Lehto Group Plc Business Review,
1 January – 31 March 2019

January–March net sales up by 14.2%, operating loss EUR 9.3 million

ECONOMICALLY DRIVEN CONSTRUCTION

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–March 2019

GROUP	1–3/2019	1–3/2018	1–12/2018
Net sales, EUR million	117.8	103.1	721.5
Change in net sales, %	14.2%	37.2%	20.7%
Operating profit, EUR million	-9.3	2.3	37.2
Operating profit, % of net sales	-7.9%	2.3%	5.2%
Profit for the period, EUR million	-7.6	0.4	28.7
Order backlog at period end, EUR million	671.4	539.6	655.6
Earnings per share, EUR	-0.13	0.01	0.49
Cash and cash equivalents, EUR million	18.5	52.1	53.4
Interest-bearing liabilities, EUR million	240.3	51.4	115.9
Equity ratio, %	28.9%	57.9%	42.7%
Net gearing ratio, %	158.1%	-0.5%	38.5%

- Compared to the corresponding period of the previous year, Lehto Group's net sales for January–March grew by 14.2%, to EUR 117.8 (103.1) million. Net sales saw strong growth in the Housing service area but contracted considerably in the Business Premises service area. In the Social Care and Educational Premises service area, net sales remained on par with the comparison period.
- The operating loss was EUR 9.3 million (operating profit of EUR 2.3 million 1–3/2018), representing-7.9% (2.3%) of net sales. This fall on the comparison period was mainly due to continued losses from renovation projects and weaker project margins in the Social Care and Educational Premises and Business Premises service areas.
- The Group's order backlog rose to EUR 671.4 million (EUR 655.6 million on 31 December 2018). The order backlog increased in the Housing and Business Premises service areas but declined in the Social Care and Educational Premises service area.
- Lehto adopted the new IFRS16 standard on 1 January 2019. This increases balance sheet assets and interest-bearing liabilities, and weakens balance sheet key indicators, such as the net gearing ratio and equity ratio. The adoption of this standard does not have any significant effects on the income statement, nor does it have any unfavourable impact on covenants for financing arrangements.

NET SALES BY SERVICE AREA, EUR MILLION	1–3/2019	1–3/2018	CHANGE	1–12/2018
Business Premises	39.6	53.5	-26.0%	267.3
Housing	63.1	34.6	82.3%	336.3
Social Care and Educational Premises	15.1	15.0	0.3%	117.8
Total	**117.8**	**103.1**	**14.2%**	**721.5**

Net sales for the comparison year have been restated according to current division of service areas.

Outlook for 2019

Lehto declined its financial outlook for the year 2019 in the stock exchange release of 9 May 2019.

Updated outlook:

Lehto estimates that the Group's net sales for 2019 will be at level of 2018 (EUR 721.5 million in 2018) and that operating profit will be 2–6% of net sales (5.2% in 2018).

The decrease in the estimated operating profit is due to further decreased project margins in complete renovation, costs related to starting business in Sweden and the loss of the first day care center project in Sweden, and the weakening of the margins of care home and business premises projects and delays in launching new projects.

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 2019, and the development of the apartment sales markets.

The main risks associated with the development of net sales and operating profit are related to decrease in apartment sales, delays in care home and school projects as well as delays in negotiations of business premises projects.

The previous outlook, published on 12th February 2019 in financial statement bulletin, was as follows:

Lehto estimates that the Group's net sales for 2019 will be at level of 2018 (EUR 721.5 million in 2018) and that operating profit will be approximately 5–7% of net sales (5.2% in 2018).

CEO Hannu Lehto:

"Our loss for the first quarter of the year was larger than expected. In our industry, it is typical for earnings to be strongly weighted towards the end of the year, but the first-quarter result fell short of our estimates. One main reason for this were the problems that occurred in renovation projects last year, and these projects are continuing to generate losses. Profitability and starting of projects have not developed as expected in social care and educational projects either.

In January, we announced to discontinue Building Renovation service area and limiting clearly renovation projects. Our remaining projects will continue to generate losses during the current financial year, and their scheduled completion dates have also been slightly delayed. We expect work on existing construction sites to be concluded on the third quarter.

Our earnings trend has also been affected by slowdown of decision-making processes in the construction market. It is taking longer to launch new business premises projects, which is in turn delaying net sales and operating profit. Care service operators have also been postponing the startup of new care home projects, most probably due to the operational challenges that have recently appeared in public.

The housing trade remains good, but we have somewhat slowed the startup of new developer-contracted housing projects due to uncertainty in the market. It seems that we are faring well also in the face of tougher competition.

Lehto's own factory production is the cornerstone of our strategy, and we still hold it to be one of the most important development trends in future construction. When it comes to profitability, it is both essential and same time challenging for us to find the correct balance in our factory production to handle both brisk growth and rapid changes in the market.

We have analysed our commercial business development and found that we have factory overcapacity for our current needs.

We will take steps to adjust factory capacity in Hartola and Oulainen to meet the balance in capacity with short-term demand. In addition, we make other efficiency improvement efforts throughout the Group to improve project profitability and reduce fixed costs."

Business development in the review period

BUSINESS PREMISES

During the review period, net sales in the Business Premises service area fell by 26.0% on the comparison period to EUR 39.6 (53.5) million. A total of nine projects were completed during the review period, the largest being Retail Park in Laajalahti, Espoo and Halpa-Halli in Äänekoski.

Lehto has been developing the Hippos2020 project in collaboration with the City of Jyväskylä, Fennia Asset Management Ltd and other investors. On 29 March 2019, Fennia Asset Management Ltd announced that it will no longer continue developing the project. However, Lehto and the City of Jyväskylä will continue and are seeking a new main financier. The project involves the standard risks associated with property development, such as acquiring tenants.

In early 2019, Lehto wound up its Building Renovation service area and transferred any ongoing renovation projects to Business Premises for completion. Finishing these projects will require more work than previously estimated and their completion will therefore be delayed, which will generate losses in 2019. There were three large-scale renovation projects ongoing at the end of the review period.

HOUSING

During January–March, net sales in the Housing service area rose by 82.3% on the comparison period to EUR 63.1 (34.6) million. Six housing projects, containing a total of 209 apartments, were completed during the period. 49 housing projects, containing a total of 3,603 apartments, were under construction at the end of the review period (40 projects containing 2,337 apartments on 31 March 2018). At period end, the number of completed and unsold apartments stood at 61 (27).

Most of the completed and ongoing housing projects are developer contracting projects located in the Helsinki Metropolitan Area and other Finnish growth centres: the Tampere, Turku, Jyväskylä and Oulu regions. The largest housing construction projects currently in progress are in Kaivoksela in Vantaa and in the centre of Oulu. One of the sites currently under construction is a 60-room hotel at the Iso-Syöte skiing centre.

The Housing service area will take over the pipeline renovations previously carried out by the now-discontinued Renovation Business service area. Demand for pipeline renovations remained good, and two pipeline renovations were completed during the review period and 10 was under construction.

At the turn of the year, Lehto launched its Lehto Total service package, which combines complementary construction and pipeline renovations for housing cooperatives. In short, a housing cooperative can sell building rights to finance a pipeline renovation. Interest has been shown in this new service and Lehto is currently examining dozens of sites. However, these projects will take some time (about two years) to be implemented.

Lehto launched its Deco wooden block of flats concept in March, and the current batch will be four storeys high. After the end of the review period, on 30 April 2019, Lehto Group Plc's subsidiary Lehto Asunnot Oy ("Lehto") and the German company DWS Real Estate GmbH ("DWS"), which is part of the Deutsche Bank Group, signed an agreement according to which Lehto will build and sell a portfolio of 542 apartments for DWS. The portfolio will contain six separate projects located in Espoo, Turku, Kirkkonummi, Riihimäki and Jyväskylä. Some of the projects are already under construction and are scheduled for completion during 2019–2020.

In accordance with the contract, Lehto will sell the apartments leased, and the portfolio's final sale price will be determined by the actual occupancy rate and rental prices. The projects will be handed over to clients individually on completion, at which point each project will also be paid for. Lehto will handle all financing and bank loans for the projects during the construction phase. This housing portfolio deal will significantly reduce the number of unsold apartments under construction.

SOCIAL CARE AND EDUCATIONAL PREMISES

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

Net sales in this service area remained on par with last year's, that is, EUR 15.1 (15.0) million. Three care and service units and one school were completed during the review period. There were 11 care and service units, three schools, one daycare centre and one healthcare centre under construction at the end of the review period.

As in the previous year, production during the review period was geared towards unique and complex buildings. Lehto has faced challenges in both the design and implementation of multi-storied buildings, and moving from established 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 is working to enhance project management in this service area. Operations are now more clearly targeted on developing Lehto's own product concepts, and on more efficient use of the company's own manufacturing. These measures are expected to gradually improve project profitability in this service area.

There was a decline in care home construction during the review period. Care home projects are being postponed, most probably due to care operators making provisions for the operational challenges they are currently facing. In spite of the current lull in the care home market, 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.

SWEDISH OPERATIONS

Lehto's Swedish subsidiary has been operational for just over a year. The unit is currently carrying out a daycare centre project in which three modular day care centres will be built in the municipality of Botkyrka. In September 2018, the unit received an order for one additional daycare centre. The modules will be built at the Hartola factory in Finland and be transported to Botkyrka for final assembly. There have been problems in coordinating factory production and on-the-site work, which has had a negative impact on the project margin.

Lehto has shifted the focus of its operations and is now seeking to expand, particularly into the construction of wooden blocks of flats that utilise prefabricated modules. This move seeks to address the need for affordable small apartments.

In early March, Thomas Perslund took up his position as the unit's new Managing Director.

FACTORY PRODUCTION

The use of prefabricated products lies at the core of Lehto's business. Lehto manufactures a variety of building modules and elements at its own production facilities for its own use. Lehto has production facilities in Oulainen, Hartola, Humppila, Siikajoki and Ii, totalling about 50,000 m^2.

During the review period, Lehto's factory capacity was found to be unnecessarily high in relation to its short-term need for factory products. The need for factory products has declined due to delays in the startup of care home projects and in developer contracting housing projects, and a year-on-year reduction in the number of business premises projects requiring large roof elements.

After the end of the review period, Lehto took steps to adjust its factory capacity to meet short-term requirements.

Balance sheet and financing

CONSOLIDATED BALANCE SHEET, EUR MILLION	31 Mar 2019	31 Mar 2018	31 Dec 2018
Non-current assets	48.5	27.0	37.7
Current assets			
Inventories	385.3	172.0	238.2
Current receivables	144.1	110.6	139.0
Cash and cash equivalents	18.5	52.1	53.4
Total assets	**596.3**	**361.6**	**468.3**
Equity	140.3	154.0	162.4
Financial liabilities	240.3	51.4	115.9
Advances received	110.9	95.6	88.3
Other payables	104.8	60.6	101.8
Total equity and liabilities	**596.3**	**361.6**	**468.3**

Lehto adopted the new IFRS 16 Leases standard as of 1 January 2019. Adoption of this standard does not have a significant impact on Lehto's net sales or operating result, but affects several balance sheet key indicators, such as net gearing ratio (which will increase) and equity ratio (which will decrease). The changes to key indicators caused by adoption of the standard do not have an unfavourable impact on Lehto's covenants.

The most significant effects of applying IFRS 16 in the 31 March 2019 balance sheet are: an increase of EUR 99 million in financial liabilities, an increase of EUR 8 million in non-current assets, and an increase of EUR 91 million in inventories. Long-term plot leases for construction projects are presented under inventories. The equity ratio (taking finance leasing liabilities into consideration) stood at 28.9% and the net gearing ratio was 158.1%. The adjusted equity ratio (without the finance leasing liabilities under IFRS 16) stood at 36.3% and the net gearing ratio was 87.4%. Lehto is adopting a simplified approach during the transitional period, and will not therefore be adjusting its comparison figures.

The other main changes in Lehto's balance sheet during the review period (that is, not related to IFRS 16) were an increase in inventories and an increase in financial liabilities to finance growth in inventories. This growth in inventories was a result of an increase in the volume of housing projects under construction.

At the end of the review period, Lehto's cash reserves totalled EUR 18.5 million, and the company also had an undrawn credit facility of EUR 61.1 million at its disposal. In 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 29 March 2019, Swedbank AB added EUR 25 million to this Revolving Credit Facility.

Personnel

The average number of Group personnel during the review period was 1,557 (1,457 in 2018). The number of personnel at period end was 1,534 (1,552 on 31 Dec 2018). About 50 per cent of the Group's personnel are salaried employees and 50 per cent of employees work in factories and on construction sites.

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.

On March 19, 2019 Lehto issued a directed share issue free of consideration related to the reward payment for the performance period 2016 of the long-term incentive plan adopted by Lehto in 2016. In the share issue, 58,691 new shares of Lehto Group Plc were issued free of charge to 25 Lehto Group's key employees in accordance with the terms and conditions of the incentive scheme. As a result of the share issue, the total number of the Company's shares and voting rights is 58,309,443.

Resolutions of the Annual General Meeting

In accordance with the proposal of the Board of Directors, the Annual General Meeting of 29 March 2019 decided that the dividend payable for the financial year ending on 31 December 2018 would be EUR 0.24 per share, or a total of EUR 13,994,266.32. The dividend was paid to shareholders who on the record date for the dividend payment, 2 April 2019, were recorded in the shareholders' register held by Euroclear Finland Oy. The dividend payment date was 9 April 2019.

The AGM confirmed the number of Board members to be five. Pursuant to the proposal made by the shareholders' nomination committee, Martti Karppinen, Mikko Räsänen and Pertti Korhonen were re-elected as members of the Board of Directors, and Anne Korkiakoski and Seppo Laine were elected as new members. Päivi Timonen and Sakari Ahdekivi left the Board. The Board members' term of office will expire at the next Annual General Meeting.

At its organisation meeting, the Board of Directors decided to elect Martti Karppinen as its Chairman and also decided to establish an Audit Committee. Seppo Laine was elected as the Chairman and Mikko Räsänen and Pertti Korhonen as the members of this committee.

The above-mentioned and other decisions of the Annual General Meeting were disclosed in the stock exchange release of 29 March 2019.

Events after the review period

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Vantaa 8 May 2019

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