. Globally, we've increased our New Equipment sales force by 10% last year while driving sales efficiency via new tools, process improvements, technology and aligned incentives. With that, we still have opportunity to further improve our coverage to the tune of approximately 5 points to 10 points more globally. And that will drive additional share in New Equipment. Ultimately, higher New Equipment share gives us that opportunity to convert more units into our Service portfolio.

Now, in addition to sales coverage, we also have opportunities in our current product offering that allowed us to better position – be better positioned to service the New Equipment market. Let me highlight two examples on slide 22. We identified an opportunity and our low-rise entry level market in emerging countries. To address this, we launched Gen2 Prime two years ago at a 30% lower cost versus the previous lowest cost platform. Since the launch, we've continued to expand our offering by increasing both its size and speed now reaching 16 markets, places like India, Southeast Asia, Turkey, parts of the Middle East and Africa, giving us an additional 5 points of New Equipment market opportunity, resulting in thousands of bookings since launch.

We have a similar opportunity with Compass 360, our destination dispatching system, whereby reducing the cost by 20%, we've widened the addressable market to include mid-rise buildings in addition to our existing high-rise offering, further expanding our coverage by 4x and more importantly leading to a 30% increase in unit sales over the last two years. Installing solutions like Compass Destination System is an important element in our overall service strategy as we convert and retain over 99% of these customers. However, it isn't just about expanding our current product lines.

You can see some of our latest innovations on slide 23. Our Gen360 system is the most advanced product in the industry, a digitally native platform. In fact, it's the first in the industry to offer drive-by-wire technology, allowing us to move from a more mechanical to an electronic architecture, similar to the innovations introduced in the airline and automotive industries. This step function change brings many new features, including the introduction of an electronic versus a mechanical safety braking system. This change alone brings many benefits to our customers. The components themselves are significantly smaller, allowing our customers the ability to put a nine-passenger elevator into a hoist way, which previously only accommodated an eight-person elevator.

In addition, as you see with the picture on the slide, the elevator hoist way no longer needs to penetrate that roof line, which is both a cost savings for the builder and an architectural design benefit. The electronic architecture also provides us significantly more information on the elevator, allowing us to reduce the number of entrapment by 50%, while at the same time ensuring – excuse me – enhancing our ability to fix issues remotely. All of this improves reliability, productivity and the value we can provide our customers. Based on our experience with connected products, we expect this technology to contribute to New Equipment share growth while also continuing to provide improvements in our retention and our conversion rates as these units from New Equipment flow into our Service portfolio.

Gen360 has been released in six countries in EMEA, and we're now in the process of expanding the range to cover other large markets around the world. And we're expecting approximately 20% of our bookings this year to be on our connected solutions, either Gen3 or Gen360. Clearly, our strategy for New Equipment growth has demonstrated results as shown on slide 24, gaining 2 points of share over the last two years and is a balance of

Copyright © 2001-2022 FactSet CallStreet, LLC

tactical elements combined with new innovations that are driving significant customer value. As we stand here today, Otis's product lineup has never been stronger. We've expanded our product platforms where necessary to properly cover the market while making strategic investments in our new connected platforms that's both Gen3 and Gen360, putting us in a great position to win in the market. This growth in new equipment, as discussed, is an important driver to accelerate our service portfolio.

So let me turn now to discuss additional levers to grow our service business, starting on slide 25. With over 2.1 million units on our portfolio, Otis has the largest portfolio and the largest service business in the industry. On the left, you see that about 60% of our portfolio is in multi-family residential, with the remainder a mix across all other verticals, making us well-positioned for the new hybrid way of living and working. The maintenance and repair revenue from these units is about $6.5 billion, and the more units in our portfolio, the more opportunity we have to sell additional services to our customers. And we have momentum growing our portfolio, as I said last year, by 3% driven by our industry leading retention rate of 94%, which has improved over the last two years. At the same time, our conversion of new equipment units to our service base ended last year at approximately 62% and it could also continues to see nice improvement, especially in China.

If we look to slide 26, in addition to selling more new equipment units, we are continuing to drive service growth by focusing in three important areas. First, improving our customer experience and leveraging the power of our IoT solution Otis ONE. Second, selling subscription services that improve the retention rate, while providing incremental revenue, and then finally earning our share of the growing modernization market.

If we move to slide 27, focusing on improving the customer experience is our mission at Otis. And we've made significant headway in putting technology in the hands of our frontline employees allowing us to address two of our customers biggest pain points. The number of times their equipment shuts down unexpectedly and our response time. Our field teams have done an amazing job with the help of process improvements and technology to reduce these metrics by 15% and 20%, respectively, over the last two years. As you can imagine, with the global footprint we have in the decentralized nature of the work, this has been no small task. The focus on customer service has led to improved satisfaction demonstrated by the ultimate in customer loyalty metric retention rate, which has improved by over a point over the last two years. We believe, though, there's more work we can do here.

In fact, with the introduction of Otis ONE on slide 28, we can deliver the customer experience to a new level, while also driving productivity. Both key elements that will allow us to further accelerate our portfolio growth. With the introduction of Otis ONE, we can now provide real-time information from the elevator directly to our experts, our technicians and most importantly, our customers. And this gives us the ability to drive step function change and customer satisfaction.

Let me illustrate how by sharing with you feedback that we're hearing from our customers. Without Otis ONE, our customers must call us when technicians arrive on site they only know that an elevator is shut down. They don't know where the elevator is or why it shut down, starting the comprehensive troubleshooting process only when we arrive on site. With Otis ONE, the elevator notifies us when it's having a problem. No need for the customer to call, allowing our experts to go to work with the help of artificial intelligence, often fixing a portion of the issues remotely. When we do dispatch a technician, we send them with predictive information to help accelerate that diagnosis. The result, less time on site for our technician while improving uptime for our customers truly a win-win.

In our China market where we're furthest along in operationalizing the solution, 80% of the time we recognize our shut down before the customer. This prevents the customer from having to worry about the issue. This is resulting in productivity savings of approximately 10% and improved customer satisfaction through a 5% reduction in

Copyright © 2001-2022 FactSet CallStreet, LLC

unplanned service calls. Given our experience already, we're confident that as we further operationalize Otis ONE we can reduce our customers biggest pain points more consistently. A key element that allows us to further accelerate our portfolio growth while simultaneously improving productivity.

Let's switch now to discuss our progress in selling digital products and subscription services on slide 29. We've had success today, but we're just beginning to scratch the surface. Historically, we've sold upgrades as a one-time sale. Today, we have several products out on the market that change that strategy. Over the last few years we've been successfully selling products, using Software as a Service model, charging a monthly fee for things like content on screens and elevators, or the ability to call an elevator from an app on your phone.

All of these services are adding incremental value to our customers and resulting in additional monthly revenue. As an example, we sell our eView product, which is a data, voice and multimedia solution. It allows our customers to attract and maintain their tenants and differentiate their self from the pack. This product can contribute up to 15% to 20% incremental revenue on top of our standard maintenance contract. Clearly, our customers are seeing value and we're realizing a threefold benefit. Improve profitability via improved revenue per unit, increased conversions into our service base and improved retention rates.

In addition to these technologies, we have other digital products like Compass 360 that we just spoke about that provide incremental reoccurring revenue per month. And as we continue to add capabilities across our solutions, we're driving adoption within the customer base. And this is truly just another example on how the size of our portfolio matters is it gives us a larger base to continue to sell services from.

The last lever to discuss is capitalizing on the modernization opportunity on slide 30. Modernization refers to upgrading a unit that is currently within a building. These mods can vary in size from a small upgrade, such as replacing the interior wall of an elevator cab to something very large, like replacing the entire electrical system. And it's a key part of our growth strategy for two main reasons. First, the market is growing, and as that installed base ages, it restarts that service cycle, giving us the opportunity to grow our portfolio as well as keep units in the portfolio and continue that stream of maintenance revenue for years.

The chart on the left clearly highlights the substantial market opportunity, the typical timeframe for customers to modernize is around 20 years, and approximately a third of the installed base, or approximately 6.5 million units are over 20 years old and 3 million of these units are located in Europe with an emerging opportunity growing in China. Over the next few years, the number of units over 20 years old in China is expected to double.

Now, modernization projects can take many forms, and given its complexity, we're focused on standardization and simplification. First, we focused on expanding our coverage of standard products, including leveraging our suite of energy efficient upgrades and digital solutions. At the same time, we're improving our sales tools by leveraging our data and expertise. We've developed an internal app for our team where we can leverage our database of installed units to identify modernization prospects and recommend solutions based on the unit history, the customers' needs and budget. With these targeted modernization tools and products, we expect to capitalize on the growing base of aging elevators and grow our modernization revenue mid-single-digit plus over the mid-term.

So to recap on slide 31, as you've heard today, Otis has a strong and improving position in both the new equipment and our service segments. Our focus is to drive our portfolio growth and outpace the market in each region by increasing our new equipment share, converting more units and delivering differentiated value to our customers. Over the next five years, this growth in our portfolio will fuel our mid-single-digit service revenue

Copyright © 2001-2022 FactSet CallStreet, LLC

growth. Thank you for the opportunity to speak with you today. I'll now turn it over to Rahul to discuss the financial results and the outlook. Thank you.

Rahul Ghai

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

Thank you, Robin. And good morning, everyone. I'm going to cover a few key topics today. I'll provide details on our 2022 and medium term outlook, actions that we're taking to continue to improve margins, optimize the tax rate and allocate capital to create value for our shareholders. But before I do that, let's take a look at Otis' performance over the last three years on slide 33. From 2019 to 2021, net sales grew at an annualized rate of 4.4% with 3% organic growth, and we ended 2021 above 2019 levels in both segments, despite all the challenges from the pandemic.

We grew adjusted operating profit at an annualized rate of 8% and expanded margins by 100 basis points and 130 basis points at constant segment mix. Similar to sales, margins in both segments are above 2019 levels through volume growth, productivity initiatives and focused cost containment actions. Looking back at 2020, we navigated the pandemic and the subsequent macro challenges with only low-single-digit decline in organic sales and grew profit approximately $50 million.

And then in 2021 as the markets recovered, we leveraged the investments we have been making to continue to gain share. In addition, we grew profit and margins while dealing with intense cost pressures. This performance not only shows the resilience of the business model, but also its potential to benefit from end market growth. It also highlights the focus of this management team on execution and commitment to achieving the targets that we have set as an independent company. It is solid progress and spin, but there's clearly a significant opportunity ahead of us. And in 2022, we will build on that foundation with 3.5% sales growth at the midpoint and 30 basis points of margin expansion. We expect sales growth and margin expansion in both segments. And we will continue to make progress on the tax rate to achieve high-single-digit EPS growth and generate $1.6 billion in free cash flow.

Looking further at the EPS bridge on slide 34. We expect EPS growth of 6% to 10% in 2022 with operating profit growth of $95 million to $165 million at constant currency contributing $0.16 to $0.27 to EPS growth. This is driven by increased volume in both segments and improved service pricing. In new equipment, we expect material and installation productivity along with higher [ph] EMEA (00:40:16) pricing to offset approximately $90 million of commodity headwinds and the backlog margin pressure.

In service the continued progress and productivity helps us absorb the higher labor cost. By offsetting the margin pressures in both segments, the incremental profit is close to 30% of increased revenue at the midpoint. Foreign exchange is expected to be a $0.07 EPS headwind primarily from the weakening of the euro and the yen against the US dollar. Despite lower new equipment sales in China, we expect China profit to grow through improvement in the service business and other cost containment actions.

This higher profit in China and other JV increases in non-controlling interest expense and reduces EPS by $0.02 to $0.04. FX translation impact and other non-controlling interest expenses are mostly offset by $0.10 of EPS accretion from the Zardoya transaction. Lastly, we expect to reduce our adjusted tax rate by an additional 50 basis points to 100 basis points this year, adding $0.02 to $0.03 to EPS.

Our 2022 outlook represents the fourth consecutive year of strong earnings growth and the third year of expanding adjusted margin by at least 30 basis points. With 90% of the EPS growth this year, driven by operating profit growth at constant FX and the balance from a lower tax rate. Annualized EPS growth is approximately 13%

Copyright © 2001-2022 FactSet CallStreet, LLC

between 2019 and 2022. Well ahead of the high-single-digit medium term growth expectation outlined at our last Investor Day.

Moving to slide 35, over the medium term, we will build on this momentum and expect to expand adjusted margins on an average by about 40 basis points annually. This improvement will come from a combination of volume and segment mix benefit, maintaining the new equipment profitability, expanding service profitability through productivity and price increases, and a laser focus on cost containment.

Let me spend a minute on each of these elements, starting with new equipment on slide 36. Between 2019 and 2021, we grew adjusted operating profit by approximately 20% and expanded margins by 40 basis points. In 2022, we expect margins to be flat to up 20 basis points as we continue to find ways to mitigate the higher commodity costs and pricing pressure from projects that we sold during the pandemic by increasing prices on book and ship business, reducing product cost and improving installation execution.

The cost reduction initiatives include leveraging our global supply chain and making sure our supplier contracts reflect our global scale while maximizing local availability. We're also reducing product cost by expanding common platforms in our factories and optimizing design for installation. By implementing this strategy in Japan, we reduce our product cost by 14% in 2020 and an additional 6% in 2021. We've had similar success in South Korea that we've previously shared, and this year we are implementing the strategy in our factories in Europe.

Designing with installation in mind not only helps reduce material and labor cost, but also the complexity associated with the installation of a new unit. And since 2019, we have improved installation productivity savings, the difference between the booked and the delivered margin by about 75%, a key contributor to the margin expansion in the new equipment segment. All this while allowing us to target previously unaddressed market sub-segments and drive incremental share in the market. We've achieved similar success in driving productivity and margin expansion in service.

And turning to slide 37, from 2019 to 2021, we grew service adjusted operating profit by approximately 12% and expanded margins by 140 basis points. In 2022, we expect margins to be up 50 basis points, driven by volume growth and improvement in service pricing. In the service segment, approximately 70% of our cost is labor and we focused our effort to offset the annual cost increases by driving productivity in the field.

We have reduced the service hours per unit adjusted for mix by about 5% between 2019 and 2021. Deploying Otis ONE and the apps that Robin and Judy spoke about are enabling that productivity. But in addition, we also have taken steps to advance mechanic specialization and optimize service routes to improve customer response time, minimize travel time and enhance the efficiency of the service visits.

Looking more closely at the digitalization and how that is improving our route optimization efforts on slide 38. The examples branch on the left highlights the overlap and routes that exist today for various mechanics, by eliminating that overlap and focusing the mechanics in a certain geographical area, we've reduced the travel time by 30% and the number of routes by about 25%. There's a high degree of correlation between the number of routes and the number of service technicians, and eliminating a route gives us the opportunity to redeploy that technician to perform profitable repair work. Simulating that route optimization benefits across 80 branches are approximately 9% of the portfolio units can eliminate nearly 10% of the routes needed for those units, allowing us to balance the workload across mechanics in the field and drive improvements in response time and maintenance completion.

Copyright © 2001-2022 FactSet CallStreet, LLC

We can also reduce the number of miles travel to service this 9% of our portfolio by approximately 10% or 225,000 miles. Thus, the benefits of route optimization are three-fold. One, improving the service level for our customers; two, yielding productivity benefits for Otis; and third, reducing the cost and the environmental impact of unnecessary travel. To-date, we've implemented this optimization tool in about 40 branches, primarily in North America and Europe and plan to expand this to cover about 20% to 25% of our branches in 2022.

So we have several initiatives, installing Otis ONE, increasing the use of apps to save hours, focusing on mechanics on either service or repair, optimizing the routes and each one of these initiatives is contributing to the reduction in hours spent on the field. And we've seen significant runway, not only to expand the geographical scope of these initiatives, but also to extract incremental benefit, giving us the confidence to expand service margins by 40 basis points to 50 basis points annually over the medium term.

Another contributor to service margin expansion is a focus on rationalizing SG&A expense on slide 39. Otis has invested over the last few years to create capabilities and implement systems that were needed. We've reached a steady state of those investments and our goal over the medium term is to reduce SG&A as a percentage of sales by another 100 basis points. And we will continue with several actions that we are taking to leverage our scale and align processes and tools globally and centralize back office functions.

We made strong progress on rationalizing the incremental costs from becoming a public standalone company reflected in the 30 basis points reduction in SG&A as a percentage of sales over the last two years. We now have a common ERP system for 70% of our revenue with the objective to expand that to 80% by end of this year, allowing us to take work out of the branches and migrating that to a shared services cost center. Our back office in India has grown 3x over the last three years to about 400 employees. Optimizing SG&A expenses will be a key contributor to a margin expansion over the medium term.

The other item that will drive EPS growth is the reduction in the adjusted tax rate on slide 40. We started in 2019 with a 34% tax rate and our tax team has done a great job over the last two years of reducing that rate by over 5.5 points. We've taken several actions to achieve this including optimizing a business structure and offshoring debt geographically to align debt with cash generation. This has not only lowered our interest cost, but also reduced the foreign and repatriation taxes as 80% of Otis' profit is generated outside the US. In 2022, we expect to achieve another 50 basis points to 100 basis points of reduction and end the year with a tax rate between 27.5% to 28%.

As we continue our journey of optimizing our operating and financing structures, we believe you will have measured improvement every year in our tax rate and achieve a rate of between 25% to 27% over the next three to four years.

On slide 41, we expect to generate robust cash flow of between 100% to 110% of net income or about roughly $5 billion between 2022 and 2024. We've already completed the $500 million of debt repayment that was required as part of the Zardoya transaction and do not expect to repay additional debt during this time period. We will continue to pay a solid dividend between 35% to 40% of GAAP net income and participate in bolt-on M&A where it makes sense strategically. Typically between $50 million to $100 million of spend annually. We plan to use the remaining $2 billion of free cash flow over the next three years for share repurchases and targeted and accretive M&A.

Also, following our debt repayment, we're now in a position to recommence share repurchases in 2022 and plan to complete buyback of between $300 million to $500 million before the end of this year. Our business model is

Copyright © 2001-2022 FactSet CallStreet, LLC

not capital intensive, and we will continue to be extremely balanced and disciplined in deploying the excess cash to ensure that creates value for our shareholders.

Rounding out the discussion on slide 42, over the medium term, we expect organic sales growth of low to mid-single digits, with new equipment up low single digits and service up mid-single digits. Otis' adjusted operating profit margin is expected to expand 40 basis points on an average annually driven by segment mix as service grows faster than new equipment dropped through from higher service revenue, pricing improvements, productivity initiatives and cost containment actions.

This growth and operating profit, along with the reduction in adjusted tax rate and number of shares outstanding, will lead to 10% plus EPS growth over the medium term. And as I described on the last slide, we expect free cash flow conversion to remain strong, allowing us to strategically deploy capital while returning get majority of the cash to shareholders through dividends and share repurchases. These targets are an improvement over a previous mid-term guidance and highlight the increased confidence we have in this business model and the ability of our team to execute.

And with that, I'd like to pass it over to Mike before we get started on Q&A. Thank you.

QUESTION AND ANSWER SECTION

Michael Rednor A
Senior Director-Relations Contact, Otis Worldwide Corp.

Thank you, Rahul. We will now open the lines for an hour of Q&A. [Operator Instructions] We will now play a short video, while we gather the Q&A roster.

[Video Presentation] (00:53:39-00:54:49)

Operator: [Operator Instructions] Our first question comes from Jeff Sprague with Vertical Research. Jeff, your line is open. You can ask your question. Again Jeff, your line is open. You can ask your question. Would you like me to move on to the next question? Would you like me to move on to the next question?

Jeffrey Todd Sprague Q
Analyst, Vertical Research Partners LLC

I'm sorry. Hey, you got me there?

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

Hey, Jeff, we can hear you.

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

We can hear you, Jeff.

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

Copyright © 2001-2022 FactSet CallStreet, LLC

Good morning.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Okay. Yeah, sorry about that.

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

No worries.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC
Q

Maybe the screen [ph] frozen (00:55:44) at the same time. Thanks. Good morning, everyone. I just want to dig a little bit more into kind of the trajectory of service revenue growth. And really, the nature of my question is, what would you expect for capture on price and revenue per user as you rollout the services. I mean, it looks like if we – look at the last four years, right, your service revenue CAGR was about 3% while units were up about 2% on a CAGR basis. So there's a point in there which I assume this maybe some price and mix, but maybe you could just triangulate us on that and then what you'd expect on a go forward for a price and ARPU?

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

Yeah, let me start, and then I'm sure Rahul you'll add. Good morning, everyone. So we have been getting for the past three years, Jeff, about a point on service price per year. And we see that continuing and nothing to do with mix. It's just been steady pricing as well as productivity gains happening at the same time. This year with inflation, we expect at least a point on service pricing as we have escalation clauses written into most of our service contracts for inflation and other indices in both Europe and the Americas. So we see that continuing to grow. As I said in my opening comments, all of our service revenue in every region is accretive to our margins. So everyone is contributing.

Rahul, you want to talk about revenue.

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

Yeah. So just to add to that, Jeff. So if you look at our service growth over the next three to four years, as we've outlined, our portfolio we're seeing is grows as kind of 3-percent-plus, the mix actually works a little bit against us because a part of this growth is coming from China. And that drives the overall revenue per unit down. So that's a little bit of a headwind, but we offset that with price increases. And as Judy said, our price growth in 2019 when we turned the corner was about 1 point in 2021, was about 1 point and that's what we baked in into the model.

And then the rest comes from repair growth as we add more units and then modernization, we're expecting that to grow at mid-single-digit plus, as Robin outlined in her presentation. So that's the overall – like composition of the service growth. This doesn't bake in any huge improvement from either the inflation that Judy just mentioned or any Otis ONE benefit that Robin mentioned in her prepared remarks. So that's the – so we've kept it at 1% and hopefully we can do better than that.

Copyright © 2001-2022 FactSet CallStreet, LLC

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Right, and so the mix is negative on a geographic basis, but it sounds like you would expect kind of on a like-for-like country basis with some of the new offerings for revenue per user to actually begin to track a bit higher. Is that correct?

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

A

That is correct. But we kind of – we haven't baked that into this outlook. We've kept it at that 1% that we've achieved in the last couple of years.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Right. And just if you wouldn't mind just to come back to the China market. Can you just provide a kind of a real-time update on what you're seeing there in terms of kind of order activity backlog conversion and maybe how you see that the first half playing out versus the second half? And I'll leave it there. Thank you.

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

A

Yeah. Thanks, Jeff. So, China, as we just said at our earnings call a few weeks ago, we expect the segment to be down, especially for our book and bill business minus 5% to minus 10% this year. What we're seeing on the ground right now is pretty consistent with that, and we see that playing out more in the first half than the second half. But even at that, you're talking 600,000 units in the segment. So we're back to 2020 levels.

For us, that's something we can certainly achieve and grow on, because we've been gaining share in China consistently since we put our strategy in place for sales coverage, doubling our A&Ds as well as is really introducing Gen3 last year, which has taken off in China. So on the new equipment side in China, we will deal with this and compete. Infrastructure, we're seeing pick up nicely, Jeff, and we expect that to continue. Tier 1 and Tier 2 cities are still leading. And that's where our expanded sales coverage and agents and distributors have really paid off for us. So we will weather the first half and we believe that the China market, especially in new equipment, will finish the year about where we [ph] send (01:00:24) maybe a potential for improvement. But in the out years, we assume right now in our model it's going to be flat.

Operator: Thank you. Our next question comes from Nigel Coe with Wolfe Research.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning. Thanks for the detail here, [indiscernible] (01:00:41). I wanted to go back to the Jeff's question and really just dig into the 3% unit growth. I know you would keep that in 2021. But going forward, it seems that the sort of the natural rate is 1% to maybe 2% from just the growth in installed base. So just wondering, the bridge to 3%, is that is just better retention? Is it mainly higher kind of capture rates on the installs? I mean, just a bit more color there would be helpful.

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

A

Copyright © 2001-2022 FactSet CallStreet, LLC

Yeah. There's a little bit of a geographic mix going on, Nigel. When you look at the segment growth up to 23 million units in 2024 really it's – so much of that is in China, where we have great opportunity, which gets us excited. We had high teens portfolio growth there both of the last two quarters in 2021, but the growth rates are a little slower in the segments, in some of the more mature markets where we have obviously more presence and more of our portfolio.

So we're kind of balancing that mix as we look out in time. The 3-plus-percent will drive again from China, achieving in the teens as well as every one of our region's growing their portfolios. So it's the strategy we put in place. If you look back a decade, we didn't have that laser focus on growing our portfolio and accelerating it. Now everything we're doing is managing and measuring to that.

We talked about our conversion rates. We talk about our retention rates in China. Our retention rates have gone up significantly, as have our conversion rates because we've put out service depots and we've extended our reach and added Otis ONE. So China will continue to grow significantly for service and we will see rates – we've got high retention rates in Western Europe in the high 90s, but even that can get improved when we add connected devices, when we have that stickiness with customers and we're seeing that in the benefit of Otis ONE.

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

So, Nigel, just to...

Nigel Coe
Analyst, Wolfe Research LLC
Q

Great.

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

...I think Judy mentioned about the growth rate in China, and that's clearly going to drive the overall growth in portfolio, both from market growth and obviously us capturing part of the growth. I mean if you look at our new equipment share in China, it's kind of mid to high-teens, right. And if you look at our service growth – service share in the market, it's up 5%. So clearly there's a big gap there and over the last two years, we've demonstrated that we can start catching up. I mean, we grew our portfolio in China high-single-digits in 2020 and then obviously high-teens last year.

So, clearly the right trajectory, but even if you go outside China, there is a huge opportunity for improvement here even though we have best in class retention rates, there is tons of opportunity for improvement and we do believe that digitization is a lever for that. I mean, if you look at our attrition rates on where we have connected the units, especially in Europe, where we have installed our multimedia solution over the last couple of years. I mean in Spain, we've already shared on attrition rates are around at 1% mark. And even outside Spain, if you look at our attrition rates on places where we have that multimedia screen installed. Our attrition rates are sub 1%. So that is clearly going to help us as we go from 33% of our portfolio connected to closer to 60%.

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

Yeah. Nigel...

Copyright © 2001-2022 FactSet CallStreet, LLC

Nigel Coe
Analyst, Wolfe Research LLC

[ph] No (01:04:17) question...

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

Just one last comment to add. Digital disruption in this industry favors the OEM and that may be counterintuitive in other industries, but in our industry where in the past, it's been so highly mechanical. Now moving to being connected, having data, having the digital ecosystem, it actually favors us versus all of these independent service providers, which is why you're seeing the growth you're seeing in China and we're going to be able to exploit that and really grow this portfolio again from 1% to 2% to 3% that we proved last year and 3-plus-percent going forward. 2.5 million units by 2026 and we see that as very realistic.

Nigel Coe
Analyst, Wolfe Research LLC

Great. Thanks for the detail, that's great. And my follow on is really around industry consolidation. You've cleaned up the Zardoya structure. I'm getting tips and feedback on the block next few years, Toshiba [ph] after fail (01:05:18) and a lot of smaller APAC players. How do you see the [ph] industry structure (01:05:25) evolving over the next medium term and from your approach? I understand you're not kind of pitching Otis as a growth [ph] factor in the story (01:05:33). But do you think that the scope to be a bit more acquisitive going forward?

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

Look, in terms of consolidation and actually in terms of investment, there's a few really important things to know. We're not balance sheet constrained. I think that's the most important. I think we have demonstrated that with our really a debt handling of the Zardoya transaction as well as, as the debt that our treasury team has taken on. When you look at the debt we've brought on for Zardoya and now pay down $500 million of debt already in the last six weeks of this year so that we could start share buybacks.

We've proven that in the regions where we compete, which is globally, we can place our debt in local currency and optimize again for the benefit of the shareholders significantly. But we're always looking for opportunities. The last couple of years, we've done about $135 million in bolt-ons. We are always looking for strategic opportunities and we'll evaluate them as they come to market and keep relationships open.

I will tell you, because I think it's important for our investors to understand it's not just about revenue and size. The key to this market is density in every market you're selling in and most importantly, you're servicing, because that density gives you the productivity and it's that density that we believe, Nigel, gives us that margin differential we have versus the competition. As Robin said, we're the only OEM in the top eight markets. That's purposeful. We go in markets early and we have staying power. We've been in Japan. We're just celebrating 90 years.

So, we understand density in every market. We want share gain in every market, portfolio growth in every market and so we're in a really good place now to where bolt-ons makes sense. We're going to look at strategic options. We're always interested. But I really like our position where we are right now as the industry leader.

Operator: Thank you very much. Our next question comes from Julian Mitchell with Barclays.

Copyright © 2001-2022 FactSet CallStreet, LLC

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Hi, good morning.

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

Good morning, Julian.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

I just wanted to circle back on the point on service pricing, so I suppose in sort of a slide 31 and you mentioned, I think earlier that you've had sort of 1% service price increase per unit per year on average. But in recent years, you've seen a doubling in the number of connected elevators. I think in the installed base at Otis, so just wondered why that maybe didn't translate into a bigger service price uplift because when I look at slide 29, you've got this sort of schematic of high-teens price increase per unit and again, when I look ahead, you're still assuming only 1% service price increase per unit even with that. So, I'm just trying to understand what's that discrepancy between the very high theoretical kind of extra service price per unit from Otis ONE and obviously the high inflation macro backdrop and then what seems a very small drops through to the 1% that you're actually realizing historically and the forecasting that you'll get.

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

Julian, let me explain our Otis ONE strategy that we put in place several years ago. And now where we are taking it and what we've learned from the market. Our strategy, I believe, we're spot on. We decided to invest our own CapEx for Otis ONE, originally as a productivity tool, and we had a fairly simple sensor in these first 100,000 plus units, almost 200,000 units that we've deployed, which was mainly data driven. We invested in it and we knew it would help us, and we've shown that it's helped us from productivity.

We talked – Rahul talked about it in terms of what that yielded in China specifically already. Now that we've had it out there, we've learned and we've talked to customers and they've said we want more. So, we haven't charge for it from a subscription service standpoint significantly to-date. We chose to put it in the highest cost, maintenance cost markets around versus sprinkling these everywhere because again it gets back to our thesis of density. When you have density, you can optimize the routes. You can use the mechanics more productively, more efficiently.

So, we put these in the high cost markets. In North America, we put them in China where there's regulated maintenance visits and we put them in multiple countries in Europe where we have higher cost of labor as well. What the customers have told us is beyond data. They find value in this. They get to see the heartbeat already. We do that primarily complementary. Now, they want two other really key functions, data and voice and data voice and multimedia. And those are where we're going to start getting, we'll start ramping those shortly. And those are where we're going to start getting more of the subscription services.

On the data and voice side, it's an easy sell because most of you know, there's an emergency phone line in every elevator by code. What we're doing is we're switching that landline and the cost that right now a building manager basically pays themselves, not through the elevator company to have that line there to revenue for Otis, because it will be included in our data and voice solution. In the multimedia solution, we go even higher end and this really does give customization for the customers, it allows their building to be more attractive to tenants, and it drives

Copyright © 2001-2022 FactSet CallStreet, LLC

subscription revenue, because it's more real time and in the case of Gen360, lets you communicate in the event of an entrapment.

So it's really early days for data and voice and data voice and multimedia, and we're just really starting to ramp those up, which is why we've been probably, I think, realistic, but maybe conservative on what we're showing in the medium term. But we want to get them out there. We want to see what that customer attraction and retention rate would be in terms of staying on a multimedia, when we've done it before in other countries, in Spain and in other countries, again, the stickiness is almost 99% we have retention rates, so revenue goes up. We get better retention rates. It's a win all around. And now the customers are pulling forward.

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

A

Yeah. And Julian, as Judy mentioned on the voice, we're just launching the solution, so that's a brand new product out there. The multimedia we have installed about 100,000 of these units already in Europe. They're working. They've been in the market for the last few years, and the revenue that we are getting on those units is about 15% to 20% higher. I think we had that in one of our previous presentations that we put out there. So, on the multimedia side, we are getting 15% to 20% higher revenue per unit.

So that's clearly out there. So but again, it's early days, and the amount of price that we will get is going to differ by region and depend on – and will differ by region depending on what solutions would the customers prefer. If they're going in for that lower data and solution – we don't think there's a lot of price there, there's a lot of productivity benefits, as Judy mentioned. But as we go up the chain, there is definitely voice and multimedia, we'll start getting revenue per unit, and that's what our prior experience would suggest. And again, obviously the benefit goes beyond retention and conversion.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's helpful. Thank you for that detail. And then maybe secondly, just looking at the balance sheet and you have that helpful slide 41 on that topic, but just wanted to try and understand, when you're talking about this the very good outlook for sort of service profitability and the stability of that cash flow. How are you thinking about the right balance sheet leverage profile, understand that you might move that higher for the [ph] other (01:13:43) acquisition. But in general, this is clearly a business that can support a lot of balance sheet leverage. So just curious sort of how you're thinking about buybacks in that context beyond this year and what you think the appropriate kind of through cycle leverage is for a business like this?

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

A

Yeah. So we will end this year Julian at just above 2 times net debt to EBITDA. So that's where we will be and obviously as we're not – we're not blind to pay down any more debt, nor borrow any debt in this outlook so obviously, that ratio keeps coming down over time. So what you see here on the page is on slide 41 is the fact that the cash that we're generating over this time period, we plan to return back to shareowners and ensure that that is accretive to the bottom line on those especially on the EPS. So through share repurchases and targeted M&A. So that's going to be the goal.

Now I think the bigger question which is also that we have about a $1.6 billion on our balance sheet as of last year and the question is how do we put that to use? And the challenge there, as we previously discussed, is that about 90% of our cash is outside US at this point. And how do we bring that back? So repatriation is a challenge,

Copyright © 2001-2022 FactSet CallStreet, LLC

now we've done extremely well. Our repatriation in 2021 was 2x the levels in 2020, so we are making incremental progress.

And even this year, if you look at obviously, we've repaid the $500 million of debt already. We've launched – we've announced $300 million to $500 million of buyback starting this year. So clearly we're making progress on repatriation. But we haven't backed that in into in terms of how we're going to distribute that. So if you're able to repatriate more than the free cash that we're going to generate, we're going to put that to work as well. So the right level is we don't need a $6 billion of free cash on the balance sheet we need a lower number now but the challenge is how quickly can we repatriate that back into the US.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Got it. And Rahul, are you sort of thinking net leverage, as you said 2 times-ish at the end of this year that's a good sort of place hold there as we look out?

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

Yeah, 2 times is a good number and for us, that keeps us solidly BBB and that'll be a good number for us.

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

And Julian, it's important because so many of our customers give us cash advances that that solid investment grade rating is really is so critical. I think we've proven our capital management, we're ahead of what we said at Investor Day two years ago. We weren't even going to do any buybacks until 2022 and in 2021, we purchased $725 million of buybacks. And as we announced earlier this morning, we're restarting $300 million to $500 million for this year and we'll continue to drive return to the shareholders.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Great. Thank you.

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

Thanks, Julian.

Operator: Our next question comes from Steve Tusa with JPMorgan.

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

Good morning, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Yeah. Hi, guys. Good morning. Thanks for the detail. What are you guys assuming a little more detail on recapture? There weren't a lot of numbers around that. Can you maybe just talk about that aspect of the business model?

Copyright © 2001-2022 FactSet CallStreet, LLC

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

A

Yeah. I can start and Robin can jump in here, Julian – sorry, Steve. So on recapture, we've made a lot of progress, Steve. I mean last year, our recapture was substantially better over 2020, so we said it I think in our earnings call that we made improvements across all three metrics retention, recapture and conversion. So recaptures are working really well. We've made a lot of progress on that, especially in China as we've expanded our network and started installing Otis ONE which has made us far more competitive with these independent service providers.

So we've made a lot of progress in China where the biggest opportunity is by the way. So that's our biggest recapture market. Now as we go outside China, Steve, there's a little bit of a balance going on between driving improved retention and recapture. And what we are finding is that our teams get stretched when we push on all three metrics all at the same time. And the biggest pool – the profit pool that we have is the portfolio that we have inside today and we don't want to lose that. So there's a little bit of a focus more on improving our retention rates in the more mature markets, so and that will – we will keep driving that. But as we go to the developing markets where we had lost some units over a period of time, there's definitely an improvement opportunity on recapture and Otis ONE is going to be a big tool because that makes us competitive. Robin, I don't know if you want to add anything?

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.

A

Yeah. No, I think what Rahul covered is right on. I mean, the only thing I could add is that we continue where we can specializing some of our sales force to be able to go after that particular part of the market, especially Otis originally manufactured equipment, it's obviously a perfect play with the Otis ONE value proposition to bring those units back into our portfolio. So, we're going to continue to push on that where we can.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

So is that – how much is that adding from a growth perspective, I mean, is that like a 0.5 point of growth every year, like just maybe a little more granularity around how to think about that as initiative going forward, understanding it's maybe a little bit lumpy year-to-year?

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

A

Yeah. So if you think about our overall growth, Steve, at the 3% plus, I mean, right now our retention is about 94%. And given that with Otis ONE and other things, I think we can drive that maybe 1 point to 1.5 point better over this time period. So clearly losing less that, if you lose kind of get this to 95%, 96%, so that drives 1 point to 1.5 point of improvement over this period. So that gets us from 3 to 3.5 point. Our conversion rates, we expect that to get better and recapture is going to be the tail end. But it's somewhere between maybe 0.25 point or so over this time period annually.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay.

Copyright © 2001-2022 FactSet CallStreet, LLC

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

Yeah. And our conversion rates, Steve, are up 2% from Investor Day. We're up from 60% to 62% globally. So we're making progress on every metric. And again, recapture is probably the – it absolutely is the lowest margin contributor. So while we're specialized in it, again, bring Otis units home for us, it's all about bringing that retention rate up. It was sub-94%, but close to rounding when we stood before two years ago, we're over 94% now, it's industry-leading and we got to keep taking it up.

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.
A

And then maybe...

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

And then just one...

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.
A

Sorry, Steve. The one thing I'll just add as well is don't forget the growth from the new equipment share as well. So we get more units to be able to convert. So that's beneficial on both sides is that we sell more new equipment, more new equipment units and improving our share. And then we also increase our conversion rate. Those are our certainly one of the more profitable pieces of the service business. So bringing those in is very important for us.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Got it. And then just, Rahul, on the cash conversion. Is that solely a function of the NCI dynamics from Zardoya? Can you maybe just – anything else there? You guys are looking at from a cash perspective, I think you're generating roughly, I don't know, $1.6 billion to $1.7 billion for the next three years to get to that $5 billion total, I mean, anything else going on cash conversion, we should keep in mind for the next couple of years?

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

No, the convergence, Steve, it's pure math. I mean, last time we stood before you a couple of years ago, we said, hey, $110 million to $120 million, obviously that did not factor in any – the Zardoya transaction. It'll be – Zardoya NCI is about $80 million. So if you do math, that's about roughly 8 points, right. So that obviously pushes us closer to $100 million to $110 million that we're guiding now. What we try to do, Steve, as we did last – two years ago, is not bake in a lot of working capital improvement into this.

So we've said – we've done a remarkable job in reducing working capital. It's half of the level it was back two years ago. So what we basically let the net income flow through to free cash as disclosed and not baked in lot of working capital improvement into this timeframe. So if we keep the momentum going on working capital, hopefully we can do better than what we have on the page. But that's a good place to start and then we'll take it from there.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Copyright © 2001-2022 FactSet CallStreet, LLC

Got it. Thanks, guys. Appreciate it.

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

Thanks, Steve.

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

Thanks, Steve.

Operator: Our next question comes from Miguel Borrega with BNP Paribas Exane.

Miguel Borrega
Analyst, Exane SA (United Kingdom) Q

Hi. Good morning, everyone. Few questions for me and thank you for taking the time. On your connected units, the Americas seems to be lagging [ph] in the region (01:22:40). Any specific reason for that? And then can you walk us on a more practical example? And I appreciate your comments around increased retention, less downtime, et cetera. But can you walk us on the economics of driving 30% to 60%? Is this coming mostly from selling new elevators that already come with adoption? Or will that be an extra effort with reconnecting all the units?

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

Do you want to take the second part first?

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp. A

Sure, sure. So if I just sort of talk about kind of where we are right now with connected units, we got about a 30% of our portfolio connected right now. Our mid-term goal, as you heard, is to connect about 60% of it. So that is a little bit of acceleration from where we are today. Part of that is through shipping new units and our factories are now geared up and the majority of them to ship connected units. But it also includes continuing to retrofit units out there in the marketplace. So we're certainly excited about the progress that we're making there.

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

Yeah. Miguel, in terms of the Americas, we've really done the rollout so far in North America, which is the bulk, obviously the US and Canada and now our Florence, South Carolina factory is shipping units with Otis ONE as part of our Gen3 product launch, and they're now shipping with Gen3 and with Otis ONE inside. So we're going to pick this up. It is math. If you get from where we are today to get to that 60%, we can't just stay at 100,000 a year. We understand that. We're trying to balance any semiconductor challenges this year, because obviously all these connect and have a gateway. But we've got to – we got to pick that up significantly in the next few years. And we know that and we've got plans for that and it's already included in our guide in terms of CapEx.

Miguel Borrega
Analyst, Exane SA (United Kingdom) Q

Copyright © 2001-2022 FactSet CallStreet, LLC

Thank you. And then just a follow-up on the free cash flow guidance going to [ph] 100%, 200% (01:24:42) and I understand the dynamics on working capital, but also following up on the connected units, will you require a step up in investments? And also, can you shed some flavor on the payback and the marginal return on connecting these older units. Thank you.

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

Yeah. No, the CapEx, as Judy just mentioned, Miguel, that's already in our numbers, so we know that – we will be expecting a little bit. I mean, if you look at our guide for 2022, it has a little bit of a step up in CapEx from last year. So it's around the edges. I mean, it's not a lot. So we can easily absorb that within the guide that we provided. So it's not $50 million, $100 million incremental. It's just in that $10 million to $20 million range of incremental CapEx this year, depending on how much we do. So that's well within the guide that we provided.

In terms of the payback, I think as we've outlined, the payback comes in multiple different ways. But it is definitely a great investment for us. And we've made it at the lower end units, we install it as – at our own cost, and the productivity benefits with a little bit of price easily pays for that. And we are happy to make that investment any day of the year.

And then, as we go on the – at the higher end, especially with the multimedia, our customers are more than willing to pay for it. So that doesn't actually require a lot of investment for us because the customers so far have been paying for it. And again, if you decide that, okay, that's someplace we want to invest, we'll start figuring that out. And obviously that will come with – that needs to come with substantial amount of subscription revenue for us to make a payback work. But that is in the future. Right now, the customers are paying for it.

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

Very low capital-intensive industry and specific to Otis, that 1.5% of revenue we spend on CapEx most years, and that feeds the business well. Similar kind of number on our R&D, Miguel, and our strategic investments. And that really continues to drive our innovation engine.

Miguel Borrega Q
Analyst, Exane SA (United Kingdom)

That's great. Thank you.

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

Thank you, Miguel.

Operator: Our next question comes from Joe O'Dea with Wells Fargo.

Joseph O'Dea Q
Analyst, Wells Fargo Securities LLC

Hi, good morning. Thanks for taking my question. The first one is just on Service competition, I think you made the comment that the top five participants have 40% share. And I'm curious how that varies by region and then how it's competition versus independents changing as we move towards digitalization? Are you seeing more price competition out of that group? How are they trying to adapt to this?

Copyright © 2001-2022 FactSet CallStreet, LLC

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

A

Thanks, Joe. So in terms of the regional mix, I'll start in China where 75% of the Service market is maintained by independent service providers. And so, it – really it does shift by region. But the top five, when you look globally, have about 40% of the share. Again, the top five would have less than 25% in China. So it's pretty significant, which means there's lots of opportunity. That gets me to the second part of your question. Again, I really believe that the – whether you call us the incumbents, the OEMs, as elevators have now hit a real inflection point, whether that's through digital connection, whether that's through additional data available, whether that's through just advancements in innovation in terms of sensors, in terms of just how elevators operate, the increased microelectronics getting smaller and our ability to just put more in a share – in a hoist way, that favors the OEM.

We have the scale, the ability, the investments, the technology and the competencies to be able to roll out Otis ONE and similar solutions throughout the globe. So the ISPs, what it does is it gives us again more data for us to act upon. It allows us before a customer even calls our Otis line to know that there's an issue with an elevator and a dispatch – to do a truck roll to dispatch one of our capable field service technicians with the information they need, with the part they need, and we're really seeing incredible customer response to that.

Small players can't make that investment and can't have the ecosystem, which is the helpdesk, the availability of data, the simultaneous situational awareness. What's critical for us is that ecosystem. And that's why I think the OEMs have the advantage here. Because when a call – if a call does come in, instead of – and we've had multiple instances of this throughout the globe – instead of our Otis line operator immediately dispatching someone, they get to see the same data that our Otis – that our technician has and somewhat at a higher level what our customer has, and they can see that the elevator's already reset. We don't need to send a truck, which does – makes us more productive and helps from an ESG perspective because we're driving less miles and adding less greenhouse gas emissions.

So it's a win-win all around for the OEMs. As we continue to ramp up, you're going to see that that value prop happening. And with that productivity, we can actually price in certain markets where it's far more competitive against the ISPs at a lower price point, still have accretive margins and take back that business and take future business from the ISPs. So we think this is a real switch in the dynamics. And that's why when you look at our portfolio growth and you see us going from about $7.9 billion in Service revenue in 2021 to a $10 billion Service revenue in 2026, that's almost twice the growth we had as we look back four or five years. And it all comes together in the ecosystem and I think – again I think, the advantage comes to us.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Those are helpful details. Thank you. And then, I want to touch upon on the China agents and distributors, and if you could talk about how sort of properly sized do you think you are there now? And then may be related to that, how efficient you are, so if you have anything with respect to revenue generation per kind of agent and what you think is achievable?

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

A

Yeah, well, we don't disclose kind of revenue per agent. We haven't shared that information. When we had Investor Day last time, right, before we became independent, we had our strategy ready to go in China and we knew we needed improved coverage, we needed improved relationships with agents and distributors, which is the core of how you go to market in China, and we knew we needed to focus in different places, both in improving our

Copyright © 2001-2022 FactSet CallStreet, LLC

product offering, training and bringing on agents and distributors quickly and really excelling more in the Tier 1 and Tier 2 cities that were growing. That strategy was put in place and the last two years we've delivered.

So we probably had about 1,000 distributors, roughly, when we spun and became independent. We ended last year at about 2,200, so almost – more than doubled. We think, give or take a few hundred, that's about the right level. There's a learning curve we go through, there's a pruning that we go through to for those that aren't yielding because we have to make sure they understand our value proposition as well as our product line. We think we're at a really good place, 2,200 give or take a few, we'll continue to change them out, but we have developed really strong relationships that allow – has allowed us really growth in segment. We've had share growth in China over the last two years in New Equipment, significant gain, especially in Tier 1 and Tier 2 cities, especially with the key accounts, these larger accounts who want to have us for maintenance as well. So all those strategies are coming together, and it's really through that well-thought-through and now well-executed strategy in China that really has allowed us to grow our orders at 2x the order – the market growth, and we shared that at earnings in one of our appendix charts.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

And then, just a clarification, given some of the focus on free cash flow, it's probably a rounding issue, but I think if you just do the math, the $5 billion that implies a free cash flow margin kind of more in line with the margin growth you're outlining for New Equipment, is there any reason why free cash flow margins won't grow at the 40 bps you're targeting at the total EBIT level for?

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

A

Yeah, part of that, Joe, is again, as I said earlier, our 2020 and 2021 free cash flow number, how working capital improvements kind of baked in and we delivered substantial working capital improvements. As we look forward, we've not included that in our outlook. So that's the reason why the free cash flow doesn't grow at the same rate and the margins are more just as you mentioned. So hopefully we can do better on working capital and we can keep driving that down, which should provide an upside to the outlook that we've just provided.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Thank you. Appreciate it.

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

A

Thank you, Joe.

Operator: Our next question comes from Cai von Rumohr with Cowen.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Yes, thanks so much. So you guys have a 94% retention rate, which is the best in your industry. And I think you've said that the average contract comes up for renewal every four years. So that translates into essentially a 75% win rate of contracts that do come up, which for a razorblade business is not particularly impressive. Can you give us some color? I think you mentioned, you're in the high-90s in Europe, maybe by geography where is it

Copyright © 2001-2022 FactSet CallStreet, LLC

way above that and where is it lower? And maybe also by product i.e. connected versus unconnected, I know connected probably hasn't come up for retention – for renewal yet. Thank you.

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

Yeah. So, no – Cai, great question. So if you – first, it's not a razorblade model. We do make money on New Equipment. So for us, it's New Equipment – it's not a lost leader. We do make money in both our segments. But I think your point is absolutely right. And that's exactly right where the – that we do have an opportunity to improve our retention rate. Now we are not going to win every single contract that comes up for renewal for multiple reasons. It could be our service levels on a particular execution, it could be price, it could be multiple other things. So we definitely – there is some level of attrition that will happen. So – and the idea to drive the improvement in retention is going to come both from stretching the length of the contract and executing better, reaching the customers first. And I think that's what Robin mentioned, that we do have specialized sales forces that are going after retention, calling customers before – well before the contract comes up for renewal. So we don't run the risk of losing that contract when it does come up for renewal.

So there are opportunities, and that is the reason why I said earlier that in terms of focusing our retention on recapture versus retention, we've had a little bit of a switch and we are focusing a little bit more on retention, especially in the mature markets. And the length of contract is different by region and we have an opportunity to improve, I would say, our retention rate in North America, in Europe, in China. Our Asia Pac, outside Asia, we do pretty well, but those three regions is definitely an improvement.

And on the digital side, I would say that where we have the multimedia screen installed, because that has been going on in Europe, our attrition rate overall is about 1 point in both in Spain, which we've discussed previously, and outside of Spain. So that is a good – that's a good signpost for us. And even in Japan, where we've had the older technology connected, our attrition rates of somewhere in the 2% to 3%, and that's almost an annual renewal, Robin?

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.
A

Yeah.

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

So, that's the overall rate. So I think there's clearly an opportunity to improve our retention across the board. But Robin, I don't know if you want to add anything here on how we drive that further.

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.
A

Yeah, I mean, I think, we would say that we've got between 1 point and 2 points of improvement opportunity in our overall retention rate. As – I think, as Rahul said, sort of 1 point maybe coming from sort of basic improvement in our service quality, just basic blocking and tackling and providing better service to our customers; and then, 1 point or so from our digital side. And I think we've got some early signs that the digital solution is helping us not just in Europe, but maybe a little bit in China as well as we continue to roll out that solution, we'll learn more from that. So we think there's some upside there.

Copyright © 2001-2022 FactSet CallStreet, LLC

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

But Asia and China, fair to say, it's typically a one-year service contract versus four.

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.
A

Yes.

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

Different parts of Asia, obviously.

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.
A

Yes. Yes.

Cai von Rumohr
Analyst, Cowen & Co. LLC
Q

Got it. And then, so, I think you've said that you have – if we look at the elevators serviced by others, you have the largest percentage of Otis elevators, i.e., maybe you can give us how many – what percent of the elevators serviced by others are produced by Otis. And then you said, you think you have an advantage in trying to win those elevators back because of your understanding of how they're built. You basically can offer a more powerful connectivity offering. So maybe walk us through that opportunity and what you're doing to pursue it.

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

Yeah, Cai, we have over 3.5 million Otis elevators. It's probably we can round up a little higher than that now that we've manufactured through time that are in service somewhere in the world today. Of that, we maintain ourselves a little over 1.5 million of those, so 2 million, 2 million-plus opportunity of Otis units to bring home.

And the reason we understand them better is we understand what happens in the controller, which is the computer, the brain of the elevator to-date that has – that evolved in the 1960s, 1970s, 1980s, and now is really prevalent everywhere before this really next connected methodology that's been rolling out now for a few years.

So about a 2 million portfolio opportunity again, for the ability for us to put an Otis ONE sensor on, to be able to get the fault codes, to be able to understand by those logs what's happening, to be able to really just feed our data lake, and that data lake gives us really the ability to be predictive, to be trans – to really be able to know when to send a mechanic out to replace a part. It's a little bit, I try to liken kind of our new technology, whether it's Otis ONE or Gen360, but especially Gen360 I liken that to the automotive industry where maybe 20, 30 years ago you could go to your local mechanic to get something repaired because they had the ability to do it mechanically and it was great.

But now you take it back to the dealer, and that's when I talk about the OEM having the advantage. Think of us as that automotive dealer that manufacturer who's got that access. In our case, though, obviously the elevator doesn't leave the building. So that's why we needed to be connected. That's where we get a lot more remote

Copyright © 2001-2022 FactSet CallStreet, LLC

actions, where code allows. Some places it doesn't allow, but where code allows, our remote diagnosis and remote actions are just – are going to pick up over this medium-term.

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.

A

Yeah. And maybe I could just give you, so...

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Thank you.

Robin Fiala
Vice President-Sales & Marketing, Otis Worldwide Corp.

A

Sorry. Maybe I could just give you an example that happened just last week, talking with a customer about sort of the benefits that Otis ONE can offer. And one of our customers' biggest frustration points, as you can imagine, is sort of having an intermittent issue. And just teeing off of Judy's example, just think about it in your own life, when you take your car, you're having an issue with your car, you take it to the dealer and, oh, by the way, when you get there, the issue is no longer happening. That happens as well, sometimes with our customers on elevators. And in this particular situation, we had a building where we then put Otis ONE on because we were having an intermittent issue. By putting Otis ONE on, then because we can now see exactly what's happening in the building remotely, both on our mechanics handheld tools as well as our experts PCs, we were able to immediately see what was happening, even though we weren't in the job site, right? So we were able to immediately see what's happening, diagnose the issue quickly for the customer, ended up really thrilling that customer; and the customer saying to us, it's like having an Otis mechanic in my building, 24/7, which is really again sort of the power of what Otis ONE can offer our customers.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Terrific. Thank you very much.

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

A

Thanks, Cai.

Operator: Our next question comes from John Walsh with Credit Suisse.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, good morning. Thanks for all the detail and taking all the questions. I wanted to go back to something you said in your prepared remarks around the digital revolution favoring the OEM. And just conceptually, I think we're still relatively early days in this globally, we'd love to get your thoughts on, is this a race to connect the quickest before new entrants come into the market? And then, maybe just as you think about it geographically, where are you having the most success on your digital connection rate? I know you've held up Japan in the past, can every geography look like Japan or is that the kind of always be one that just naturally has a higher digital connection rate than other geographies? Thank you.

Copyright © 2001-2022 FactSet CallStreet, LLC

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

Yeah, John. I don't think it's a quantity race. I think it's a density race. And that's been our strategy all along is to place it, not again with 2.1 million units, some of which are fairly aged and really wouldn't benefit from it. It's about placing it to where it can optimize both for a customer and for us in productivity, especially our data solution. The higher end, the premium solution with multimedia will be different. That'll be more of a pull from the customers. But we've made a strategic decision to deploy the data based on density, and we think that's going to play out for us. We don't see it going everywhere and we don't see it needing to be real-time everywhere. We can – there's places we can put it like your -when someone comes to maybe read your meter for utility, you don't need that every 10 minutes or every day, right? You need that monthly to be able to check the stability of – and be able to provide that reading.

Recall that over – almost 60% of our portfolio is residential and a lot of those residential units, whether they're in Europe or other places, you really don't need as much sophistication. So our data center can be perfect and we can tune it. The other part besides density is its scalability for the future, and we made sure from the time we started that we had over-the-air updates, because the most expensive, time-consuming and costly element for us is to have to send one of our field professionals to load software or to do something like that.

So we have the architecture of Otis ONE allows for over-the-air updates so we can send out and make sure it's obviously cyber secure, that's a given, that's a foundational element for us, but also allow us to add features. Probably, I would say, the place we're seeing the most benefit right now is in China, in terms of ramping up versus the mature – more mature market in Japan. Do you want to comment on something?

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

No, I think Robin had in her prepared remarks, John, about the benefits that we are seeing in China, including reduction in hours, reduction in maintenance visits, being able to see and we're seeing similar success. I mean, the other example that she highlighted, you saw the reduction in the service visits, time to address the customer issues, which they're all helping the retention rate.

So I think the benefits are global, they obviously vary a little bit. And in China, we can take even the maintenance hours down because we can now conduct a third of the visit remotely. Now, that's what China-specific benefit because the code is kind of working in our favor and the regulators are working with us. But we are seeing other opportunities in some of the Western European countries as well, where we don't have to do maintenance visits by code. We can also eliminate our visits. So I think the benefits are everywhere. Obviously, that depends on regions and operationalizing it. But I think Japan is a great example. Spain is another places where we've had a long history with tremendous success. And now China is coming up next. But I think in every market where you have high labor costs, you can see the benefit.

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

And John, I just remind everyone listening that, remember, we're in the life safety business here, where the code varies fairly drastically based on countries, based on regions, based on cities, here in the United States. Everyone's got a slightly different code, and that really does when you talk about digital disruption create that need for domain knowledge and density, as I said. So that's what makes it advantage OEM versus a one local advantage or really a lot of new entrants trying to get into this market. This has – we take to safety, reliability and most importantly safely moving several billion passengers a day very seriously and the responsibility that goes

Copyright © 2001-2022 FactSet CallStreet, LLC

with that. And that's why we haven't seen lots of new entrants in the modernization market or in the New Equipment market for decades.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. I appreciate that answer. And then maybe as a follow on, you alluded to it in your answer right there and obviously covered it a little bit earlier, but just wanted to get a little more specific on some of the regulatory changes were anticipating in China as it relates to service. Believe they've been piloting now for a couple of years that change, or 24/7 monitoring and getting rid of the every two-week visit. Just what do you have embedded in your expectations around China regulations and is that something you think we actually see getting formalized going forward? Thank you.

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

A

Yeah. We have not included any assumptions that we would be able to not have to do the two people every two weeks across China for our service portfolio in our medium-term outlook. We are absolutely part of the pilots. They are being driven city by city, by the local regulatory group. But we have – and you have to share your data with the regulator as well, which we're happy to do in China and we do that on a regular basis.

We think there's value – everyone sees there being value. It's just in a prove-it-to-me stage. And so, we're going to watch those proof points. We don't know when those cities that have been piloting will allow us to go to less than twice a month for a maintenance visit for every elevator installed in China. We're going to have to watch that play out and those benefits when that happens and if that happens either locally or more on the country level, we'll be sure to update you and flow those through as upside.

John Walsh
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you, Appreciate it.

Operator: Our next question comes from Nick Housden with RBC Capital Markets.

Nick Housden
Analyst, RBC Capital Markets

Q

Yes, hi, everyone, thanks for taking my questions. My first one is just around capital allocation and how dynamic that is. And I guess firstly, what exactly is the logic behind the 35% to 40% dividend payout ratio? And then secondly, how consistent do you expect the value of the buybacks to be? Is around $750 million a year, a good benchmark for the future? And then maybe it varies a bit by the M&A opportunities that you've mentioned; and to some extent, the debt repayments down the road. And does this also kind of encompass the repatriation issues that you were talking about, Rahul?

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

A

Yeah. So I can start, Nick, and Judy can add. So on dividends, starting there, our goal we have a fairly stable cash flow and it is not a capital-intensive business, as we previously discussed. So we feel – when we came out of UTC, we had started with the goal that we'll be around 40%, right? Obviously, we set the dividend and our net

Copyright © 2001-2022 FactSet CallStreet, LLC

income has kind of grown much faster than dividend during this time period, which is good news. So now our dividend is below that 35-ish, even 35% number.

So our goal is to get back that number to around 35% to 40%. That probably feels like the right number, obviously, it's not set in stone by any means, right? We can obviously vary that. I mean, we can vary the pace at which we grow the dividend and we can – we definitely don't want to go backwards, but we don't need to go above 40% at this point. So we feel like it's the right number in that ballpark and we'll grow that at measured pace between now and when we get to the end of this medium-term outlook. So that's on dividends.

On the share buyback, it feels like it should be linear because at the end of day, our goal would be to distribute the cash that we generate every year. So that's the objective and that's what you see on that – outlined on that page with that $5 billion number. Now, in 2022, that may be lower just given the fact that we do have that $500 million of debt that we've repaid. So it'll vary a little bit with that, but there is no magic here. As soon as we repatriate that, we should be able to grow, but it may be a little bit lower in 2022, just given the debt repayment and then we'll grow from there. So that's what I would say. But there's no magic and then we'll keep working the remaining $1.6 billion that we have on the balance sheet and we'll keep working that lower and hopefully we can put that to work as well.

Nick Housden
Analyst, RBC Capital Markets

Q

Okay. That's very clear. I guess just very quickly on that repatriation issue, is that something that should ease over time or is this just kind of something that we have to live with?

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

A

It is something we have to deal with every year. We don't – we didn't start out as a public company with a lot of distributable reserves, so that's our challenge. So at the end of the day, the cash that we distribute should grow with the earnings. But since we didn't start with a lot of distributable reserves, we do have some trapped cash.

But again as I said earlier, Nick, we've made tremendous progress. I mean in 2020 we probably repatriated maybe $500 million or so. And last year the number was 2x that. And this year, again, I'm repeating what I said earlier, but we've had a really good start. We've repaid the cash. We repaid the debt and in fairly early part of the year, and then we started the buyback. So we'll keep working it. It's clearly a focus for us. And I think our tax and treasury teams are working really, really hard to make sure that we can put the cash to work, but it is something that's an ongoing issue for us.

Nick Housden
Analyst, RBC Capital Markets

Q

Okay, great. And then maybe just quickly, and so I know you don't explicitly guide for it. I'm just wondering how you think about your return on invested capital, your capital efficiency. Because I'm seeing based on what you've said today that you'll have a higher share of the Service business, more digitalization, more subscription services, more revenue per service technician. So if we put all that together, am I right to think that your returns on capital could increase quite significantly over the next two years?

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

A

Copyright © 2001-2022 FactSet CallStreet, LLC

Yeah, they should, Nick. An even I don't have the numbers in front of me but our ROIC is fantastic. I mean, Otis is not a asset-intensive business to begin with. We haven't made any large acquisitions over this last, I don't know, 20 years maybe. So it's a pretty low asset base. So our ROIC is very, very high. And in this outlook, we are obviously not baking on a big M&A to drive this growth that we've just outlined. So you're right. The fact is ROIC, which is already at a very, very good level, should even improve from this point on.

Nick Housden
Analyst, RBC Capital Markets

Q

Great. Thanks very much.

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

A

Thanks.

Operator: And I'm not showing any further questions at this time. I'd like to turn the call back to Judy for any closing remarks.

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

Thank you, Kevin, and thank you, everyone, for joining us today. As you can see, I mean, the fundamentals of this market are strong. The fundamentals of this business are strong. We are focused on value creation: value creation for you, our shareholders; value creation for our customers with our innovative offerings; value creation for our colleagues; and value creations for the communities where we live and serve. We understand and we've spent the last two years executing our long-term strategy. We've grown the business despite macro challenges and we will continue to grow this business. The Service business will continue to be absolutely foundational to our growth, and you have our commitment that we will manage capital wisely and allocate as much as we can back to our shareholders and to our investors. We appreciate your support in us and we'll continue to perform.

Thank you very much. Stay safe, everyone.

Copyright © 2001-2022 FactSet CallStreet, LLC

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2022 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.