

Otis (OTIS): Going Up

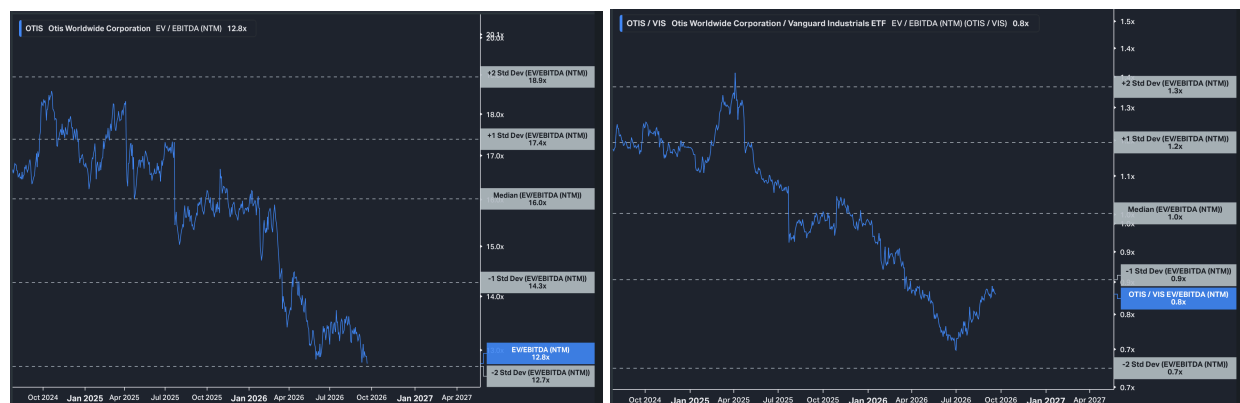
OVERVIEW

Otis is a company where the part everyone is punishing is not the part that makes the money. New Equipment, the segment that sells and installs elevators, is the piece the market watches because it is the piece taking the headlines, orders flat YoY, China in a fifth consecutive year of property crisis, two guidance cuts inside twelve months. But New Equipment is only about a third of revenue and roughly 7% of segment operating income. Service, the maintenance, repair, and modernization of the 2.4 million elevators Otis already has in the field, is the other 93%, it renews at over 90%, and it does not care what China's housing starts did this year.

The thesis does not require China to bottom, and it does not require New Equipment to reaccelerate, it only requires new instalments to remain stable. It requires the existing installed base to keep paying its maintenance bill, which it has, it requires modernization of aging US and European elevators to keep compounding, which it is, growing well above the underlying market's own 4% rate, and it requires the stock's two guidance cuts to have been about margin and mix, not about the annuity itself, which the numbers support.

The stock trades at its lowest valuation ever, down about 35% from its October 2024 all-time high of \$102.64 and sitting at \$67.23, right on its 52-week low.

As the stock returns to an EV/EBITDA multiple of about 15x, which is already 1 standard deviations below their normal EV/EBITDA valuation, I expect the stock to be trading at around \$97 dollars within the next 12 months, allowing for a 39% from today's price.



STOCK PERFORMANCE: LAST 12 MONTHS

1. **October 2025:** shares hit a 52-week high of \$94.57 after a Q3 beat, sentiment was still constructive on the elevator names generally.
2. **January 2026:** the year opened at \$87.41, already down from the October high as New Equipment softness became the dominant storyline.
3. **February 2026:** a rally to \$93.06, the year's high, before the slide resumed.

4. **April 22, 2026 (Q1 earnings):** EPS missed despite a revenue beat, though the dividend was raised 5%, first real crack in the story.
5. **June 2026:** shares at \$73.27, down sharply from the February high with no single catalyst, just a grind.
6. **July 22, 2026 (Q2 earnings):** revenue beat again, but FY26 profit guidance got cut, and the stock fell 5.6% that day on a trade management chose to make itself, spending roughly \$50M more on service quality now at the cost of near-term margin.
7. **Today:** shares sit at \$67.23, essentially at the 52-week low, still drifting lower weeks after the last piece of news.

WHAT IS THE MARKET NARRATIVE

China's property sector is in its fifth straight year of crisis. Developer financing is down 19% year over year, residential sales value is down 14%, Evergrande and Country Garden already restructured, and Vanke is now asking for bond extensions. New housing starts fell over 20% in 2025, and since starts lead elevator orders by two to three years, the market is pricing in this trend impacting OTIS numbers in 2027 and beyond. Otis's own China New Equipment orders were down in the high teens this past quarter, and total company New Equipment orders fell 5% globally because Americas and EMEA growth wasn't enough to offset it.

That story is true, and it's why the stock is where it is. The market sees a cyclical business getting crushed by a structural Chinese property collapse, bolted onto a leveraged balance sheet with no deleveraging plan, and it is pricing Otis like the whole company is New Equipment.

HOW MY THESIS IS DIFFERENT

New Equipment orders being down 5% in the quarter and flat YoY is a real number, and I'm not going to pretend China isn't the reason for it. But it is the wrong number to underwrite the company on, because New Equipment is 7% of operating profit and the money isn't in new installations. What actually matters is whether the 2.4 million units already installed keep generating service revenue, and whether the aging fleet in developed markets keeps needing modernization, and both of those are running independently of China. Of course, if new installations were collapsing this would mean future collapse for the services business, but the fact that they are flat YoY, the fact that they are increasing average revenue per service and retention while each installation lasts for 20 years, I tend to believe that this China re-rating is justified yet overdone.

Otis's growth outside China rests less on new installations and more on an aging installed base feeding its Service segment. Seven million of the world's 21 million elevators are already over 20 years old, the point where breakdowns accelerate and maintenance costs start exceeding the cost of an upgrade, and that population is projected to more than double to 15 million within a decade. Modernization orders were up 43% year over year in Q4 2025 with backlog up 30%, and modernization revenue grew 24% in Q2 2026, both independent of China. This is a Service-segment dynamic, not a New Equipment one, but since Service already carries roughly

93% of Otis's operating profit, it's the driver that actually matters for the stock regardless of how China's New Equipment orders trend

Modernization revenue grew 24% this quarter on backlog Otis already booked, and even modernization orders, the forward number, were up 9% globally, with China specifically strong on government-funded retrofit programs even while Chinese New Equipment collapses. China is not one story here, it's two, a collapsing new-build market and a growing modernization market, and the market is trading Otis as if only the first one exists.

The two guidance cuts were not about the annuity breaking, they were about New Equipment margin (down 220bps to 3.1%) and a deliberate service-quality investment management chose to make for long-term retention. That is a real near-term EPS headwind and I'm not waving it away, 2026 consensus EPS is flat for a reason. But 2027 consensus EPS growth reaccelerates to 12%, which tells you the Street thinks this is a one-year digestion, not a structural impairment.

THE SERVICE STACK

Service economics: on trailing twelve months, Service is 67% of revenue and roughly 93% of segment operating income, recurring, contracted, and it renews at over 90%. The moat underneath it is straightforward, elevators are safety-critical regulated systems, so switching to an independent servicer means giving up proprietary parts, diagnostics, and documentation Otis controls. Otis, KONE, Schindler, and TK Elevator control about 70% of the global new-equipment market between them, an oligopoly, and Otis leads it by installed base.

Digital connectivity: Otis ONE puts sensors on elevators that feed real-time fault and ride data back to Otis, so a technician gets dispatched before something breaks. Connected units show about 5% higher retention and 10% higher conversion into paid service contracts. It's bundled into tiered service contracts (Prime, Plus, Pro) rather than sold as its own subscription, and only 25-35% of the installed base is connected today, so there's real runway left.

Aging fleet: 7 million of the world's 21 million elevators are already past the 20-year mark where maintenance costs start exceeding the cost of an upgrade, and that population is projected to more than double to 15 million over the next decade. The broader modernization market itself only grows about 4% a year, Otis is taking share inside it, not just riding it.

CAPITAL ALLOCATION AND THE DEBT QUESTION

Otis carries \$8.85B of debt against \$813M of cash, 3.09x EBITDA, and negative book equity. There is no stated deleveraging plan, a \$700M note issued this year was refinancing, not paydown, and Moody's has held them at Baa2 stable for years at roughly this same leverage level, this looks like the permanent operating structure of the business, not a problem being worked off. Capital priority is reinvestment, then the dividend (just raised 5%), then buybacks (\$243M in one recent quarter), with debt reduction nowhere in that order. I would like to see OTIS focus some of its FCF to pay for debt reduction as I think this would allow the company to further re-rate but liquidity or solvency is not an immediate problem right now.

CONCLUSION

Otis is being priced like a company whose only business is losing to a Chinese property collapse, when the business that actually pays for the dividend, the buybacks, and the debt service barely touches China at all. The stock is down 35% from its highs on a segment worth roughly 7% of operating profit, while the 93% that's left, the installed base, the modernization backlog, the digital retention lever, keeps compounding underneath it. If New Equipment merely stops surprising to the downside, the multiple has nowhere to go but up, and I'm not even underwriting China getting better to get there, just China not getting worse than what's already been guided.