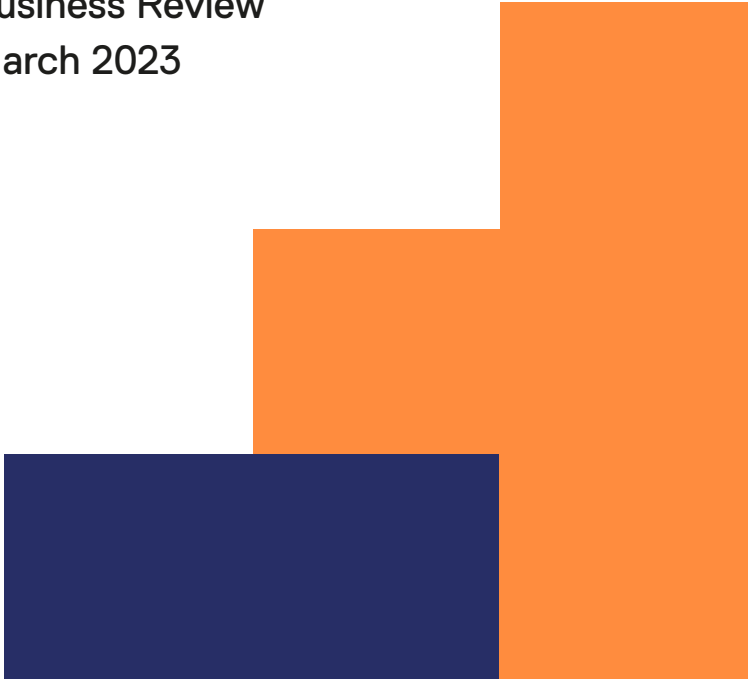




LEHTO

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Lehto Group Plc's Business Review
1 January–31 March 2023



Net sales down, but operating result improved from the previous year

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 regular 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.

Summary 1-3/2023

Group	1-3/2023	1-3/2022	1-12/2022
Net sales from continuing operations, EUR million	67.3	72.0	344.8
Change in net sales from continuing operations, %	-6.5%	-10.6%	-14.7%
Operating result from continuing operations, EUR million	-7.6	-11.3	-42.2
Operating result from continuing operations, % of net sales	-11.2%	-15.7%	-12.2%
Result from continuing operations, EUR million	-8.7	-12.3	-58.8
Result from discontinued operations, EUR million	0.0	1.5	32.1
Result for the period, EUR million	-8.7	-10.8	-26.7
Order backlog at period end, EUR million	141.2	405.8	205.9
Earnings per share, EUR	-0.10	-0.12	-0.31
Cash and cash equivalents, EUR million	7.4	9.5	13.2
Financial liabilities, EUR million	32.6	46.2	33.9
Lease liabilities, EUR million	71.7	90.0	77.8
Equity ratio, %	26.2%	25.7%	27.0%
Net gearing ratio, %	167.6%	158.3%	147.9%
Equity ratio, excl. IFRS 16 lease liabilities, %	37.9%	36.1%	38.7%
Net gearing ratio, excl. IFRS 16 lease liabilities, %	43.5%	45.9%	31.0%

Summary January-March

- ◆ In January-March, net sales from continuing operations were down 6.5% on the previous year and amounted to EUR 67.3 (72.0) million. Net sales fell in the Business Premises service area, but rose slightly in the Housing service area. Net sales decreased in Business Premises due to the cancellation of the pre-contract or project contract for six projects in 2022 following the lower number of construction projects.
- ◆ The operating result from continuing operations was EUR -7.6 (-11.3) million. The operating result was improved by the implementation of cost savings and a decrease in loss-making projects. The operating result is still burdened by some zero-margin and loss-making projects.
- ◆ No new housing projects were started up during the review period (106 housing units 1-3/2022) as the housing market was very quiet.
- ◆ At the end of the review period, 540 (1,850) housing units were under construction and the number of completed and unsold apartments stood at 91 (21).
- ◆ The operating loss was EUR 8.7 million (operating loss of EUR 10.8 million).
- ◆ At period-end, cash and cash equivalents stood at EUR 7.4 million (EUR 13.2 million on 31 December 2022) and interest-bearing liabilities excluding lease liabilities under IFRS 16 amounted to EUR 32.6 (33.9) million. The main reason behind the decrease in cash and cash equivalents was the loss-making result.
- ◆ The Group's order backlog declined to EUR 141.2 million (EUR 205.9 million on 31 December 2022).
- ◆ The order backlog for the Business Premises service area decreased by 38 per cent to EUR 31.0 million, and the order backlog for the Housing service area decreased by 29 per cent to EUR 110.2 million. The main reason for the decrease in the order backlog is that no new project agreements were made. The start-up of housing projects was slowed down by weak demand and challenges in the availability of project financing.
- ◆ After the end of the review period, Lehto signed a contract agreement valued at about EUR 26 million to build Makita's headquarters and warehouse facilities in Tuusula. The value of this order will be entered in the order backlog in the second quarter.

Net sales by service area, EUR million

	1-3/2023	1-3/2022	Change	1-12/2022
Housing	46.4	39.1	18.5%	213.3
Business Premises	21.0	32.8	-36.2%	131.5
Total	67.3	72.0	-6.5%	344.8

CEO Juuso Hietanen



In 2023, the market situation has remained as uncertain and exceptional as in 2022. In particular, the weakening of demand that started at the end of last year continued in the first quarter of 2023. The market has been difficult, especially in housing.

In our 2022 financial statement bulletin, we stated that our goal is to ensure steady cash flow and keep the number of unsold apartments low. We have succeeded in this, even though the market has posed tough challenges to Lehto and other builders. At the end of the review period, we had 91 completed housing units that remained unsold and our financial liabilities had decreased by about 30 per cent year-on-year.

The company's net sales decreased during the review period, but the operating result improved on the comparison period. Two housing projects were completed during the review period, one in Rovaniemi and the other in Tampere. No new housing projects were started up during the review period and at period-end there were 540 housing units under construction. In January, we signed an agreement to implement a care home project in Kilonkartano, Espoo, and in February we handed over the tower building project in Malminkartano, Helsinki.

Lehto has also continued to carry out various efficiency-improving measures in response to the market. Fixed costs have declined by a relatively large amount in 2022 and 2023 thanks to adjustment measures. In the first quarter of 2023, fixed personnel and other costs were around 37 per cent lower than a year earlier. In addition, we have enhanced the efficiency of factory operations. In Oulainen, we have concentrated our operations from two factories to one, and have decided to centralise the factory operations in Ii and Siikajoki at other available factory units. The vacated factory property in Oulainen has been sold and the company is currently in negotiations on the sale of the Ii factory property.

In January 2023, Lehto announced that it has started a process to seek industrial or ownership partners for the company. During the review period, the company has negotiated on different alternatives with both industrial parties and investors. On the publication date of this business review, the negotiations are still ongoing and the company will report on the progress of the process as soon as it is time.

After the end of the review period, we signed an agreement valued at EUR 26 million to build Makita's Finnish headquarters and warehouse facilities in Tuusula.

Outlook for 2023

Lehto's previously published outlook for 2023 remains unchanged.

Lehto estimates that the 2023 net sales for the Housing service area will be lower than in 2022 (EUR 213.3 million in 2022) and the net sales in the Business Premises service area will decrease significantly from 2022 (EUR 131.5 million in 2022). Operating result is estimated to improve substantially.

The reason behind the decline in net sales is the decreased amount of projects in business premises and housing. The improvement in operating profit is primarily based on a significant reduction in loss-making projects.

The most significant risks related to net sales and operating result are the development of sales of apartments and business premises and the availability of financing and guarantees for construction projects.

Business environment and business development in the review period

Development of the business environment

In its bulletin published in March, the Bank of Finland stated that Finland slipped into recession in autumn 2022 as a result of the energy crisis brought on by Russia's war in Ukraine, and that economic growth will remain very weak in 2023. It will take time for the effects of exceptionally rapid inflation and the strong rise in interest rates to be felt in the economy. However, the recession is expected to be short and mild. Turbulence in the global financial market increases economic uncertainty and may lead to weaker-than-forecast economic growth in Finland.

The Bank of Finland reported that in 2022 the Finnish economy grew by 2.1 per cent thanks to the strong first half of the year, but the war and energy crisis led to a downturn in the business cycle. According to the forecast, the economy will contract by 0.2 per cent in 2023. As interest rates are forecast to remain elevated and no quick recovery is expected in the demand for Finnish exports, economic growth will be stunted in the next few years. According to the forecast, the economy will grow by 0.9 per cent in 2024 and 1.5 per cent in 2025.

The Business Cycle Review published by the Confederation of Finnish Construction Industries RT in March reported that construction grew by slightly under 1.5 per cent last year. The industry was supported by a large workload in new building construction inherited from the previous year. Growth during the year remained weak. An exceptionally rapid rise in construction costs and high uncertainty about economic development led to the postponement of projects. Building construction start-ups and permits declined during almost the entire year. Housing construction slowed down heavily after war broke out in Ukraine. Housing start-ups decreased by almost 9,000 units last year. In the construction of non-housing projects, the volume of start-ups was down by more than 5 million m³. The volume of new production began to decline substantially after the summer. Net sales from renovation continued to see rapid growth. Due to rising costs, quantitative growth remained slight. The historically high increase in costs also slowed down civil engineering. The employment rate continued to decline.

Housing

In the Housing service area, Lehto builds new blocks of flats in growth centres and implements care homes and assisted living units around Finland. Operations focus on growing university towns, where Lehto wants to enable households with low and medium incomes to live in high-quality housing.

The Housing business primarily comprises developer-contracted housing projects, in which the company designs and builds properties on land areas that it has purchased and then sells the completed apartments to customers. These customers include private persons, private and institutional investors, and funds.

Most of Lehto's housing projects are concrete apartment buildings and are built using the kitchen/bathroom modules developed and manufactured by Lehto. These modules include the main electricity, water, heat, ventilation and sewerage solutions for the apartment and building. The modules are completely prefabricated at Lehto's own factories and transported to the construction site, where they are lowered into the building through the roof and connected to each other. This patented building method speeds up construction, improves quality and produces cost savings.

An increasing share of Lehto's housing production comprises apartment buildings that are constructed using wooden elements. Apartments in this product family are manufactured as space elements in the company's own factories in Finland – the interior surfaces of the apartment are fully finished when it leaves the factory. Space elements are self-supporting modules that are built at the factory and assembled on site. Wooden apartment buildings involve significantly more industrial prefabrication than concrete apartment buildings. Thanks to this, the on-site schedule can be significantly shorter than in concrete construction.

Lehto also designs and builds care homes and assisted living units for both care operators and municipalities. These construction projects are implemented either under ordinary construction contracts or as investment transactions, where Lehto signs a lease agreement with the service operator and sells the completed property to a party that invests in properties in the sector. In terms of building type, care homes are similar to conventional residential buildings.

In June 2022, Lehto divested its pipeline renovation business, which operated within the Housing service area. Housing's net sales figures have therefore been adjusted with respect to the comparison period.

Business development in the review period

Demand for housing construction began to weaken clearly as 2022 progressed and no change for the better has been seen yet. Consumer confidence is weak and uncertainty regarding the Finnish and global economic situation is high. Rising interest rates and inflation as well as weaker availability of financing have a negative impact on demand for housing among both consumers and investors.

The Housing service area's net sales experienced a year-on-year increase of 18.5 per cent to EUR 46.4 (39.1) million. The main factor behind growth in net sales was that two housing projects were handed over and recognised as income during the review period. The volume of housing sales to consumers grew slightly, but no project agreements were signed with large investor clients.

Sold housing units during the review period	1-3/2023	1-3/2022
Investor projects	-	51
Consumer projects	118	83
Sold housing units during the review period, total	118	134

During the review period, 118 (83) housing units in consumer projects were sold, including the sale of 80 units in a consumer project to an investor.

During the period, 656 (258) housing units were completed, but no new housing projects were started up (106 units started up in 1-3/2022). In addition to the Helsinki Metropolitan Area, the projects completed during the review period were located in Tampere, Rovaniemi and Turku. There were 540 housing units under construction at the end of the review period (1,850 on 31 March 2022).

Housing units under construction	1-3/2023	1-3/2022
Under construction at the beginning of the period	1,196	2,002
+ started up during the period	0	106
- completed during the period	-656	-258
Housing units under construction at period-end	540	1,850

At the end of the review period, 144 (375) housing units were either under construction or completed yet unsold. Of these, 91 (21) were completed, unsold apartments. New housing projects strongly focus on investor sales, but the company has the technical and operational capabilities to begin consumer projects when the market situation changes.

Unsold housing units	31 Mar 2023	31 Mar 2022
Under construction	53	354
Completed	91	21
Unsold housing units, total	144	375

The Housing service area's order backlog stood at EUR 110.2 million at the end of the review period (EUR 155.6 million on 31 December 2022). The order backlog decreased as no new housing projects were started. The housing production order backlog includes the proportion of investor projects that have been started but have not yet been recognised as net sales. A consumer project is included in the order backlog once the decision to start construction has been made and the contract for the project has been signed.

The volume of care home construction was at the same level as in the comparison period. One (1) care home was completed during the review period. At period-end, one (1) assisted living facility was under construction. Later in the financial year, Lehto is starting up a care home in Kilo, Espoo agreed on with Special Investment Fund eQ. Care home and assisted living projects are in the negotiation phase as both individual sites and as part of larger projects in city centres and suburban areas. Lehto expects demand for care homes and assisted living to rise in the longer term.

Business premises

Lehto has lengthy experience in building hall-like business premises, such as retail premises, shopping centres, and logistics, warehouse and production facilities. Lehto has also built other types of buildings, such as offices, hotels and schools – some of which have resulted in significant losses. In line with its current strategy, the Business Premises service area focuses on the construction of hall-like business premises.

Business premises are designed according to customers' needs and are built using the structural and spatial solutions that have been developed or tried and tested by Lehto. This area serves local, national and international customers, as well as cities and municipalities.

Business Premises conducts most of its operations using a 'design and implement' model in which Lehto is responsible for both the design and actual construction. Lehto also builds some business premises in the form of developer contracting, which means that Lehto acquires the plot and then designs and builds the property either wholly or partly at its own risk.

Business development in the review period

The service area's net sales experienced a year-on-year decrease of 36.2 per cent to EUR 21.0 (32.8) million. Net sales decreased due to the lower number of projects.

Three business premises projects were completed and handed over during the review period (1 in 1-3/2022). At period-end, three (15) projects were under construction, most notably a local service centre in Kivistö, Vantaa and production facility in Vantaa.

The order backlog declined to EUR 31.0 million (EUR 50.3 million on 31 December 2022). The decrease in the order backlog was due to the fact that no new project agreements were signed during the review period. On 11 April 2023, after the end of the review period, Lehto signed a contract agreement valued at about EUR 26 million to build Makita's headquarters and warehouse facilities in Tuusula. The value of this agreement will be entered in the order backlog in the second quarter.

Lehto has developed the Hippos2020 project with the City of Jyväskylä and a group of investors since 2017. On 24 April 2023, after the end of the review period, Lehto sold its rights and ownership in this project for around EUR 5 million. The condition set for the payment is that the construction of the project will be started up by another party at a later date. Lehto estimates that this agreement will not have a significant effect on the profit or the financial position of Lehto in 2023.

Lehto has implemented operational changes to improve project risk management in the Business Premises service area, and mobilised them in practice under the leadership of the service area's new EVP from the beginning of 2022. When evaluating prospective projects, the company pays particular attention to their suitability with respect to the company's resources and strategy.

Factory production

Lehto manufactures a variety of building modules and elements at its own production facilities, primarily for its own use. The company seeks to increase its sales of products outside the Group.

The major share of the factory production comprises kitchen-bathroom modules for concrete-frame apartment buildings, space elements for wooden apartment buildings and large roof elements for large business premises. In addition, Lehto manufactures external wall elements, aluminium doors, windows as well as kitchen and other fixtures at its factories.

In March, Lehto sold one of its factories in Oulainen, including its warehouse buildings, to the City of Oulainen. The sold factory measures around 10,000 m² and the total sales price was approximately EUR 4.7 million. The sale had a minor positive impact on Lehto's operating result for 2023 and a positive impact on cash flow. During the review period, Lehto also decided to close down its factory units in Siikajoki and Ii. After these measures, Lehto still has a factory measuring around 20,000 m² in Hartola and a factory of about 10,000 m² in Oulainen. Efficiency-improving measures implemented in 2022 and 2023 have reduced the fixed costs of factory production significantly.

Balance sheet and financial position

Consolidated balance sheet, EUR million	31 Mar 2023	31 Mar 2022	31 Dec 2022
Non-current assets	24.3	48.1	27.7
Current assets			
Inventories, excluding IFRS 16 assets	85.7	125.5	101.2
Inventories, IFRS 16 assets	64.9	86.5	70.9
Current receivables	47.3	74.7	50.4
Cash and cash equivalents	7.4	9.5	13.2
Non-current assets held for sale	0.0	0.0	3.8
Total assets	229.6	344.2	267.2
Equity	57.8	80.1	66.6
Financial liabilities	32.6	46.2	33.9
Lease liabilities	71.7	90.0	77.8
Liabilities based on customer contracts (advances received)	8.6	32.4	20.6
Other payables	58.9	95.4	68.4
Total equity and liabilities	229.6	344.2	267.2

The balance sheet total declined to EUR 229.6 million (EUR 267.2 million on 31 December 2022).

The key figures for financial standing and indebtedness weakened, as shareholders' equity and cash and cash equivalents decreased slightly due to the loss-making result. The equity ratio (taking lease liabilities into consideration) stood at 26.2% (27.0% on 31 December 2022) and the net gearing ratio was 167.6% (147.9% on 31 December 2022). The equity ratio without the lease liabilities under IFRS 16 stood at 36.1% (38.7%) and the net gearing ratio was 43.5% (31.0%).

Lehto has a valid Revolving Credit Facility (RCF) amounting to EUR 13 million with OP Corporate Bank plc and Nordea Bank Plc. The RCF is valid until 31 March 2024. The RCF includes securities, financial covenants related to EBITDA and minimum cash requirements, restriction on dividend payouts while the agreement is in force, and conditions related to the company's operations and the constitution and chairman of the Board of Directors. The entire credit facility was in use at the end of the review period.

In June 2022, Lehto issued convertible bonds of EUR 15 million. The convertible bonds are convertible into new and/or existing shares in Lehto. The issue aimed to improve the financing position of the company and to facilitate the company's bank financing arrangement, and the proceeds from the convertible bonds will be used for general corporate purposes.

Personnel and remuneration

The average number of Group personnel during the review period was 597 (860 in 2022). The number of personnel at period-end was 573 (664 on 31 December 2022), with temporary layoffs amounting to about 150 person years. About 57 per cent of the Group's personnel are salaried employees and 43 per cent of employees work on construction sites and in factories.

In March 2023, on the basis of an authorisation granted by the Annual General Meeting of 2 May 2022, the company carried out a directed bonus issue of 103,782 shares in order to implement the 2020 share-based incentive scheme for key personnel.

Resolutions of the Annual General Meeting

In accordance with the proposal of the Board of Directors, the Annual General Meeting (AGM) of 30 March 2023 decided that no dividend will be paid for the financial year ending on 31 December 2022.

The AGM confirmed the number of Board members to be four. Pursuant to the proposal made by the shareholders' nomination committee, Eero Sihvonen, Anne Korhikoski, Jani Nokkanen and Hannu Lehto were re-elected as members of the Board of Directors. The term of the Board members will expire at the end of the Annual General Meeting 2024.

The above-mentioned and other decisions of the Annual General Meeting were disclosed in a stock exchange release on 30 March 2023.

Events after the review period

On 11 April 2023, Lehto announced that it had signed an agreement to build the Finnish headquarters of the power tool manufacturer Makita, along with sizeable warehouse facilities. The construction project is located in Rykmentinpuisto, Tuusula. The value of the order is around EUR 26 million, excluding value-added tax. Construction is estimated to start in summer 2023 and it is expected to be completed at the end of 2024. The agreement will not have a significant effect on the profit or the financial position of Lehto in 2023.

On 24 April 2023, Lehto signed an agreement according to which Lehto sells its rights and ownership related to the Hippos project in Jyväskylä to Jyväskylän Yhteissijoitus Ky, owned by the investors, and to the special purpose vehicle Jyväskylän Hippos Ky, which was established at the time for the project. According to the agreement, Lehto hands over the plans, materials and its ownership in the special purpose vehicle to the buyers, and is released from all obligations related to the project.

Furthermore, according to the agreement, the buyers will pay Lehto a total of around EUR 5 million as consideration. The condition set for the payment is that the construction of the project will be started up by another party at a later date. The payment will be made in instalments over the course of 12 months after the construction of the Hippos project has started.

Lehto has developed the Hippos project with the City of Jyväskylä and a group of investors since 2017. According to Lehto's current assessment, the agreement will not have a significant effect on the profit or the financial position of Lehto in 2023.

27 April 2023

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