Lehto Group Plc Business Review,
1 January–30 September 2018

January–September net sales up by 46.1%, operating profit 4.5% of net sales

This is not an interim report as specified in the IAS 34 standard. The company complies with half-yearly reporting according to the Finnish Securities Markets Act and discloses business reviews for the first three and nine month periods of the year, in which key information regarding the company's financial situation and development will be presented.

The financial information presented in this business review is unaudited. Figures in brackets refer to the corresponding period of the previous year, unless otherwise stated.

Summary January–September 2018

GROUP	7–9/2018	7–9/2017	1–9/2018	1–9/2017	1–12/2017
Net sales, EUR million	198.0	121.5	489.9	335.4	597.6
Change in net sales, %	63.0%	32.6%	46.1%	44.5%	74.5%
Operating profit, EUR million	8.2	10.1	21.9	25.5	64.6
Operating profit, % of net sales	4.2%	8.3%	4.5%	7.6%	10.8%
Profit for the period, EUR million	6.4	8.4	17.2	20.5	51.6
Order backlog at period end, EUR million	696.3	551.2	696.3	551.2	538.1
Earnings per share, EUR	0.11	0.14	0.30	0.35	0.89
Cash and cash equivalents, EUR million	48.0	46.9	48.0	46.9	68.0
Interest-bearing liabilities, EUR million	122.2	51.8	122.2	51.8	36.9
Equity ratio, %	42.0%	51.3%	42.0%	51.3%	56.3%
Net gearing ratio, %	48.9%	4.1%	48.9%	4.1%	-20.6%

Compared to the corresponding period of the previous year, Lehto Group's net sales for January–September grew by 46.1%, to EUR 489.9 (335.4) million. Net sales grew in the Business Premises, Housing, and Social Care and Educational Premises service areas, but fell slightly in the Building Renovation service area.

Operating profit was EUR 21.9 (25.5) million, or 4.5% (7.6%) of net sales. The year-on-year decline in operating profit stems from weaker project margins in the Social Care and Educational Premises and the Building Renovation service areas. There are several loss-making projects in these two service areas, which burden the January–September result.

The Group's order backlog stood at EUR 696.3 million (EUR 538.1 million on 31 December 2017). The order backlog increased in the Housing, Business Premises, and Building Renovation service areas, but declined in the Social Care and Educational Premises service area. A construction project is included in the order backlog once the project contract has been signed or, in the case of developer contracting projects, once the decision to begin construction has been made and the contract has been signed.

NET SALES BY SERVICE AREA	1–9/2018	1–9/2017	CHANGE	1–12/2017
Business Premises	164.5	108.0	52.3%	181.2
Housing	197.1	128.9	53.0%	232.2
Social Care and Educational Premises	80.5	48.6	65.6%	109.1
Building Renovation	47.7	49.9	-4.3%	75.1
Total	489.9	335.4	46.1%	597.6

Outlook for 2018

Lehto lowered its financial outlook in a stock exchange release dated 19 October 2018 which was communicated as follows:

Lehto estimates that the Group's net sales for 2018 will grow by about 20-25% from 2017 (EUR 597.6 million in 2017) and operating profit is expected to be approximately 5-6% of net sales (2017: 10.8%).

The decrease in the estimated operating profit is due to further decreased project margins, particularly in the Social Care and Educational Premises and Building Renovation service areas, and slightly lower estimate in the Group's net sales. The declined net sales estimate is mainly due to delay of project starts in Social Care and Educational Premises service area. Business in Housing and Business Premises service areas is progressing as planned.

In Building Renovation service area Lehto operates on pipeline renovations and complete renovations. In complete renovation unit projects have not progressed as planned and regardless of the corrective actions the project margins have further declined and there are many loss-making projects in the unit. Lehto has informed by stock exchange release on 2 November 2018 that the company will reorganise its building renovation operations, plans to discontinue its Building Renovation service area and to merge the building renovation operations into other service areas.

In the Social Care and Educational Premises service area project margins have developed negatively too and there are also loss-making projects. The new management of the service area, appointed in August this year, has taken actions to develop project management. In addition, operations are more clearly focused on developing product concepts and utilizing more efficiently Lehto's own manufacturing. These actions are supposed to gradually improve project margins.

The profitability of the year 2018 also loaded by the non-recurring costs caused by the expansion of factory capacity and higher than estimated material and subcontracting costs.

The outlook is based on the information on the progress of ongoing construction projects and the company's estimate of construction projects to be started and sold in 2018. The main risks associated with the development of net sales and operating profit are related to the completion of ongoing projects within the estimated timeframe and costs and the development of the apartment sales.

CEO Hannu Lehto:

"There was strong growth in net sales during the period, but our result remained short of our target. Our margins for Housing and Business Premises service areas projects were good, but we experienced profitability issues in Social Care and Educational Premises projects and Building Renovation projects in particular. As a result, we have issued two negative profit warnings during the year.

This year's result is still at a good level for the sector, but clearly lower than before. The main reason is that we have not adhered to our important principles, i.e. design management and the deployment of standardised solutions.

Our sales efforts have been effective, customer demand large and the projects on offer have seemed financially viable. We aimed at average net sales growth of 10-20% per year, but actual growth has been much higher. However, we should have focused more on the basics while growing strongly.

We have analysed which factors have weakened our profitability and have started actions to restore profitability to the target level. In the future, we will maintain a much stronger focus on projects in our core areas and according to the stock exchange release published today we are taking actions to improve profitability in building renovation

Our strategy has not changed and we continue to focus on planning management, standardised solutions and our own factory-made modules and elements. We will continue to invest heavily in developing these areas."

Business development in the review period

BUSINESS PREMISES

During the review period, net sales in the Business Premises service area increased by 52.3% year-on-year to EUR 164.5 (108.0) million. A total of 19 projects were completed during the review period. The major projects included an office and hotel building in Tikkurila, Vantaa and a shopping centre in Kalajoki.

In May, the city council of Jyväskylä decided to launch the Hippos2020 project with a consortium consisting of Lehto Group and Fennia Asset Management Ltd, and also approved the main principles of the project agreements and plans. The project involves uncertainties typical of all property development projects, such as the availability of financing or finding tenants and the level of the tenants' commitment. The search for tenants is currently ongoing.

In June, Lehto signed a turnkey contract with Koy Seinäjoen Ideapark, a subsidiary of Sukari Invest Oy, for the construction of the Ideapark shopping centre in Seinäjoki. The value of the contract is about EUR 65 million, in addition to which Lehto will be in charge of additional and alteration work to be specified later. Construction work is ongoing and is estimated to be ready in last quarter of 2019.

HOUSING

In the Housing service area, Lehto builds new blocks of flats, balcony access houses, terraced houses and detached houses as part of area construction in Finland's growth centres, and particularly in the Helsinki metropolitan area.

During January–September, net sales in the Housing service area rose by 53.0% to EUR 197.1 (128.9) million. 27 housing projects, containing a total of 1,437 apartments, were completed in the period. 46 housing projects, containing a total of 3,031 apartments, were under construction at the end of the review period. At period end, the number of completed and unsold apartments stood at 10.

Both the completed and ongoing projects are located in Finland's growth centres, and particularly in the Helsinki metropolitan area. One of the sites currently under construction is a 60-room hotel at the Iso-Syöte skiing centre.

In May, Lehto Asunnot Oy (a subsidiary of Lehto Group Plc) and Avara Oy signed a framework agreement for a housing portfolio that involves the construction of 340 homes in five communities around Finland. Avara will acquire the properties for its Avara Asuinkiinteistörahasto I Ky fund. The projects are at Kalasatama in Helsinki and in Kirkkonummi, Hämeenlinna, Kuopio and Oulu. The transaction price is over EUR 53 million. Some of the units are already under construction. The sites will mainly be completed during 2019 and 2020.

SOCIAL CARE AND EDUCATIONAL PREMISES

In the Social Care and Educational Premises service area, Lehto designs and builds nursing homes, assisted living facilities, day care centres and schools to meet the needs of municipalities and nationwide care and day care service providers.

There was strong growth in this service area, with a 65.6% year-on-year increase in net sales to EUR 80.5 (48.6) million. 23 care and service units, two day care centres and one school were completed during the review period. There were 13 care and service units, three schools and one healthcare centre under construction at the end of the review period.

Production during the review period was even more clearly geared towards unique and complex buildings. There have been challenges in both the design and implementation of multi-storied buildings. Moving from standard solutions to individual solutions has had an unfavourable impact on project margins in this service area. Individual solutions require considerably more architectural design and special design, and the workload in these projects is greater than that in standard projects.

Lehto has put a great deal of work into improving project management in this service area, and operations are now more clearly targeted on developing Lehto's own product concepts and more efficient use of the company's own manufacturing. These measures are expected to gradually improve project profitability in this service area.

Lehto estimates that business will continue to be brisk in care and service construction over the coming years, and Lehto is further developing its modular, commercially configured product range for all customer segments in this service area. There is an immediate need for both temporary premises and permanent schools. The first day care projects to be implemented using modular elements are currently ongoing, and the modules will be delivered during the year. The first deliveries will go to Helsinki and the municipality of Botkyrka in Sweden.

BUILDING RENOVATION

In the Building Renovation service area, Lehto carries out pipeline renovation, complete renovation and complementary construction projects (in which additional floors are built on top of existing buildings) in the Helsinki metropolitan area.

Net sales in Building Renovation fell by 4.3% to EUR 47.7 (49.9) million. Net sales for the review period comprised contracting-based pipeline renovation and complete renovation projects. Unlike in the comparison period, no developer contracting renovation projects recognised as income upon delivery were completed in January–September.

Nine pipeline renovation projects and three complete renovation projects were completed during the review period. At the end of the review period, 18 contracting-based pipeline renovation projects, three complete renovation projects and three developer contracting renovation projects recognised as income upon delivery were ongoing.

One of the largest ongoing renovation projects involves the conversion of old offices on Satamakatu and Kanavakatu in Katajanokka, Helsinki into a hotel and apartments. There are also complete renovation projects in the centres of Helsinki and Kuopio, in which existing premises are being converted into apartments. At the end of the period, there were 21 completed and unsold apartments in the Building Renovation service area.

Although Lehto's pipeline renovation business progressed according to plan during the review period, complete renovation projects did not. In spite of corrective measures, the profit margins of several projects further weakened during the third quarter, and the unit has several loss-making projects. Project costs have increased a result of higher-than-expected workloads and an increase in the prices of subcontracted work and certain raw materials. The currently ongoing complete renovation projects are scheduled for completion in stages by the end of the second quarter of 2019.

According to the stock exchange release on 2 November 2018, Lehto plans to discontinue its Building Renovation service area and to merge the building renovation operations into other service areas; the pipeline renovation unit intented to be transferred to Housing service area and other complete renovation to Business Premises service area. The ongoing complete renovation projects shall be finalised with the current project organisation under the Business Premises service area. As the projects are completed the project organisation will be assigned to new projects in Business Premises service area.

The planned changes do not cause need for reduction of personnel.

SWEDISH OPERATIONS

Lehto's Swedish subsidiary has been operational for just over a year. The first business premise project has been completed in Länna, in Stockholm region. The unit is currently carrying out a day care centre project in which three modular day care centres will be built in the municipality of Botkyrka. In September, the unit received an order for one additional day care centre. The modules will be built at the Hartola factory in Finland and transported to Botkyrka for final assembly. The unit is also launching its first housing construction project in the Stockholm region.

Lehto is seeking to expand its operations in Sweden, particularly in modular schools and day care centres, and also in reasonably priced small apartments in Stockholm.

FACTORY PRODUCTION

Lehto manufactures a variety of building modules and elements at its own production facilities for its own use. During the review period, Lehto continued to expand and boost the efficiency of its factory capacity.

In March 2018, Lehto acquired the factory operations of Pyhännän Rakennustuote Oy in Hartola. Leased premises with about 20,000 m2 of floor area (owned and located in the Municipality of Hartola), production equipment for the manufacture of wood elements and modules, and 75 employees were transferred to Lehto in this transaction.

A new 9 000 m² factory was completed in Oulainen in September. Logistics, warehouse functions, and the manufacture of bathroom modules, kitchen furniture and other fixtures and fittings are now concentrated on this factory. Lehto has had another 9 000 m² factory in Oulainen since 2016, as well as several smaller production facilities. These smaller production facilities will now be closed.

In addition to the Hartola and Oulainen factories, Lehto also has factory units in Humppila, Oulu, Siikajoki and Ii.

Balance sheet and financing

CONSOLIDATED BALANCE SHEET, EUR MILLION	30 Sep 2018	30 Sep 2017	31 Dec 2017
Non-current assets	34.3	26.7	25.1
Current assets			
Inventories	230,2	155.8	132.9
Current receivables	133.9	82.3	111.2
Cash and cash equivalents	48.0	46.9	68.0
Total assets	**446.5**	**311.7**	**337.2**
Equity	151.5	119.2	150.7
Financial liabilities	122.2	51.8	36.9
Prepayment received	88.2	79.4	69.3
Other payables	87.3	61.3	80.2
Total equity and liabilities	**446.5**	**311.7**	**337.2**

Non-current assets rose to EUR 34.3 million, largely due to factory investments. The rise in current assets is largely a consequence of an increase in inventories. Majority of inventories consist of housing production in progress.

At the end of the review period, net gearing stood at 48.9% (31 Dec 2017: -20.6%) and the equity ratio was 42.0% (31 Dec 2017: 56.3%). These indicators had a particular impact on the increase in interest-bearing debt, to EUR 122.2 million (31 Dec 2017: EUR 36.9 million), during the review period. Interest-bearing debt largely stemmed from an increased need for working capital. Lehto's projects are now larger in scale and take longer to complete, and projects therefore tie up greater amounts of capital.

Cash and cash equivalents were approximately EUR 48.0 million at the end of the review period. After the end of the review period, on 1 November 2018, Lehto signed a EUR 50 million credit facility agreement with OP Corporate Bank plc and Nordea Bank plc. This binding credit facility is valid for three years.

Personnel

The average number of Group personnel during the review period was 1,424 (1–9/2017: 961). The number of personnel at period end was 1,539 (1,184 on 31 Dec 2017). About 46% of the Group's personnel are salaried employees and 54% of employees work in factories and on construction sites. The increased number of employees is mostly due to the expansion of factory operations and increased business in the Housing service area.

The company has a long-term share-based incentive plan in place. The aim of the plan is to combine the objectives of the shareholders and the key employees in order to increase the value of the company in the long term and to commit key employees to the company. The plan is directed at a maximum of 70 key employees and the rewards are paid after a restriction period of two years, partly in the company's shares and partly in cash. The cash proportion is intended to cover taxes and tax-related costs arising from the reward.

Events after the reporting period

On 1 November 2018, Lehto signed a EUR 50 million financing agreement with OP Corporate Bank plc and Nordea Bank plc. This financing agreement is a Revolving Credit Facility (RCF) that is valid for three years. The agreement employs the standard covenants for profitability and indebtedness.

On 2 November 2018 Lehto communicated that it will reorganise the building renovation operations, plans to discontinue the Building Renovation service area and to merge the building renovation operations into Housing and Business Premises service areas. Lehto also informed that Pekka Lindeman, Executive Vice President of Building Renovation service area, will not continue as a member of Group Executive Board.

Vantaa, 1 November 2018
Lehto Group Plc
Board of Directors

Further information:
Veli-Pekka Paloranta, Chief Financial Officer
+358 400 944 074
veli-pekka.paloranta@lehto.fi
www.lehto.fi