JCAP

Industrial
Europe

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Company Update

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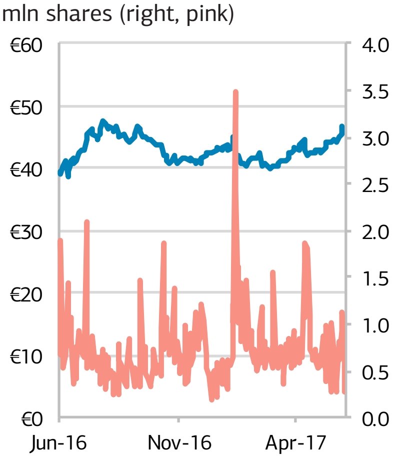
Kone Corp. (KNEBV HEL)

Current Price	Euro 46.59
Target Price	**Euro 37.73**
Downside	**19%**
Recommend	**Sell**
Market Cap	Euro 24.5 bln
Daily Turnover	628,000 shares
SI	8.1%

Kone Corp. (KNEBV HEL) last share price in Euro (left, blue) and volume in mln shares (right, pink)



Source: Bloomberg

Kone Corporation (KNEBV HEL)

The Last Hurrah

- **Kone China Sales Return to Growth in Q2**
  We expect Kone sales and orders to return to low growth of 2% in Q2 2017. Kone prices have stabilized in Q2 and may increase in low single digits. We expect Kone will end the year flat, at the top end of the company's guidance.

- **Market Improving, Kone Less So**
  We estimate, from our survey and Kone competitor reporting, that unit elevator sales rose 5-10% in China in Q1 2017. Kone underperformed the market in Q1.

- **Direct Sales Strength Turning to Weakness**
  Kone faces intense competition in direct sales to developers and projects. Price declines are higher in this channel and we estimate Kone is losing sales to competitors now focusing on this channel

- **Skinnier Prices…**
  Tier 3-4 cities are experiencing growth in property construction and this is driving unit sales growth in elevators. Local brands are more competitive in these markets with ASPs 10-12% lower than higher-tier markets.

- **…But Stable Margins**
  Materials cost growth has abated in Q2 and we expect margin erosion should be halted as a result.

- **Valuation: PT 37.73; Downside: 19%.**
  Kone has outperformed competitors in China for most of the past decade. Kone is now underperforming competitors in China. We caution that the current upturn in property construction in China will see Kone return to order and sales growth in Q2 and probably Q3 in 2017.

Upturn in China Property Finally Lifts Elevators

The market this year is perversely positive.

We expect the value of Kone's sales and orders, which were down 10% in Q1, will finish the year flat. Kone had price declines of 10% in Q1, our survey indicates that those price declines have stopped and Kone may have low single digit price growth in Q2 and Q3. Kone unit sales and orders were flat in Q1 and we expect sales and orders to grow in the range 2–4% in Q2 and Q3. We believe the China elevator market is growing at 5–10% and that Kone is underperforming the market as it faces stronger competition in its direct sales to developers and projects. Sales growth is in lower tier cities where Kone is less dominant and domestic brands are more competitive.

After two years of decline, China elevator sales, which are levered to the latter part of the construction cycle, are finally catching up with the growth in new starts in 2016. Unit sales and prices fell over 15% from the peak in 2014 by the end of 2016. Strong new starts in 2016 turned into unit sales growth for elevators in Q1 and strengthening sales in Q2. Falling demand in a market that had invested for growth led to fierce price competition. We estimate that price declines have now stopped and that we will see very moderate price growth this year. As lower tier cities and social housing are key drivers of growth the product mix will shift towards lower priced products and this will counter much of the value growth. We expect Kone sales to strengthen further in Q3 and the company will finish the year at the upper end of its guidance at zero value growth or slightly better.

Table 1. Kone Sales/Orders Q2 2017 Estimation Method

	Share of Kone Sales	Unit Growth	Price	Mix	Value Growth	Weighted Value Growth
Direct Sales	55%	5%	-4%	-1%	1%	0.3%
Distributor T1 and T2	25%	0%	0%		0%	0.0%
Distributor T3 and above	20%	15%	3%	-10%	8%	1.6%
Total Growth						1.9%

Source: J Capital

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While we are positive on Kone China business for 2017 we expect China to go ex-growth in 2018 and for this to be a drag on Kone's performance in 2018.

Table 2. Kone China Orders and Sales Estimates

	Q1 Actual	Q2 Estimate	Q3 Estimate
Orders (value)	-10%	2%	4%
Sales (Value)	-10%	2%	3%
Price	-10%	1%	2%
Units (orders)	0%	1%	2%
Units (sales)	0%	1%	1%

Source: Company Reports, J Capital

This report will focus exclusively on Kone China sales and the China elevator market. We are using company guidance and market consensus for Kone's performance in other geographies.

Table 3. 2017 Actual China Sales and Orders Performance

	Q1 Orders	Q1 Sales	Q1 Price	Q1 Units
Kone	-10%	-10%	-10%	0%
Otis	-10%		-10%	0%
Schindler	-3%		-12%	8%
Shanghai Mitsubishi		0.5%	-8%	8.50%
Canny		-1%	-11%	10%
SJEC		-4.50%	-12%	7.50%

Source: Company Reports

Market Trends in 2017

Growth shift to lower tier cities, with lower ASP.

Property restrictions, now in place in 40 Tier 1, 2 and 3 cities, have tanked property transactions in Tier 1 and 2 cities but ignited sales in lower tier cities. We estimate about 35% of property construction is in Tier 1 and 2 cities and 65% in Tier 3 and 4 cities. A return to growth in the lower tier cities is good for elevator sales. National property developers now dominate the property markets in tier 1 and 2 cities. In lower tier cities local

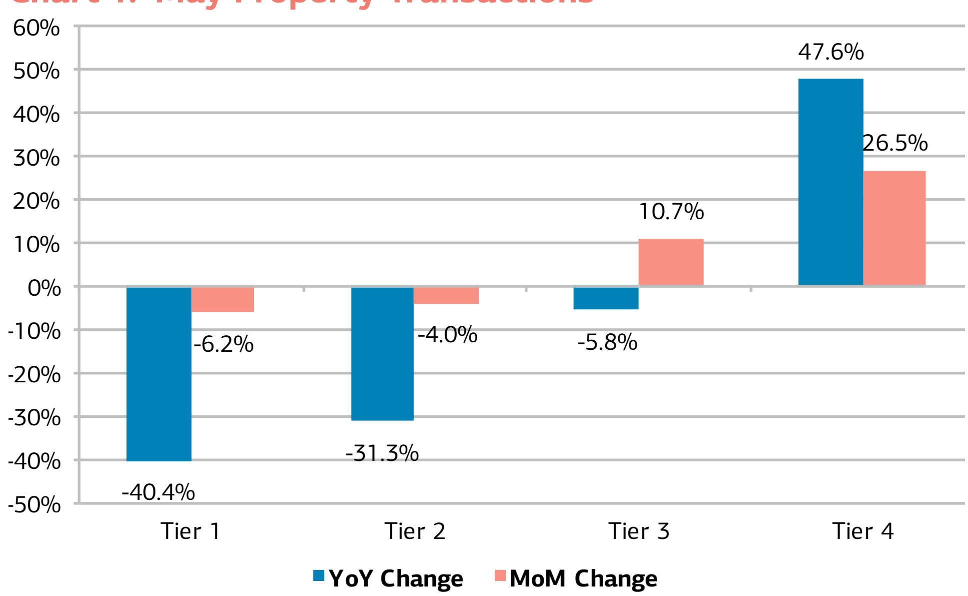
Table 4. Market Trends and Impact on Kone

	Unit	Price/Mix
Growth shift to Tier 3–5	Positive	Negative
OEM's Increased direct sales to developer	Negative	Negative
Infrastructure spend shift to social housing, schools and hospitals	Positive	Negative
Policy Restriction on Tier 1 and 2 cities	Negative	Neutral
Policy Subsidy of low rise Elevator installation	Neutral	Neutral

Source: J Capital

property developers have a much greater share of the market. Buildings are not as high or premium in lower tier cities. Local elevator brands have been more competitive in these markets. Kone has to use lower end products, drop price and sell through distributors in order to be successful in these markets.

Chart 1. May Property Transactions



Source: Local Housing Bureaus, J Capital

We have used the average unit price of Mitsubishi and Canny to approximate the price difference between Tier 1 and 2 cites and lower tier cities. Mitsubishi, No 2 by volume in the elevator market, sells well in high end properties in Tier 1 and 3 cities, Canny is pushed into lower tier mid to low end properties. The price difference is round 10 – 15% and we estimate that approximates the price difference between the tiers. Prices are falling as elevator companies seek out growth in the lower end of the market.

Table 5. Price Differential: International and Local Brands

(RMB/Unit)	2015	2016	Growth
International Brand (Mitsubishi)	211,000	194,000	-8%
Domestic Brand (Canny)	188,000	168,000	-11%
Price Difference	-11%	-13%	

Source: Company Reports, J Capital

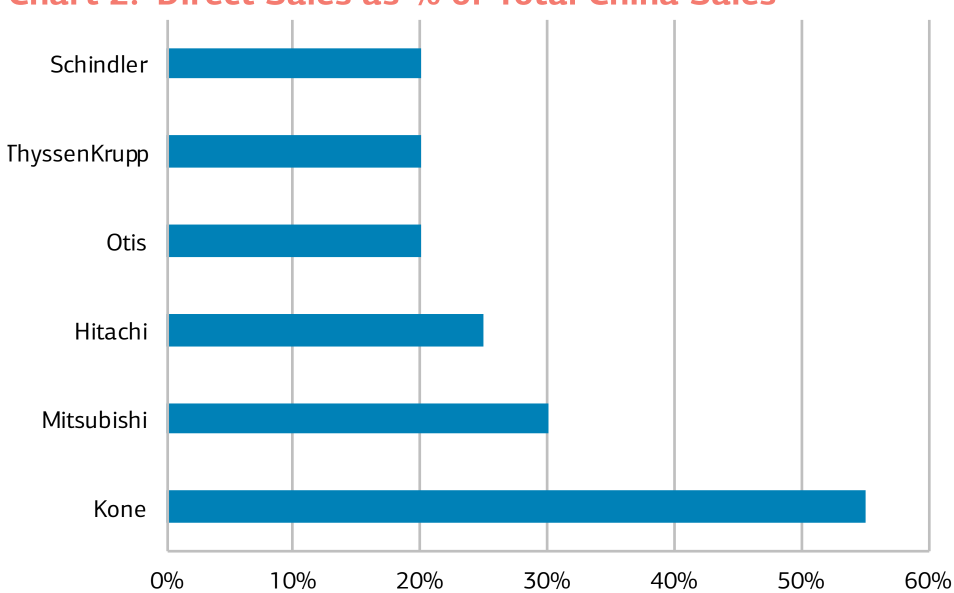
Competitors get wise to direct sales.

We have used the average unit price of Mitsubishi and Canny to approximate the price difference between Tier 1 and 2 cites and lower tier cities. Mitsubishi, No 2 by volume in the elevator market, sells well in high end properties in Tier 1 and 3 cities, Canny is pushed into lower tier mid to low end properties. The price difference is round 10 – 15% and we estimate that approximates the price difference between the tiers. Prices are falling as elevator companies seek out growth in the lower end of the market.

Direct sales to developers: Kone the first mover, now faces intense competition

Until around 2012 almost all elevator sales in China were made via distributors. Kone led the way in selling direct to developers and now sells around 55% of elevators in China directly to developers and projects. Na-

Chart 2. Direct Sales as % of Total China Sales



Source: J Capital

tional developers grew faster and took market share from local developers over the past five years. Growth in the direct sales channel was perhaps up to double the market growth rate. Kone could take market share from competitors with this strategy and become the market leader with 20% share. Mitsubishi has been firmly focused on catching up with Kone since 2014. Otis, ThyssenKrupp, and Schindler are all trying to emulate Kone's success. The net result is that there is now intense competition in the direct sales market, intensified by falling demand. In 20165 elevator prices sold via distributors fell 5 – 10% but in the direct sales channel they fell more than 15%. Our survey indicates that this channel's unit growth continues to outperform the market.

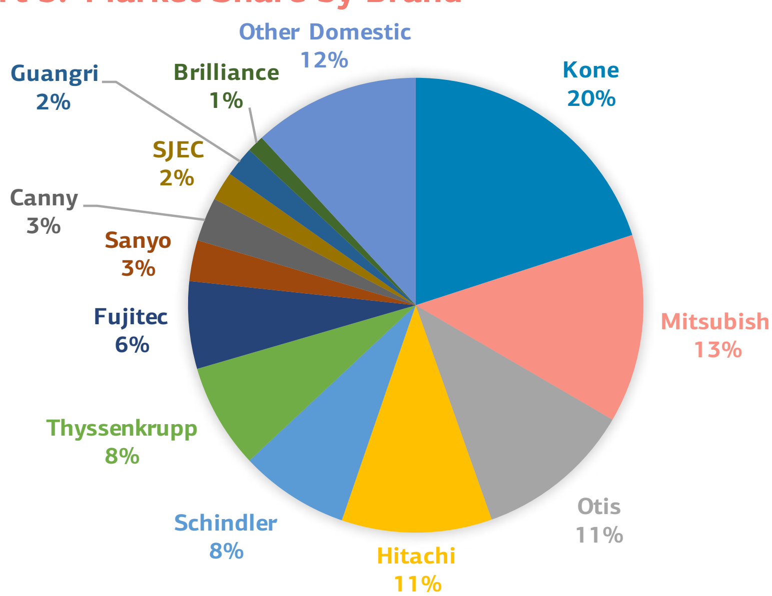
Infrastructure and policy: Social housing strong growth

Government elevator procurement data and our survey indicate that social housing demand for elevators is up 70–80% in the first four months of the year. Shandong Province plans to build 470,000 social housing apartments which is about 50% of the total number of apartments completed in 2016. In our survey four of the 10 distributors said that increased sales to social housing projects was a driver of sales growth.

Policy support for low rises will benefit domestic brands.

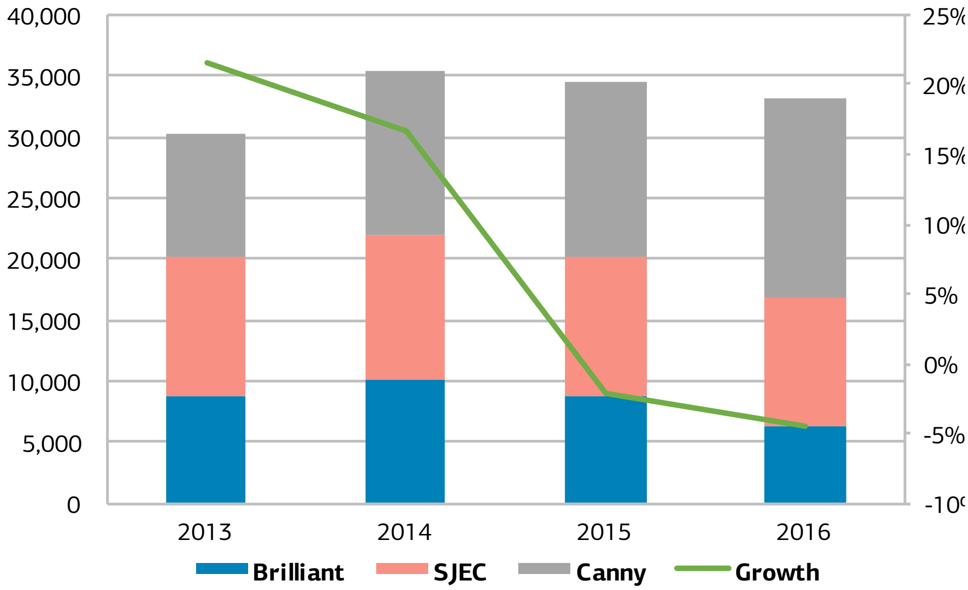
Many local governments are now subsiding the installation of elevators in low rise buildings. Previously buildings under seven stories were now allowed to install elevators. Now many local government are providing a 50% rebate to owners that install elevators. Chongqing is one of the cities promoting such a policy designed to provide better housing conditions for

Chart 3. Market Share by Brand



Source: J Capital

Chart 4. Listed Domestic Brands (Units)



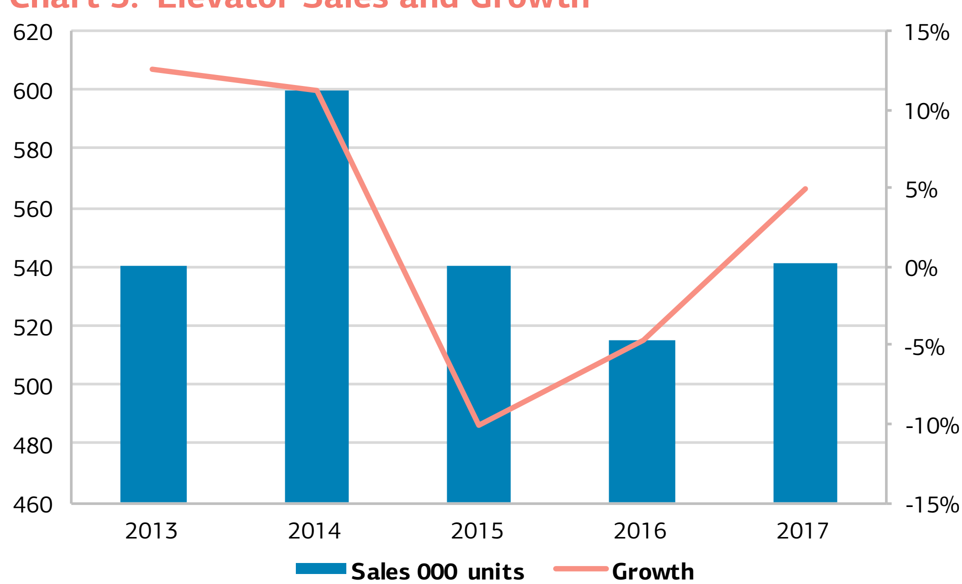
Source: J Capital

older people that struggle to walk up six stories. While this is good for the elevator market we expect local brands to benefit most from this policy. As home owners will have to pay 50% of the cost we can expect them to choose the cheapest option.

China elevator market growth

The elevator market after contracting for the past two years appears to be growing again. China bureau of statistics data for elevator and escalator

Chart 5. Elevator Sales and Growth



Source: J Capital

production for the first four months of 2017 show unit growth of 28%. The first four months of 2016 were low last year followed by higher production in subsequent months. We estimate that full year growth of the market will be around 5%. Domestic brands have slightly outperformed the market in the past two years and we expect that trend to continue as their price point and sales are more focused on the lower tier cities and low end projects where there is higher growth.

Production statistics for elevators showing production in first four months are up 28%, however, we expect that growth rate to fall to 10% over the full year, as Q1 was low last year and from May 2016 production was high.

Competitor Analysis: Shanghai Mitsubishi

Mitsubishi outperforming Kone unit sales by 10%

Kone reveals little detail on its operations in China. We believe Shanghai Mitsubishi (Shanghai Mechanical 600835 SHA), No 2 in the market, is a good comparable for estimating Kone's detailed operations in China. Mitsubishi appears to have outperformed Kone in Q1 as revenue was up less than 1%, and we estimate price was down 9%, and therefore unit sales were up 10%. We expect this was due to growing market share from Kone in direct sales to national property developers that they stressed in their annual report for 2016.

Despite falling prices and rising costs Mitsubishi has been able to only lose 70 basis points in margin over the last two years. We expect Kone has been able to achieve a similar result. Materials costs is 90-92% of costs for Mitsubishi and around half of that is steel cost. Steel prices have come off the highs of 2016 and are more stable this year. We expect with unit prices and input costs for elevators stabilizing in 2017 that margins should be stable.

Table 6. Shanghai Mitsubishi Elevator Sales and Costs

	2014	2015	2016
Sales RMB bln	17.1	17.4	17.8
COGS RMB bln	13.2	13.5	13.9
Gross Margin	23.0%	22.5%	22.3%
Sales Growth	5.5%	1.8%	2.4%
Cost Growth	5.6%	2.5%	2.6%

Shanghai Mitsubishi Elevator Sales and Costs, cntd.

	2014	2015	2016
Service Rev RMB bln	4.3	4.4	4.5
New Equipment Rev RMB bln	12.8	13.1	13.4
New Equipment Costs RMB bln	9.1	9.4	9.6
Sales Units	59,100	61,898	69,077
Sales Units Growth		4.5%	11.6%
Average Price RMB/Unit	217,291	211,116	193,670
Average Cost RMB/Unit	154,039	151,238	139,231
Unit Price Growth		-2.8%	-8.3%
Unit Cost Growth		-1.8%	-7.9%
Total Costs RMB bln	13.2	13.5	13.9
Materials Cost RMB bln	12.1	12.2	12.8
Labor Cost RMB bln	0.16	0.19	0.20
Manufacturing Cost RMB bln	0.9	1.08	1.05
Materials Cost Growth		1.0%	4.7%
Labor Cost Growth		21.3%	3.6%
Manufacturing Cost Growth		19.8%	-3.0%
Materials %	91.9%	90.6%	92.1%
Labor %	1.2%	1.4%	1.4%
Manufacturing %	6.8%	8.0%	7.5%

Source: Company Reports

China Elevator Distributor Survey

Survey Structure

- Survey of 10 elevator distribution companies.
- Located in South China (3), East China (3), West China (1), North China (2) and North East China (1).
- We have an intentional bias to the larger and comparatively stronger

market of East and South China. City tiers covered Tier 1 (2), Tier 2 (4), Tier 3 and 4 (4).

- Total surveyed companies' annual sales are 3,000 elevators or approximately 0.5% of the China market.
- Sample bias to market leader Kone
- Repeat sources: 4
- Interviews: 22–26 May, 2017

Objectives

To understand elevator orders and sales in Q2 2017, sales outlook for 2017 and changes in the market and competition environment.

Companies

Kone, United Technologies (Otis), Hitachi, Mitsubishi, ThyssenKrupp, Schindler, Fujitec, Sanyo, Yongda, Canny

Limitations

This survey does not include direct sales by OEM's which is now 30% of the market. Our sample size is small and therefore not able to statistically predict market growth.

Orders and Sales

Q2 elevator orders and sales appear to have peaked, with growth moderating in Q3.

- Q2 orders and sales appear to have peaked with a moderate decline in Q3.
- The general elevator market orders are growing around 10% and sales around 7-9%
- Kone orders and sales via distributor appears to be slightly lower than the general market by a 2-3% points. However Kone has strong direct sales of at least 55% and these sales are growing at a higher rate than the market. We therefore estimate that Kone volume order and sales are in line with the market.
- T3 city growth significantly higher than T1 and T2 cities.
- Infrastructure and social housing key sales drivers
- Property construction strong in all areas except central China where

Table 7. Percentage of All Chinese Elevator Distributors Reporting Growth

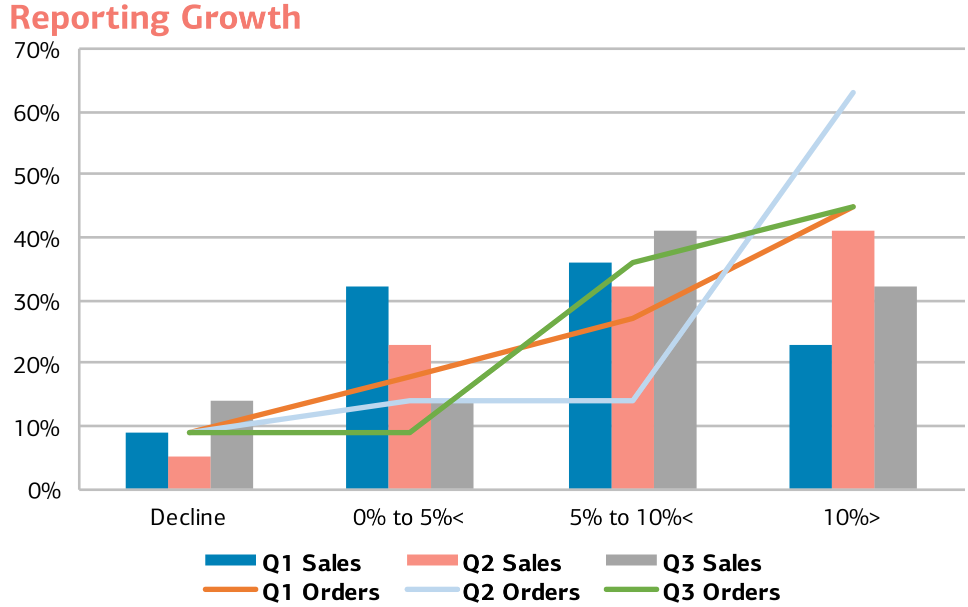
	Decline	0% to 5%<	5% to 10%<	10%>
Q1 Orders	9%	18%	27%	45%
Q1 Sales	9%	32%	36%	23%
Q2 Orders	9%	14%	14%	63%
Q2 Sales	5%	23%	32%	41%
Q3 Orders	9%	9%	36%	45%
Q3 Sales	14%	14%	41%	32%

Source: Company Reports

it is flat. Outlook is continued strength into Q3.

- Market leaders Kone and Mitsubishi appear to have stable to increasing prices, weaker brands are discounting 3-10% to achieve sales.
- Please see Appendix 1: China Elevator Orders and Sales 2017 for more details.

Chart 6. Percentage of All Chinese Elevator Distributors Reporting Growth



Source: J Capital Elevator Distributor Survey, 22–26 May 2017

Table 7. Percentage of Kone Elevator Distributors Reporting Growth

	Decline	0% to 5%<	5% to 10%<	10%>
Q1 Orders		14%	29%	57%
Q1 Sales	14%	29%	43%	14%
Q2 Orders	14%	29%	14%	43%
Q2 Sales		57%	29%	14%
Q3 Orders			43%	57%
Q3 Sales	29%	14%	29%	29%

Source: Company Reports

Manufacturer Direct Sales

- Manufactures are increasingly selling to large developers, and these developers are growing faster than the property market.
- In Tier 1 and 2 leading brands sell 30% or more direct to large developers and the sales rate of direct sales is higher than distributor sales growth.
- In Tier 3 and 4 cities, large developers are less dominant and construction growth is growing faster.
- Please see Appendix 2: Manufacturer Direct Sales Market Share and Growth for more details.

Sales Composition

- Sales mix is trending towards lower end products
- Service revenue is growing at about the same rate as new equipment sales. One Kone distributor in a Tier 2 city has been required to hand over its service business to Kone. Service remains slightly profitable.
- Pricing is starting to stabilize with half the distributors reporting prices down and half reporting prices increasing. Kone pricing has more regions reporting rising than falling.
- Please see Appendix 3: Sales Composition for more details

Market Conditions

- The survey predicts that the property construction market will continue to grow in 2H 2017. 6 respondents, mainly servicing tier 3 and 4 markets, expect growth to increase in 2H 2017, 2 expect growth to be flat. Only 1, in a Tier 1 market in South China, believes that the property market will decline in 2H 2017.
- Brands doing well: Kone, Hitachi and Mitsubishi
- Brands doing poorly: Otis, Schindler, Toshiba and domestic brands
- Orders and payments indicate a healthy market without signs of stress. Orders are being placed at a normal time and delays to delivery and payment are normal.
- Please see Appendix 4: Market Conditions for more details.

Notable Quotes from The Survey

"Shandong province has announced 903 projects for slum renovation, in total that is 469,674 apartments. In Jinan there are 100 projects and that will be for 40,775 apartments. There are total of 43,662 slum renovation apartments planned for the city. 84% have started. This includes 18,420 new social housing. and 25,242 are for paid social housing. In the surrounding counties and suburbs the new starts are 100% of planned social housing for this year. In addition there are 5 major provincial level projects in the city including a new information technology park, pharmaceutical park, auto parts for energy efficiency park and an higher education institute. Each project has an investment of over RMB 1 billion."

North China Tier 3

"Tier 4 city developers use apartments to pay for elevators. Alternatively, developers pay no down payment for the elevator. This will have the effect of wiping out smaller brands that accept these terms. This year PPP projects are good. The property sector will not be good next year. We need to watch policy. Social housing and university districts are doing well. Overheated property markets always come off the boil. There will be no problem this year. But next year there will.“

North China Tier 3

"The replacement market will be very important in the next 3-5 years. Everyone is focused on government policy on land to stimulate property construction"

East China Tier 3 and 4

"The property market resurgence is very strong. Recently the government has come out with a new policy of putting elevators into old buildings. In the past buildings under 6 stories could not have elevators, which meant a lot of old people cannot get access to elevators. Now there is a finance bureau subsidy and simple process for applying. Each building can get a subsidy of 200,000 per elevator. that is about 30% of an elevators cost. The elevator is paid for by the owners and they can draw on social benefit housing funds to pay for the elevators. This will be good for elevator sales in the future. "

East China Tier 3

"Future growth is old buildings adding elevators and renovating old elevators. The property has come back but there are limits to the growth from this sector"

East Tier 2

"Kone changed management in South China and so we no longer have much of a relationship with the company. Otis has just changed over a senior and middle management in South China"

South China Tier 2

Valuation: PT Euro 37.73; Downside 19%

We use a WACC of 8.5% and a terminal value of 2.5% to value Kone. Our model has Kone Revenue growing at 1% in 2017 and growing to 2% in 2018. Growth is due to the Americas and Europe.

Risk

- Further regulatory control of the property market in Tier 3 and lower cities in China.

Appendix 1: China Elevator Orders and Sales 2017

City/ Tier	Brand	Q1 Orders	Q1 Sales	Q2 Orders	Q2 Sales	Q3 Orders (est.)	Q3 Sales (est.)	Q2 Sales Drivers	Q3 Sales Outlook
S T2	Otis	10%	0%	30%	15%	<100%	50%	Sales to social housing projects	Letters of intent confirm continued social housing sales
S T1	Hitachi	5%	5%	10%	10%	5%	5%	Sales to social housing projects	Continued sales growth from social housing
S T1	Mitsubishi	5%	5%	10%	10%	5%	5%		
S T1	XJ Schindler	3%	3%	10%	10%	5%	5%	Policy restrictions impacting property sales	Expecting growth to slow as it is in Q2
C T2	Kone	20%	-25%	0%	0%	20%	-5%	The market was down 10-20% due to less new construction starts	Developers pushing to hand over in October so sales will improve
E T2	Kone	2%	0	3%	3%	5%	-5%	Many projects we chased from 2H 2016 closed in Q1 and Q2	Sales down, orders up
E T3	Yongda	5%	5%	6%	5%	5%	5%	Tier 2,3 sales are on fire. Increasing new starts and faster pace of construction	Continue Q2 trend
E T3	Thyssen-Krupp	10%	15%	10%	8%	5%	5%		
E T3	Thyssen-Krupp	5%	0	5%	5%	0	5%	Increasing clients and higher sales per client	Continue Q2 trend
E T3	Otis	10%	5%	10%	15%	10%	15%		
E T3	Xisi Otis	0	10%	15%	10%	10%	15%		
N T3	Giant Kone	77%	80%	50%	50%	80%	50%	Property sales are soaring, Halted construction restarting and new construction starts, One city district is being renovated	Expecting sales growth to increase with all the new construction
N T3	Otis	308%	100%	80%	50%	0	0		

City/ Tier	Brand	Q1 Orders	Q1 Sales	Q2 Orders	Q2 Sales	Q3 Orders (est.)	Q3 Sales (est.)	Q2 Sales Drivers	Q3 Sales Outlook
N T3	Canny	50%	35%	0	0	10%	10%		
N T3	Fujitec	-62%	-50%	-50%	-50%	-10%	-10%		
N T3	Kone	6%	7%	4%	2%	5%	0	Government projects increased and Tier 4 property sales have been strong post CNY	Continue Q2 trend
N T3	Giant Kone	11%	9%	15%	7%	15%	10%		
N T3	Sanyo	2%	4%	6%	5%	-20%	10%		
NE T2	Otis	10%	0%	10%	5%	10%	5%	Property sales finally went up in Q2 and prices increased	Continue Q2 trend
NE T2	Kone	5%	5%	10%	5%	10%	5%		
NE T2	Giant Kone	10%	0%	-5%	0%	5%	5%		
NE T2	Schindler	-5%	5%	10%	0%	10%	0%		

Source: J Capital Elevator Distributor Survey, 22–26 May 2017

Appendix 2: Manufacturer Direct Sales Market Share and Growth

City/Tier	Brand	Brand Direct Sales by Manufacturer	Manufacture Direct Sales vs Distributor Sales
S T2	Otis	8%	Most big developers like Vanke only purchase direct from manufacture now. Otis has very low direct sales and has given up on direct sales.
S T1	Hitachi	25–30%	Hitachi direct sales to large developers are growing faster than the market. Large developers have no risk of payment default.
S T1	Mitsubishi	30%	
S T1	XJ Schindler	5%	Direct sales to larger developers are better than distributors and growing each year. Developers prefer to buy direct from the manufacture and cut out the commissions to distributors and get better service. One major developer, Country Garden still purchases via distributors.
C T2	Kone	70%	Kone sells direct to China Resources, Vanke, Longfor. Direct sales are growing faster than distributors sales
E T2	Kone	20%	Kone is rapidly developing direct sales. This is the strategic direction of the whole market.
E T3	Yongda	10%	Direct to large developers is growing faster than the market. Yongda is focusing more on direct sales as the tier 1 elevator brands have all established direct sales departments.
E T3	ThyssenKrupp	5%	
E T3	ThyssenKrupp	30%	Direct sales are growing each year, at least increasing by 5 -8%
E T3	Otis	20%	
E T3	Xisi Otis	30%	
N T3	Giant Kone	9%	Manufactures are increasing direct sales to large property groups. They can make large sales, with low payment risk and sales cost. More stable sales than via distributors. Kone has increased direct sales from 5% to 9% this year.
N T3	Otis	10%	
N T3	Canny	50%	
N T3	Fujitec	0%	
N T3	Kone	30%	Now large developers are purchasing some of their elevators directly. Distributers cannot get much more than a service free from these developers now. Direct sales are growing faster than the market.
N T3	Giant Kone	20%	
N T3	Sanyo	5%	

City/Tier	Brand	Brand Direct Sales by Manufacturer	Manufacture Direct Sales vs Distributor Sales
NE T2	Otis	15%	Larger developer like Coli and Wanda are increasing their presence in Harbin
NE T2	Kone	20%	
NE T2	Giant Kone	5%	
NE T2	Schindler	10%	

Source: J Capital Elevator Distributor Survey, 22–26 May 2017

Appendix 3: Sales Composition

City/Tier	Brands	Product Composition (high/ low end products)	Service sales growth and profitability	Product Price Changes
S T2	Otis	No change, SOE's purchase high end and private companies purchase mid/low end	Service contracts growing by 5% matching our sales of new equipment and are profitable.	Our prices are rising, but competitors are rising less and are sometimes lowering price to win big projects
S T1	Hitachi, Mitsubishi	No big change 80% of sales are low end as customers want value for money. Only high end office buildings and hotels buy high end elevators	Service contracts are growing but we only really just cover costs.	We are maintaining price and our competitors are doing the same.
S T1	Xj Schindler	No big change. Low end elevators make up 80% of the market.	Service not increasing, just covering costs and losing money on projects that are in the outer suburbs	Costs are rising and everyone would like to raise prices, but everyone is forced to lower prices to hold market share. Prices are down 3%
C T2	Kone	Low end elevators are 80-90% of the market. Large developer have not changed. Smaller developers are not buying high end brands like Otis or ThyssenKrupp. Kone is selling moving walkways to major government projects in Chengdu	Service contracts growing faster than equipment sales as we have taken over some big residential projects	Kone is using lower price to take market share. Hitachi and ThyssenKrupp are all lowering prices. Prices are down 5 - 10%
E T3, T4	Thyssen-Krupp, Xisi Otis	The trend is towards low end elevators that are already 75% of the market	Our elevator service contracts have declined 18-20% but remains profitable. We are not willing to service elevators we did not install or are very old. They are not lowering new equipment prices to sign service contracts	Otis price is down 10%, Xisi Otis is down 10-15%, Hitachi is down 10% and Mitsubishi is down 10%.
E T2	Kone	As we have been selling to social housing it has mainly been the low end Kone product 60-70% of sales. High end products are sold to hospitals, offices and hotels.	Service is now done by Kone. We are no longer allowed to service.	Kone is up 3-5% and Hitachi and ThyssenKrupp are up about the same.
E T3	Yongda, Thyssen-Krupp	The difference between low and high end elevators is less and less. If a developer is selling well then they want the higher end elevator	The manufacturers manage service. We are losing a lot of contracts so growth is low . Management committees choose the contracts and so they choose the cheapest.	Yongda price is up 5%. Thyssenkrupp is the same and Giant Kone is dropping price to win contracts

City/Tier	Brands	Product Composition (high/ low end products)	Service sales growth and profitability	Product Price Changes
N T3	Kone, Giant Kone, Sanyo	Tier 3 and 4 cities typically have second and third tier elevator brands. Luxury apartments in Tier 3 cities will have first or second tier elevator brands. Tier 4 cities have more intense competition, and prices are low and there is a lot of payment risk. Third tier brands are most common.	Maintenance growth rate is not high. The market is very messy. The price of maintenance contracts is unattractive and falling. There was once a little profit but not any more. Manufacturers are not using low sales price to get long term service contracts.	Giant and Giant Kone prices have increased 2-3%. Sanyo price is the same. Competitor prices are stable or falling. Hitachi and Schindler prices have fallen 5%. Fujitec's new model is 3 - 5% lower than the old model.
N T3	Giant Kone, Otis, Canny, Fujitsu	Everyone is concerned with safety and so higher end products and brands are doing better now	Price competition for service contracts is so intense you can only break even. Xisi Otis is using lower new equipment prices to win longer service contracts. Service contracts growing at 15%	Kone price is up 3%, Otis 1.5%. Over 20 elevators per order Otis will give a 2% lower price. In the past it was only 1%. Giant Kone and Shanghai Fushi price is unchanged
NE T2	Otis, Kone, Giant Kone, Schindler	No big change, there is no big increase in luxury apartment projects	It is harder to win service contracts. Manufacturers are now servicing elevators directly. So our contracts are falling.	Otis price is down 3 - 5%, Kone price is up 5% others are still stable.

Source: J Capital Elevator Distributor Survey, 22–26 May 2017

Appendix 4: Market Conditions

City/ Tier	Brands	Demand Segments Growth	Expectations for Property 2H 2017	Which brands are doing well?	Which brands are not doing well?	Orders placed late?	Orders delayed for delivery?	Payments delayed?
S T2	Otis	Growth is coming from residential property	Government control measures are putting a lot of pressure on property, the economy is down and so expecting sales to decline	There is a lot of staff turnover in all the elevatory companies. Market share is stable.	Otis low staff change over not a very dynamic company	Late	Few delays	Few
S T1	Hitachi, Mitsubishi	Residential property up 10% 1H. Shopping center, office and infrastructure have lower growth.	We expect property to be okay in the 2H as the whole market is slowly improving. Expecting good elevator demand	Kone and Mitsubishi ar doing well. They are growing at 16-20%. They have more competitive pricing and so growing better	ThyssenKrupp, Schindler, and Otis are only doing okay. Price and after sales service are not good enough	Normal	None	None
S T1	Xj Schindler	Residential is 70%, office 10%, shopping centres 10% other 10% no change from last year.	Expect the rate of growth to decline in the 2H	In the most recent years domestic brands have been increasing sales, brands like Kangli, Jiashi, shenlong. Domestic brands have 5-10%. They are growing as they are price competitive with the tier one brands.	There are some domestic brands that may go bankrupt, developers are not paying them and price pressure has been intense this year. Tier 1 and 2 brands are in a price war which will cause consolidation in the sector as smaller players exit the market.	Late as cash flow is tight	Few delays	None
C T2	Kone	Residential growing but growth slowing. Shopping complex sales are falling. As shopping centres are being completed they are remaining largely empty	Looking at new starts and the state of the economy, if the government relaxes restrictions then there could be an increase in sales. If it is better than last year at least we will have something to do.	Kone and IBM have developed a online maitaince portal, focusing on inteligent systems development. Kone is the number one in sales in Sichuan province	Kone had a maintance problem in Taiwan and they have been fined in Chengdu for maintaince. It is always competitors that cause these problems. Kone lost a contract in Chengdu for this reason.	Normal to late	50% late delivery	Few

City/ Tier	Brands	Demand Segments Growth	Expectations for Property 2H 2017	Which brands are doing well?	Which brands are not doing well?	Orders placed late?	Orders delayed for delivery?	Payments delayed?
E T2	Kone	Residential is flat, office sales grew 30% 1H, shopping centres are flat, railway stations sold 6 elevators none last year, hospitals are flat	We have been developing away from supplying property developers and now sell 95% to government projects. The property market has been good but we are not willing to touch the sector as we do not have sufficient capital.	Mitsubishi and Hitachi have been growing well, with annual growth of 8-10%. They have good long term distributors and new distributors that are aggressive with sales. This is combining for good sales growth and they are increasing market share.	Otis is not doing well, they have too many restrictive policies, Otis review of distributors is intense and they have lost a lot in the process.	30% normal, 60% late and 10% very late	None	Few
E T3	Yongda, Thyssen-Krupp	Residential was the growth driver and sales mix went up 10% points. Office and shopping complexes were flat.	We expect the property market to continue to grow in the 2H	Kone is doing best growing at 15%, They are supporting disrtibutors well and have increased market share by 3%	Schindler is not doing so well, their model updates are slow	Normal	Few delays	None
E T3, T4	Thyssen-Krupp, Xisi Otis	Residential down 15%, offices down 5%, Shopping malls down 20%, Hospital and schools are up 10% and renovation of old districts up 12%.	2H will be much more difficult, the market is almost saturated	Hitachi is up 3 - 4% , the product has been in the market a long time and the price is low	Toshiba is not doing well, they have no new products and their current product range does not match the market, terms for distributors are inflexible.	Normal to late	70% delayed	Few
N T3	Giant Kone, Otis, Canny, Fujitsu	Residential up 10-15%, Offices down 30%, not familiar with shopping malls and infrastructure	The real estate market in Tier 3 and Tier 4 cities is exploding	Schindler won a PPP proect and is up 20%, their pricing is now low and government relations are strong, and they are taking market share	Local brands are not doing well	Normal	None	Banks are paying mortgage funds to developers late by 3 - 4 months, and so developer payments to us are delayed

City/ Tier	Brands	Demand Segments Growth	Expectations for Property 2H 2017	Which brands are doing well?	Which brands are not doing well?	Orders placed late?	Orders delayed for delivery?	Payments delayed?
N T3	Kone, Giant Kone, Sanyo	Sales to residential have grown at the fastest rate. Sales to infrastructure are also increasing but not by much.	In the 2H the rate of new starts should continue. The price per SQM is expected to increase by RMB600 in the 2H, in some areas it could be as much as RMB1,000. People will keep buying because they will be afraid of the price rises.	The most competitive brand at the moment is Hitachi. Hitachi is direct selling in the city. If they can accept the payment terms then they can get really good price discounts, lower than some domestic brands. This type of direct selling method is growing at 30% and they have increased their market share by 5%	Toshiba in this city is not doing well. Their price is not competitive in this market.	Late (building shafts that fit all brands)	Few delays	At the moment payments are good, but always concerned that developers will delay payments
NE T2	Otis, Kone, Giant Kone, Schindler	Residential and office up 5%, Shopping malls and infrastructure down a little.	2H will improve and we expect to sell more elevators as the Heilongjiang property market is improving	ThyssenKrupp is doing well, sales up 15%, won a large shopping complex project and increasing market share	Schindler is not doing well, their escalators are good but their elevators quality is not good	Orders are placed in June for delivery in Sept/ Oct. In the North external con-struction stops in November.	None	Many

Source: J Capital Elevator Distributor Survey, 22–26 May 2017

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