

Otis Worldwide Corp. (OTIS)

Updated July 28th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$61	5 Year CAGR Estimate:	-1.8%	Market Cap:	\$26.4 B
Fair Value Price:	\$36	5 Year Growth Estimate:	7.0%	Ex-Dividend Date¹:	08/20/20
% Fair Value:	169%	5 Year Valuation Multiple Estimate:	-9.9%	Dividend Payment Date¹:	09/10/20
Dividend Yield:	1.3%	5 Year Price Target	\$50	Years Of Dividend Growth:	26
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	N/A

Overview & Current Events

Otis Worldwide Corp. debuted as an independent, publicly traded company on April 3rd, 2020 after being spun off from United Technologies (previously UTX, now Raytheon Technologies, RTX). However, the company's history is extensive after being founded in 1853 and having previously gone public in 1920. Today Otis is the leading company for elevator and escalator manufacturing, installation and service. The company's products move 2 billion people per day and maintain more than 2 million customer units worldwide. The \$26 billion market cap business, headquartered in Connecticut, generated \$13.1 billion in sales in 2019 and employs 69,000 people. Otis is a constituent of the S&P 500 Dividend Aristocrat Index due to its United Technologies lineage.

On July 27th, 2020 Otis declared its second standalone quarterly dividend of \$0.20.

On July 28th, 2020 Otis reported Q2 2020 results for the period ending June 30th, 2020. For the quarter total revenue equaled \$3.03 billion, down -9.6% compared to Q2 2019. New Equipment sales were down -13.7%, while revenue at the Service segment fell -6.3%. Adjusted net income equaled \$244 million or \$0.56 per share compared to \$258 million or \$0.59 per share in the prior year quarter.

Otis also updated its 2020 outlook. The company now anticipates net sales to be down -4.5% to -6.5% and adjusted earnings-per-share of \$2.20 to \$2.30. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$4.74	\$5.49	\$5.34	\$6.21	\$6.82	\$6.29	\$6.61	\$6.60	\$7.61	\$8.26	\$2.25	\$3.16
DPS	\$1.70	\$1.87	\$2.03	\$2.20	\$2.36	\$2.56	\$2.62	\$2.72	\$2.84	\$2.94	\$0.80	\$1.12
Shares²	921	907	919	917	909	838	809	799	861	864	434	434

Note that we have elected to show United Technologies historical data in the table above, to illustrate the type of operating company from which Otis was spun off. This will be an imperfect measure as Otis made up less than 20% of United Technologies sales; however, it does offer some clues into the consistency of the new business.

Otis has a number of long-term growth drivers available in the way of increased urbanization, a growing middle class and digitalization. All of these factors will continue to spur demand for Otis' products and should bode well for the category leader. At the very least, Otis stands a very good shot at capturing its "fair share" of growth in the industry.

That being said, the COVID-19 pandemic calls into question all demand in the short-term and could very well be a hindrance for some time, although management's latest guidance is more encouraging. With services making up 57% of sales and 80% of operating profit last year, there is some resiliency to the business, as we saw in Q1 2020. We are forecasting \$2.25 in EPS – at the midpoint of current guidance - and 7% growth over the next five years. Management's prior expectation of high single-digit intermediate term EPS growth may come true, but there are a lot of variables to keep an eye on in the short-term.

¹ Estimate.

² In millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.0	14.6	14.7	16.0	16.4	17.0	15.3	17.7	16.8	16.1	27.0	16.0
Avg. Yld.	2.4%	2.3%	2.6%	2.2%	2.1%	2.4%	2.6%	2.3%	2.2%	2.2%	1.3%	2.5%

We are again using United Technologies history in the above table to give you a sense for how shares traded in the past. During the last 10 years shares of UTX traded hands with an average P/E ratio of about 16 times earnings. We believe this is a fair starting multiple for Otis as well, taking into consideration the enhanced risk to the standalone business paired against strong growth avenues and reoccurring revenue from servicing. With shares currently trading at 27 times our expectation of earnings, this could imply a significant valuation headwind. The new \$0.20 quarterly dividend implies a payout ratio of just under 40%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

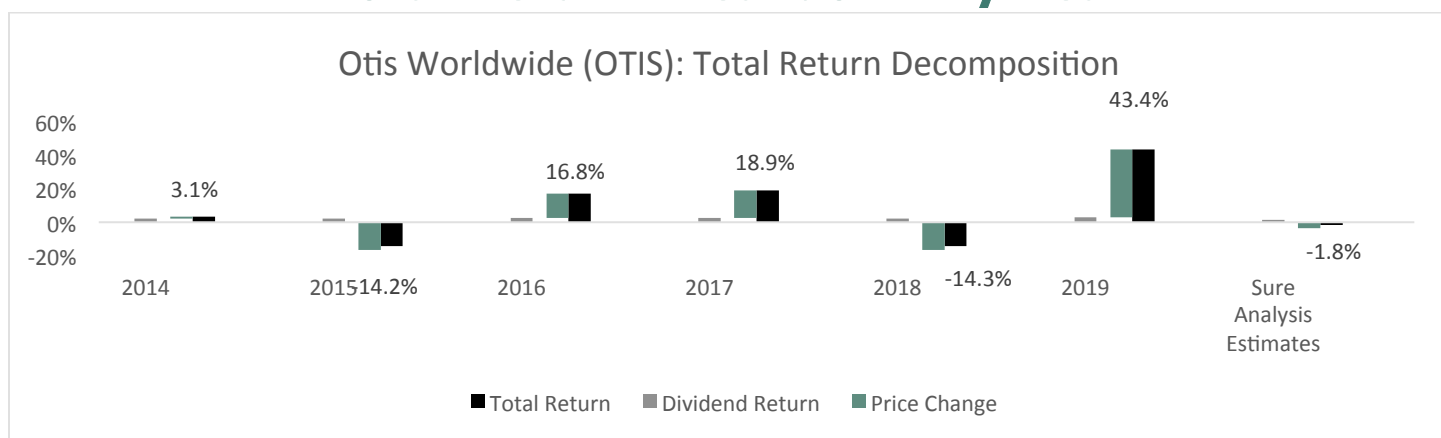
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	36%	34%	38%	35%	35%	41%	40%	41%	37%	36%	36%	36%

Otis enjoys a competitive advantage in its namesake brand, along with the #1 position in the category the company created. Moreover, with the largest installed base of elevators and escalators, reoccurring service revenue can smooth out results in less certain times. During the last recession United Technologies posted earnings-per-share of \$4.90, \$4.12, \$4.74 and \$5.49 during the 2008 through 2011 timeframe. While some of that ballast is gone with the company splitting up, we still believe Otis should perform reasonably in lesser times. Moreover, the targeted ~40% payout ratio will allow for flexibility in the future.

Final Thoughts & Recommendation

Shares are up 15% since our last update. Otis has been a very strong business for 167 years. Now that it is once again a standalone company, it offers a “pure play” on a variety of important and growing trends around the world. While the cyclicity of the firm may have increased, we are encouraged by the ongoing service revenue. However, today’s valuation leaves something to be desired in our view. Total return potential comes in at -1.8% per annum, driven by 7% growth and a 1.3% dividend yield, offset by the potential for a significant valuation headwind. This view could be too conservative if the business performs better than expected or if the valuation remains elevated, but we are not yet willing to make that speculation at this juncture. We rate shares as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	52,275	55,754	57,708	56,600	57,900	56,098	57,244	59,837	66,501	77,046
Gross Profit	14,321	15,385	15,555	16,132	17,002	15,667	15,773	15,636	16,516	19,981
Gross Margin	27.4%	27.6%	27.0%	28.5%	29.4%	27.9%	27.6%	26.1%	24.8%	25.9%
SG&A Exp.	5,798	6,161	6,452	6,364	6,172	5,886	5,958	6,429	7,066	8,521
D&A Exp.	1,300	1,263	1,524	1,735	1,820	1,863	1,962	2,140	2,433	3,783
Operating Profit	6,898	7,846	7,684	8,549	9,593	7,291	8,221	8,138	8,553	8,966
Op. Margin	13.2%	14.1%	13.3%	15.1%	16.6%	13.0%	14.4%	13.6%	12.9%	11.6%
Net Profit	4,373	4,979	5,130	5,721	6,220	7,608	5,055	4,552	5,269	5,537
Net Margin	8.4%	8.9%	8.9%	10.1%	10.7%	13.6%	8.8%	7.6%	7.9%	7.2%
Free Cash Flow	5,068	5,661	3,714	4,586	5,134	4,294	1,793	3,237	4,020	6,276
Income Tax	1,725	2,134	1,711	1,999	2,244	2,111	1,697	2,843	2,626	2,295

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets (\$B)	58,493	61,452	89,409	90,594	91,206	87,484	89,706	96,920	134,211	139,716
Cash & Equivalents	4,083	5,960	4,819	4,619	5,229	7,075	7,157	8,985	6,152	7,378
Acc. Receivable	8,925	9,546	11,099	11,458	10,448	10,653	11,481	12,595	14,271	13,524
Inventories	7,766	7,797	9,537	10,330	7,642	8,135	8,704	9,881	10,083	10,950
Goodwill & Int.	21,781	21,861	42,990	43,689	42,976	42,904	42,743	43,793	74,536	74,109
Total Liabilities	35,844	38,632	62,340	57,375	58,642	58,640	60,537	65,499	93,601	95,485
Accounts Payable	5,206	5,570	6,431	6,965	6,250	6,875	7,483	9,579	11,080	10,809
Long-Term Debt	10,289	10,260	23,221	20,241	19,701	20,425	23,901	27,485	45,537	43,648
Total Equity	21,385	21,880	25,914	31,866	31,213	27,358	27,579	29,610	38,446	41,774
D/E Ratio	0.48	0.47	0.90	0.64	0.63	0.75	0.87	0.93	1.18	1.04

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.7%	8.3%	6.8%	6.4%	6.8%	8.5%	5.7%	4.9%	4.6%	4.0%
Return on Equity	21.1%	23.0%	21.5%	19.8%	19.7%	26.0%	18.4%	15.9%	15.5%	13.8%
ROIC	13.7%	15.1%	12.3%	11.0%	11.8%	15.0%	9.9%	8.1%	7.3%	6.4%
Shares Out.	921	907	919	917	909	838	809	799	795	864
Revenue/Share	56.65	61.48	63.65	61.85	63.51	63.52	69.29	74.88	82.09	89.18
FCF/Share	5.49	6.24	4.10	5.01	5.63	4.86	2.17	4.05	4.96	7.26

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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