LEHTO GROUP PLC

Report by the Board of Directors

Summary 2019

Group	1-12/2019	1-12/2018
Net sales, EUR million	667.7	721.5
Change in net sales, %	-7.5%	20.7%
Operating profit, EUR million	-41.8	37.2
Operating profit, % of net sales	-6.3%	5.2%
Profit for the period, EUR million	-35.7	28.7
Order backlog at period end, EUR million	481.8	655.6
Earnings per share, EUR	-0.61	0.49
Cash and other liquid assets, EUR million	59.2	53.4
Interest-bearing liabilities, EUR million	189.2	115.9
Lease liabilities in interest-bearing liabilities, EUR million	46.8	
Equity ratio, %	29.6%	42.7%
Net gearing ratio, %	115.9%	38.5%
Equity ratio excluding lease liabilities, %	33.8%	
Net gearing ratio excluding lease liabilities, %	74.1%	

In 2019, net sales were down 7.5% on the previous year and amounted to EUR 667.7 (721.5) million. Net sales grew in the Housing service area and declined in the Business Premises and Social Care and Educational Premises service areas. Growth in the net sales of Housing was driven by continued good sales. During the year, 1,837 apartments were sold (1,929 in 2018).

The operating loss was EUR 41.8 million (operating profit of EUR 37.2 million), or -6.3% (+5.2%) of net sales. The operating result was affected by losses in three areas: about EUR 31 million from complete renovation operations, around EUR 12 million from operations in Sweden and approximately EUR 11 million from the Social Care and Educational Premises service area. The operating results of the Housing and Business Premises service areas were positive.

Due to loss-making businesses, the company's financial standing weakened. Net gearing ratio without lease liabilities in accordance with IFRS 16 grew to 74.1% (38.5%) and equity ratio without lease liabilities in accordance with IFRS 16 declined to 33.8% (42.7%). Indebtedness was at its highest at the end of the third quarter, but declined in the fourth quarter, thanks to the ending of several loss-making projects and cash freed up from net working capital. Cash and cash equivalents grew to EUR 59.2 (53.4) million during the financial year.

The order backlog decreased to EUR 481.8 (655.6) million due to the decrease in the number of ongoing housing and social care and education premises projects. The order backlog for the Business Premises service area grew.

NET SALES AND OPERATING PROFIT BY QUARTER, EUR MILLION

	Q1 2019	Q2 2019	Q3 2019	Q4 2019	2019
Net sales	117.8	128.5	151.5	269.9	**667.7**
Operating result	-9.3	-18.3	-14.4	0.1	**-41.8**

NET SALES BY SERVICE AREA, EUR MILLION

	1-12/2019	1-12/2018	Change
Business Premises	170.8	267.3	-36.1%
Housing	409.2	336.3	21.7%
Social Care and Educational Premises	87.7	117.8	-25.6%
Total	**667.7**	**721.5**	**-7.5%**

Restructuring measures

Lehto implemented many business restructuring measures in 2019, focusing especially on the project preparation phase and project management. In addition, Lehto's Board of Directors has decided on new structural and operational restructuring measures that seek to bolster Lehto's competitiveness and profitability, especially in the one-to-three-year timeframe.

Lehto is focusing even more strongly on areas based on its strategic competitive edges: standardisation and factory production. As part of this focus and due to changes on the market, Lehto plans to downscale the offerings of the Social Care and Educational Premises service area and merge its functions into other service areas, such that its care home and assisted-living facility functions will be transferred to the Housing service area and its school and daycare centre construction functions to the Business Premises service area. When selecting which projects to implement, particular attention will be paid to ensuring that they are a good fit with Lehto's strategy. The combination of business functions will also yield synergy benefits, especially in design, calculation, procurement and production.

The operational changes seek to improve project margins and eliminate negative deviations in them.

Lehto has launched a Group-wide development programme that focuses especially on improving the quality of project preparation prior to the construction phase. These actions are expected to improve profitability gradually as from the second half of 2020 onwards.

Lehto will start employee cooperation negotiations aiming to merge the functions of the Social Care and Educational Premises service area into other service areas and streamline operations in the Housing service area. Negotiations concern approximately 400 employees and based on Company's estimation may have impact of maximum 110 man-years.

Business environment and business development in 2019

GENERAL MARKET ENVIRONMENT

Construction remained brisk in Finland during the first half of 2019 but began to decline in the second half. In their business cycle reports published in October 2019, the Confederation of Finnish Construction Industries RT and the construction trends group of the Ministry of Finance estimated that total construction output would decline by 1–2% in 2019 and further by 1.5–3.5% in 2020.

In spite of the decline in construction, growth in the number of new building permits granted was seen in the second half of the year. According to Statistics Finland, building permits for 9.5 million m3 were granted in September-November 2019, up 5.9% on the previous year. The greatest increase in volume was seen in the case of public service buildings, with 47.8% year-on-year growth in building permits. Building permits in terms of cubic metres also grew significantly in the case of business premises and office buildings, up 39.4%. Building permits for housing construction were down 8.5% on the previous year in terms of cubic metres, which is primarily due to the decline in the volume of terraced and detached houses. The volume of building permits for apartment buildings was at the previous year's level.

It is estimated that the construction of about 38,000 housing units was started up in 2019, about 7,600 fewer than in the previous year. The number of housing startups is expected to decline further to 32,000 in 2020. Public-sector construction of business premises rose to a record high, but there was a significant decline in the construction of business premises and offices. (Confederation of Finnish Construction Industries RT 10/2019)

BUSINESS PREMISES

In the Business Premises service area, Lehto builds office premises, retail premises, logistics, warehouse and production facilities, leisure facilities and large shopping and activity centres. Business premises are designed according to the customers' needs and are built using the structural and design solutions developed or tried and tested by Lehto as well as Lehto's own industrially prefabricated elements. The service area serves local, national and international customers.

Most of the business in the Business Premises service area comprises turnkey projects, where Lehto assumes overall responsibility for both design and construction. Lehto also builds some business premises in the form of developer contracting, which means that Lehto acquires the plot and designs and builds the property either wholly or partly at its own risk.

Demand for business premises was slight at the beginning of the review period but picked up some in the latter half. There were delays independent of Lehdo in the launch of several projects. Demand for large logistics and commercial buildings declined, but there was greater demand for office and hotel projects. The service area's order backlog rose to EUR 185.2 million (EUR 167.6 million on 31 December 2018).

Net sales in the Business Premises service area declined by 36.1% from the comparison period to EUR 170.8 (267.3) million. The decline in net sales is due to a decrease in the number of projects and the smaller average size of projects. Significant delays in several startup of larger projects also contributed to the decline in net sales.

Business premises: Seinäjoki Ideapark

A total of 24 projects were completed in the review period (31 in 2018), the largest of which was the Ideapark shopping centre in Seinäjoki, measuring about 70,000 m^2. At the end of the review period, 20 (19) projects were under construction, most notably three hotel projects in the Greater Helsinki area, a logistics centre in Kerava and a Prisma hypermarket in Varkaus.

Lehto has been developing the Hippos2020 project in collaboration with the City of Jyväskylä, Fennia Asset Management Ltd and other investors. In 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. A project company has been set up for the project. It is responsible for the costs of the development work. A building permit has already been granted for the project, but its implementation involves the standard risks associated with property development, such as acquiring tenants.

During the review year, Lehto started up several construction contracts for business premises measuring under 3,000 m². In addition, Lehto agreed on the construction of several larger projects, notably:

- In June, Lehto and Fennovoima signed a contract for the design and construction of an administrative building and plant office for the Hanhikivi 1 nuclear power plant. The contract is valued at about EUR 30 million.
- In August, Lehto and Meconet Oy agreed on the construction of a new factory in Hirvaskangas, Äänekoski. The project is over 8,000 m^2 in size. Construction began in autumn 2019 and the production facilities will be completed in spring 2020.
- In November, Lehto began building the ART Hotel in Jätkänsaari, Helsinki. The hotel is operated by Primehotels Oy. The investor is Fennia Asset Management's Terrieri Kiinteistöt fund. Building size is about 6,600 m² and the project employs modern industrial prefabrication, which both speeds up construction and enhances quality. The project will be completed in spring 2021.
- In December, Lehto and Yandex, an IT corporation that runs Russia's largest web search engine, agreed on the construction of a datacenter in Mäntsälä. This project will measure about 10,000 m^2 and construction began in December. It is expected to be completed in autumn 2020.
- In December, Lehto started to build a Prisma hypermarket in Varkaus with Osuuskauppa PeeÄssä. The project consists of a retail property measuring 12,500 m² that contains a Prisma hypermarket measuring about 7,500 m² and five small retail premises with associated premises. There will be a summer gardening store and 584 parking spaces outside.

Complete renovation operations

In early 2019, Lehto wound up its Building Renovation service area and transferred its complete renovation operations to the Business Premises service area. At the same time, the company decided that, in the future, new complete renovation projects will only be undertaken selectively on condition that the renovation is related to new construction projects or when it is a significant part of a larger commercial entity. Lehto had committed to a number of such projects even before the discontinuation of the Building Renovation service area.

During the financial year, four significantly loss-making complete renovation projects were completed and substantial warranty repairs were carried out for earlier complete renovation projects. All in all, complete renovation operations caused losses of about EUR 32 million in the financial year.

At the end of the review period, Lehto started up a new complete renovation contract in Helsinki, for which lehto had committed already before the decision to discontinue complete renovation business was made. In this project, an old office property will be renovated and converted into a hotel. The project is valued at about EUR 27 million. In the first half of 2020, Lehto will also start up another complete renovation contract in Helsinki based on an earlier commitment. The project is valued at about EUR 14 million and involves the renovation and conversion of an old educational premises for use as housing. The company has focused on high accuracy in the design, resourcing and preparations for the implementation of these new projects and projects are followed up with specific measures.

SOCIAL CARE AND EDUCATIONAL PREMISES

In the Social Care and Educational Premises service area, Lehto designs and builds care homes, assisted-living facilities, daycare centres and schools to meet the needs of municipalities and nationwide care and daycare service providers. The 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 fund that invests in properties in the sector. The majority of the properties built by the service area are 1-2-storey wooden buildings, but it is also building an increasing number of diverse and multi-storey concrete buildings.

Net sales of Social Care and Educational Premises declined by 25.6% from the previous year to EUR 87.7 (117.8) million in 2019. Care homes and assisted-living facilities accounted for EUR 56.7 (97.2) million of net sales, while schools and daycare centres accounted for EUR 31.0 (20.6) million.

Social Care and Educational Premises: Attendo Äänekoski

Demand for care homes slackened significantly and 10 new care home projects were started up (11 in 2018). During the review period, 14 (28) care home and assisted-living facility units were completed, and 4 (8) were under construction at the end of the period. In addition, one healthcare centre was completed during the period. The average profitability of care home projects weakened significantly year-on-year due to two clearly loss-making projects.

The volume of school and daycare centre construction grew. Three schools were completed during the financial year: Päivölänlaakso (Kerava), Kärkölä and Suutarila (Helsinki). The construction of six new schools and three new daycare centres was started up in the review period. The margins of school projects have varied greatly and on average have been substantially lower than the margins of Lehto's ordinary contract projects.

Lehto plans to downscale the functions of the Social Care and Educational Premises service area and merge them into the Group's other service areas, such that its care home and assisted-living facility functions will be transferred to the Housing service area and its school and daycare centre construction functions to the Business Premises service area. When selecting which projects to implement, particular attention will be paid to ensuring that they are a good fit with Lehto's strategy. The planned combination of business functions would yield synergy benefits, especially in design, calculation, procurement and production.

The order backlog of the Social Care and Educational Premises service area at the end of the review period was EUR 29.2 million (EUR 60.0 million on 31 December 2018). The decline in the order backlog is due to the decrease in the number of care sector properties under construction.

HOUSING

In the Housing service area, Lehto builds new housing in apartment buildings, focusing mainly on Finland's growth centres. The majority of Lehto's housing projects are developer contracting projects, in which Lehto designs and builds properties on land areas that it has purchased and then sells the completed apartments to customers. Customers include private persons as well as private and institutional investors.

Housing production is divided into two product families: Nero and Deco. In addition, as from the beginning of 2019, the Housing service area has included the pipeline renovations business, which was earlier part of the Building Renovation service area that was discontinued at the beginning of the year.

Most – more than 70% – of Lehto's housing properties are concrete Nero apartment buildings. In the Nero concept, the building frame is largely cast in situ concrete. Thanks to this, the building has good sound insulation properties and enables the use of interesting architectural solutions. Nero properties employ the kitchen/bathroom modules developed and manufactured by Lehto. These modules include the main electricity, water, ventilation and sewerage solutions for the apartment and building as well as a complete kitchen. The modules are completely prefabricated at Lehto's own factories and transported, well-protected, to the construction site. At the site, the modules are installed in a vertical shaft and connected using a method patented by Lehto. This building method ensures rapid completion of construction, improves quality and produces cost savings.

Today, a growing share of Lehto's housing production comprises wooden housing projects. Apartments in the Deco product family are manufactured as space elements in the factory – the interior surfaces of the apartment are fully finished when it leaves the factory. The use of space elements shortens the duration of on-site construction work. Also, the technique ensures that wooden interior structures do not become wet during the construction phase. Deco apartments involve a substantially higher amount of industrial prefabrication than Nero apartments.

The Optimi product family, which will be phased out, consists of detached houses built in area construction projects. Their implementation emphasises architecture and functional space solutions. Optimi production has not been able to effectively harness Lehto's strategic competitive factors: strong planning control, standardisation and factory production. For this reason, Lehto has decided to gradually phase out the Optimi product family and focus instead on the growing market for wooden apartment buildings.

Demand for housing remained at a good level during the review period, although the sales periods lengthened. More new housing was on offer in the market than before, which led to slightly tighter competition and price pressure in areas with a high level of supply.

Net sales in the Housing service area grew by 21.7% from the previous year to EUR 409.2 (336.3) million in the review period. Net sales growth was generated by the increase in housing production and sales in all major market areas. Housing sales periods were longer than last year and the greater supply of housing in the market has reduced housing prices somewhat, especially in the last quarter. Raw material and subcontracting costs have risen slightly since last year, due to which the average margin on housing projects saw a year-on-year decline. Some project development failures also weighed on the result. As from the beginning of 2019, the Housing service area has included housing built under complete renovation projects. The comparative information has been adjusted accordingly.

During the review period, a total of 1,837 (1,929) housing units were sold, 1,499 in developer contracting projects and 338 in contract projects. On 30 April 2019, Lehto Group Plc's subsidiary Lehto Asunnot Oy 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. Four of these six projects were completed during the financial year; two of them have been sold and two will be sold in the 2020 financial year. The remaining two projects will be completed in 2020. In accordance with the contract, Lehto will sell the apartments leased, and the portfolio's

Housing: Deco, As Oy Sipoon Sigfrid

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.

SOLD HOUSING UNITS DURING THE REVIEW PERIOD

	1-12/2019	1-12/2018
Contract	338	758
Developer contract	1,499	1,171
Sold housing units during the review period, total	**1,837**	**1,929**

During the review period, 2,872 (2,159) new housing units were completed and at the end of the review period, 1,485 housing units were under construction (3,322 on 31 December 2018). The number of unsold housing units under construction declined and amounted to 518 at the end of the review period (1,715 on 31 December 2018). 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 Helsinki Metropolitan Area and in the centre of Oulu.

The table below presents the number of housing units under construction. Contract projects include not only contracts ordered by clients, but also housing construction projects developed by Lehto in which the company sells the entire share capital of the established housing cooperative to the client during the project.

HOUSING UNITS UNDER CONSTRUCTION

	1-12/2019	1-12/2018
Contract	628	1,263
Developer contract	857	2,059
Housing units under construction, total	**1,485**	**3,322**
of which sold	967	1,607

UNSOLD (AVAILABLE OR RESERVED)

	1-12/2019	1-12/2018
Under construction	518	1,715
Completed	276	72
Unsold, total	**794**	**1,787**
including DWS units	402	462

The number of completed and unsold housing units stood at 276 at period end (72 on 31 December 2018).

In March, Lehto launched the Deco wooden apartment building concept, which makes it possible to build a four-storey wooden building as a space element solution. The concept provides good support to the company's strategy, as it effectively harnesses industrial manufacturing and standardised solutions, for instance. Product development was largely also driven by demand and megatrends such as ecology and Finnishness. The modules of Lehto's wooden blocks of flats are built using domestic wood materials at the company's factories in Finland. The construction of wooden blocks of flats is also interesting due to the changes in the business environment, as such projects are currently supported, such as by zoning plots suitable for this purpose in key locations in growth centres. In addition, wooden blocks of flats are an excellent match for current additional and complementary construction projects because the construction site phase that disturbs the neighborhood is so short.

During the review period, the availability and terms of financing for housing projects became significantly more stringent. In addition to weaker availability and stricter terms, the tightening of the financial market increases the financial expenses of projects and also slows down Lehto's startup of developer contracted housing projects. As one alternative means of financing housing projects, Lehto plans to market selected RS sites with no housing company loans. In this arrangement, the end customer independently organises financing from a bank of their choosing. The benefits are an even lower purchase price and often a higher loan-to-value ratio. Lehto is also looking into financial solutions that would serve as alternatives to ordinary bank-based financing to finance developer contracting projects.

The order backlog of the Housing service area at the end of the review period was EUR 267.4 million (EUR 428.0 million on 31 December 2018). The order backlog declined particularly in the last quarter, when 1,385 apartments were completed and handed over. The housing production order backlog includes the proportion of started developer contracting projects that has not been recognised as net sales. A construction project is included in the order backlog once the decision to start construction has been made and the contract for a developer contracting project has been signed.

At the beginning of June, Juha Höyhtyä, M.Sc. (Civil Eng.), MBA, was appointed as the new Executive Vice President of the service area and as a member of the Group's Executive Board. Mr Juha Höyhtyä has long experience of the construction business. He has worked for the construction company Lemminkäinen for a total of 24 years both in Finland and abroad. Most recently, he served as CEO of Telinekataja Oy, in which position he worked for approximately four years. Pasi Kokko, the previous head of the service area, left Lehto's employ at the turn of March and April.

Pipeline renovation

The Housing service area has taken over the well-organised and profitable pipeline renovations previously carried out by the now-discontinued Building Renovation service area. Demand for pipeline renovations remained good, with eight pipeline renovation projects completed during the review period, and nine under construction at period end. Net sales in the pipeline renovation business grew by 11% from the previous year to EUR 31.6 million. In future, pipeline renovations are looking to operate in the Tampere economic area, too.

SWEDISH OPERATIONS

During the review period, the Swedish unit focused on completing the ongoing daycare centre project as well as starting up its wooden apartment building business based on space elements.

The daycare centre project comprises daycare centres being built in the municipality of Botkyrka using space elements. There have been significant problems in coordinating factory production and on-site work phases and fulfilling the requirements of the customer. As a result, the project has posted a loss. Initially, the project included three daycare centres, two of which have been completed. The construction of the third daycare centre has not been started yet. Lehto is currently negotiating with the client to terminate the contract.

Lehto has decided to focus its Swedish operations on the construction of wooden apartment buildings implemented with standardised space elements. In the early phases, the projects will be carried out as fixed-price contracts. The development work on the wooden apartment buildings was carried out in 2019 and Lehto expects that the first project will be started up in mid-2020.

Due to the loss-making daycare centre project, Swedish operations have a negative impact of EUR 11.9 million on the 2019 consolidated operating profit.

On 5 March 2019, Thomas Perslund took up his position as the new Managing Director of Lehto Sverige. He has earned a name for himself in Swedish construction thanks to his leading roles in projects for Stockholm's Friends Arena, Oscar Properties, NCC and the City of Stockholm. He has more than 20 years of experience in the field.

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 m².

During the review period, personnel capacity was reduced in factory production. Lehto engaged in employee cooperation negotiations in May-June, as a result of which 51 employees were terminated and 53 laid off temporarily. In September, Lehto started new employee cooperation negotiations that also covered factory operations personnel. The redundancies, part-time work and layoffs implemented due to the negotiations corresponded to a reduction of about 100 person-years.

Lehto's factory in Hartola

Balance sheet and financing

Consolidated balance sheet, EUR million	31 Dec 2019	31 Dec 2018
Non-current assets	55.8	37.7
Current assets		
Inventories, excluding IFRS 16 assets	210.3	238.2
Inventories, IFRS 16 assets	40.1	
Current receivables	86.3	139.0
Cash and cash equivalents	59.2	53.4
Total assets	**451.8**	**468.3**
Equity	112.1	162.4
Financial liabilities	142.4	115.9
Lease liabilities	46.8	
Advances received	73.2	88.3
Other payables	77.3	101.8
Total equity and liabilities	**451.8**	**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 December 2019 balance sheet are: an increase of EUR 46.8 million in financial liabilities, an increase of EUR 6.6 million in non-current assets, and an increase of EUR 40.1 million in inventories. Long-term plot leases for construction projects are presented under inventories.

The company's financial standing weakened during the financial year and, accounting for lease liabilities, the equity ratio was 29.6% and net gearing ratio 115.9% at the end of the year. The equity ratio, adjusted for comparability with previous periods and without the lease liabilities under IFRS 16, stood at 33.8% and the net gearing ratio was 74.1%. Lehto applies a simplified approach during the transitional period and will not adjust its comparison figures.

EQUITY AND LIABILITIES

Equity declined to EUR 112.1 (162.4) million during the financial year. The decrease in equity was largely due to losses of EUR 35.7 million during the financial year and dividends of EUR 14.0 million paid in April.

Financial liabilities grew to EUR 142.4 (115.9) million. Liabilities grew due to loss-making operations. Liabilities related to actual construction projects declined during the financial year.

Advances received declined to EUR 73.2 (88.3) million. Advances received include payments received for projects under construction to the extent these are not yet recorded in net sales.

Other liabilities decreased to EUR 77.3 (101.8) million and they include liabilities related to ordinary business operations, such as trade payables of EUR 29.8 (40.3) million and VAT debt of EUR 12.8 (19.7) million.

ASSETS

Non-current assets amounted to EUR 55.8 million at the end of the review period (EUR 37.7 million on 31 December 2018). Non-current assets include goodwill of EUR 4.6 (4.6) million, EUR 12.1 (12.7) million in factory buildings, EUR 7.2 (8.5) million in machinery and equipment and EUR 2.1 (0.9) million in capitalised development costs.

Inventories grew to EUR 250.4 (238.2) million. The reason behind this growth is the recognition of

EUR 40.1 million in lease liabilities in the balance sheet in accordance with IFRS 16. The value of inventories not related to lease liabilities declined by EUR 27.9 million. This is due to the decrease in construction projects in progress.

Current receivables declined to EUR 86.3 (139.0) million, including trade receivables of EUR 50.5 (62.2) million and percentage-of-completion receivables of EUR 29.6 (71.1) million. The decline in receivables is due to the lower business volume.

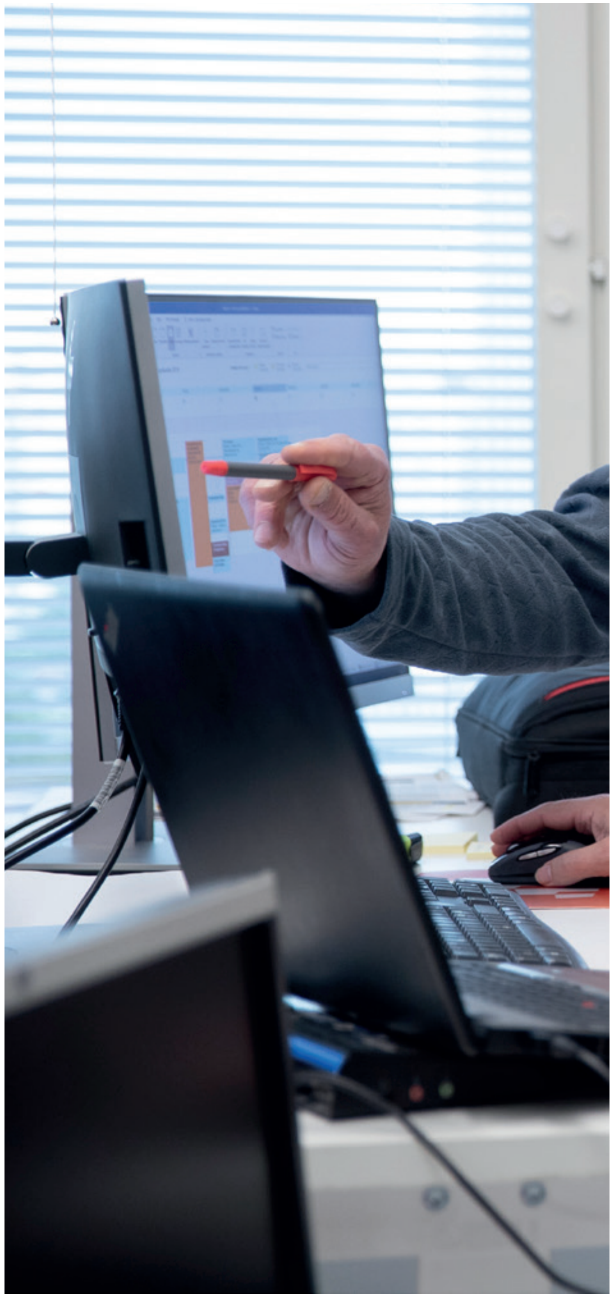
Cash flow statement, EUR million	**1–12/2019**	**1–12/2018**
Cash flow from operating activities		
Result for the period + adjustments to accrual-based items	-34.3	34.5
Change in net working capital	23.2	-52.8
Total cash flow from operating activities	-11.1	-18.3
Cash flow from investments	-6.6	-13.7
Cash flow from financing	23.5	17.5
Change in cash and cash equivalents	**5.9**	**-14.5**
Cash and cash equivalents at the beginning of the period	53.4	68.0
Cash and cash equivalents at the end of the period	59.2	53.4

Net cash flow from operating activities was EUR -11.1 (-18.3) million, which includes a positive impact of EUR 23.2 (-52.8) million due to the decrease in net working capital. The decline in net working capital was caused by the decrease in inventories and receivables during the review year. Net working capital was at its highest at the end of the third quarter and decreased significantly in the fourth quarter when housing projects were completed and the care home portfolio in the balance sheet was sold.

Net cash flow from investments was EUR -6.6 million, of which EUR -4.1 million relates to tangible assets, mainly replacement investments, EUR -3.6 million to intangible assets and EUR 1.6 million from sales of associate.

Net cash flow from financing was EUR 23.5 million positive. A total of EUR 132.6 million was drawn in loans and EUR 90.1 million was repaid. Cash flow from financing also includes cash expenses of EUR 14.0 million due to dividends paid.

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 covenants for profitability and indebtedness. In March 2019, Swedbank AB was added to this credit facility with a EUR 25 million share, increasing the total sum to EUR 75 million.



The covenant levels of the RCF financing agreement were renegotiated with financiers during the review period. As a result of the negotiations, the full amount of the RCF is limited to EUR 54 million and this full amount was in use on the closing date.

Personnel

The average number of personnel during the review period was 1,454 (1,457). The number of personnel at period end was 1,274 (1,552 on 31 Dec 2018). About half of the Group's personnel are salaried employees and half employees working at construction sites.

During the review year, the company conducted two employee cooperation negotiations. Lehto engaged in employee cooperation negotiations in May-June, as a result of which 51 employees at the Hartola and Oulainen factories were terminated and 53 laid off temporarily. The redundancies, part-time work and layoffs implemented due to the September-November negotiations corresponded to a reduction of about 144 person-years and are expected to yield annual cost-savings of slightly under EUR 7 million. The majority of the measures affected factory production, in which personnel will be laid off in 2019-2020, with a total effect of 100 person-years.

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 19 March 2019, Lehto carried out a directed share issue free of consideration related to the reward payment for the performance period 2016 of the incentive plan adopted in 2016. In the share issue, 58,691 new Lehto Group Plc shares were issued free of consideration to 25 Group key employees in accordance with the terms and conditions of the plan.

On 1 April 2019, Lehto announced that Kaarle Törrönen, Vice President, Human Resources, had been appointed to the Executive Board. He has worked for over 33 years in various leading HR and planning positions in the Finnish Defence Forces.

Research and development

Lehto develops and manufactures building modules and components, such as bathroom/kitchen modules, housing space elements, wall elements, large roof elements, technical building modules, windows and some smaller building renovation modules at its own production facilities. The purpose of developing modules is to enhance building quality and to accelerate the construction process.

The development of modules, components and space concepts is part of continuing operations, and the related costs are largely recorded as an expense in the income statement. Capitalised development expenditure during the financial year amounted to EUR 1.0 million. The most significant development investments are related to factory-made product design and the development of product factory operations.

Responsibility and environmental issues

The built environment has a major impact on the development of the urban landscape. The trend in urban development is towards sustainable housing, mobility and services. Vast amounts of materials are moved in construction, from land masses to a variety of products and coatings. The construction industry plays a major role in reducing construction's carbon footprint and cutting down on waste. The construction cluster is Finland's largest employer and many young people work in the industry. The construction industry is also heavily male-dominated.

Responsibility is one of the values that guides Lehto's operations. The key elements that enhance Lehto's productivity and competitiveness — design control and the use of standardised building elements and modules that are prefabricated in our own factories — also form the core of our responsibility efforts. Lehto's goal is to build efficiently while saving energy and resources, to reduce the material waste generated in construction, and to be a good employer that is fair to everyone.

Lehto Group's corporate responsibility comprises three focus areas: responsible construction, personnel wellbeing, and responsibility of business practices.

The CEO is responsible for Lehto Group's responsibility and the CFO heads up responsibility reporting. Operational responsibility work is managed on a decentralised basis in accordance with our key focal areas, primarily by the HR Director, Sourcing Director and Legal Counsel. The management team monitors trends in the key indicators of responsibility.

Lehto Group reports to external stakeholders on its responsibility in connection with annual reporting, and our reporting complies with the requirements laid down for non-financial information in the Accounting Act.

The Group's legal structure

At the end of the financial period, the Group was comprised of the parent company, Lehto Group Plc and its seven operative subsidiaries. In all subsidiaries, the parent company has a 100% shareholding. The Group also comprises temporary real-estate companies or shareholdings in them.

The Group's parent company is not engaged in actual business operations but serves as a hub for a number of shared Group functions which are relevant for the manageability and cost efficiency of the Group's operations. These include human resources management, accounting, coordination of financial affairs, legal affairs, business development, sourcing and purchasing, communications, marketing and information management.

Other significant events during the financial period

On 18 March 2019, Lehto Group Plc's Board of Directors decided, under the authorisation of the Annual General Meeting, to carry out a directed share issue free of consideration related to the reward payment for the performance period 2016 of the incentive plan adopted by Lehto in 2016. Information on the launch as well as the key terms and conditions of the plan has been announced in a stock exchange release published on 20 December 2016. In the share issue, 58,691 new Lehto Group Plc shares (the "Issue Shares") were issued free of consideration to 25 Group key employees in accordance with the terms and conditions of the plan. The Issue Shares corresponded to approximately 0.1 per cent of Lehto's shares and votes prior to the share issue. After the share issue, the total number of Lehto shares and the votes they confer is 58,309,443.

On 1 April 2019, Lehto announced that Kaarle Törrönen, Vice President, Human Resources, had been appointed to the Executive Board, while Pasi Kokko, who had served as the Executive Vice President of Housing and a member of the Executive Board, was leaving Lehto.

On 9 May 2019, Lehto downgraded its financial outlook for 2019. Lehto announced that the Group's net sales for 2019 will be on par with 2018 (EUR 721.5 million in 2018) and that operating profit will be approximately 2–6% of net sales (5.2% in 2018). The factors underlying the revised outlook for operating profit were the losses on complete renovation projects, the higher-than-expected costs of starting up business in Sweden, the loss on the first daycare centre project, the weaker margins of care home and business premises projects, and delays in the startup of new projects.

On 5 June 2019, Lehto announced that Juha Höyhtyä had been appointed as Executive Vice President of the Housing service area and as a member of the Group's Executive Board.

On 6 August 2019, Lehto published a release in which it estimated that the Group's net sales for 2019 will be either at the same level or lower than in 2018 (EUR 721.5 million in 2018) and that the full-year 2019 operating result will be in the red due to the steep losses posted in the first half of the year (operating profit of EUR 37.2 million, or 5.2% of net sales in 2018). The outlook for net sales was weakened by delays in the startup of business premises projects. The major reason behind the weaker outlook for operating profit is the significantly higher than expected losses on complete renovation projects. The outlook for operating profit was also weakened by individual loss-making projects in the Social Care and Educational Premises and Business Premises service areas and a slight decline in the selling prices of apartments.

On 19 August 2019, Lehto announced that Toni Kankare had been appointed as Chief Commercial Officer and Jukka Haapalainen as Executive Vice President of Factory Production. The previous head of factory production, Pekka Korkala, had left his position at his own request. Kankare and Haapalainen were also appointed as members of the Group's Executive Board.

On 1 November 2019, Lehto announced that it expected consolidated net sales to be lower in 2019 than in 2018 (net sales in 2018: EUR 721.5 million). Even though the company estimated that the fourth-quarter operating result would be positive, the operating result for the second half of the year would be negative due to the operating loss in the third quarter (operating loss in January-June 2019: EUR 27.5 million). The release stated that the main factors impacting on net sales and operating result in the second half of the year were the further losses on complete renovation projects in the third quarter, the pushing back of the completion dates of certain housing projects to 2020, and the weakening of the average margin in housing projects.

Risks and factors of uncertainty

Lehto assesses risks in its daily operations on a continual basis and develops Group-wide risk management practices together with its operative companies. Through the continuous development of risk management, we seek to attract new business opportunities and partners, as well as to further improve the profitability and predictability of our operations. Further improvement of risk management and responding to the challenges of a growing business are Lehto's top operational priorities.

The main risks in the operative business include general risks related to project pricing, schedules, quality, technical implementation and the adherence of stakeholders to agreements. Lehto's reliance on module production and the partial dependence of its housing production on the schedule and efficiency of module production present a risk related to deviations or interruptions in the implementation of modular products.

In its business operations, Lehto is also exposed to risks relating to the availability of financing, overall economic trends and political decision-making and other risks relating to the activities of the public sector. As part of its operational business, Lehto continuously concludes agreements with various parties. The related risks include the technical, legal and commercial condition of the acquired property. The unique and complex construction projects in Lehto's Business Premises service area, in particular, always involve risks related to implementation and costs.

Lehto's business is partly so-called traditional contracting and partly its own production, where the final customer is not always known when starting the construction project. These business models involve different risks. In traditional contracting, project income is recognised according to the degree of completion. The main risk in this model is that total costs for the project exceed the estimated costs or the completion of the project is delayed.

The main risk in own production is that the company is not able to sell the production within the planned time schedule or at the planned price. In addition, project costs can exceed the estimated costs. Failure in project pricing, technical implementation, estimating costs and time schedule, selling the property or finding financing can have a negative impact on the company's result and financial position.

Part of Lehto's business involves agreements according to which Lehto builds premises in line with the customer's needs and only sells the premises upon their completion or at a later stage to a fund, for example. Despite Lehto's completion of premises according to the agreed schedule and costs, Lehto carries a risk related to the capacity of the fund to provide the cash required for the purchase of the premises at the agreed time of payment.

The project business the Group carries out is characterised by variation, which can be significant, in profit between different reporting periods due to the accounting methods of projects. The Group's cash flow is usually generated in step with a project's degree of completion, however such that the last instalment payable after the completion is bigger than the other instalments. Thereby a delay of an individual project can have an effect on the sufficiency of financing. In addition, a project delay may mean that net sales and operating profit from that project are pushed back to the next financial period, thereby weakening net sales and operating profit in the current financial period.

As a result of business growth, working capital is tied up in inventories and receivables in particular. In a situation where the company's business is expanding simultaneously in several service areas, large purchase commitments for construction sites are realised and receivable payments from customers are delayed, the company may run into a situation where its additional financing costs will increase.

Changing building regulations or zoning policies can also have significant effects on the company's business. In a period of economic growth in construction, the availability of skilled labour may also present a risk for the planned launch of a project in the agreed schedule.

The main risks related to the net sales, result and financial position during the current financial period are the decrease in housing sales volume and price level, delays in the startup of care home, school and business premises projects, and higher-than-expected project costs and thereby the adequacy of financing.

Lehto seeks to manage these risks with proactive sales efforts, monitoring sales trends, precise project monitoring and rapid corrective actions. Lehto has launched a Group-wide restructuring programme that seeks to improve project margins and eliminate negative deviations in them. The programme focuses especially on improving the quality of project preparation prior to the construction phase.

In order to ensure sufficient financing, Lehto is actively discussing various financing solutions with providers of finance.

Lehto aims to control risks at each level of the organisation. Risk management includes risk identification, estimation and plans to avoid them. More information on Lehto's risks and risk management is available at www.lehto.fi.

Flagging notifications

On 25 January 2019, Lehto received a notification pursuant to Chapter 9, Section 5 of the Securities Markets Act from OP Fund Management Company Ltd. According to the notification, the total Lehto shares and votes held by the OP-Suomi Pienyhtiöt and OP-Suomi investment funds, which are managed by OP Fund Management Company Ltd, had decreased below the five (5) per cent limit to 4.71% on 23 January 2019.

Annual General Meeting 2019

The Annual General Meeting of shareholders of Lehto Group Plc took place in Oulu in the premises of Technopolis in the address Elektroniikkatie 8 on 29 March 2019. The Annual General Meeting approved the financial statements for 2018 and discharged the Members of the Board of Directors, the Chairman of the Board of Directors, and the CEO from liability.

The Annual General Meeting resolved in accordance with the proposal by the Board of Directors to pay dividend of EUR 0.24 per share, a total of EUR 13,994,266.32 for the financial period that ended on 31 December 2018. The dividend will be paid to shareholders who on the record date for the dividend payment, 2 April 2019, are recorded in the shareholders' register held by Euroclear Finland Ltd. The dividend payment date is 9 April 2019.

The Annual General Meeting resolved that the Board of Directors shall consist of five members. Pursuant to the proposal made by the shareholders nomination committee Martti Karppinen, Mikko Räsänen and Pertti Korhonen were re-elected and Anne Korkiakoski and Seppo Laine were elected as members of the Board of directors. The term of the Board members will expire at the end of the Annual General Meeting 2020.

The Annual General Meeting resolved that the remuneration of the members of the Board of Directors shall be made in Lehto Group Plc shares and in cash, with approximately 40 per cent of the remuneration paid in shares and the remainder in cash. The yearly remuneration paid to the Chairman of the Board of Directors was resolved to be EUR 69,000 and to the Deputy Chairman and the Members of the Board of Directors EUR 34,500. Should the member of the Board of Directors abstain from accepting the remuneration in shares and in cash, shall the remuneration be paid entirely in cash when it shall be EUR 55,200 for the Chairman of the Board of Directors and EUR 27,600 for the Deputy Chairman and the members of the Board of Directors. In addition, for each Board meeting other than ones held via telephone or email, EUR 750 shall be paid for the Members of the Board, and EUR 1,500 for the Chairman of the Board of Directors.

For each meeting of the Audit Committee other than ones held via telephone or email the members of the Audit Committee shall be paid a remuneration of EUR 400 for the Member of the Committee and EUR 600 for the Chairman of the Committee.

Reasonable travel expenses incurred in connection with Board meetings or Committee meetings shall be paid in accordance with the instructions of the tax authority. The per diem allowances are included in the attendance fee.

The audit firm KPMG Oy Ab was re-elected as the auditor. KPMG Oy Ab has informed the company that C.A. Tapio Raappana would continue as the responsible auditor. The auditor's fee shall be paid on the basis of an invoice approved by the company.

The Annual General Meeting authorised the Board to decide on the purchase of the company's own shares in one or several instalments using assets belonging to the unrestricted equity of the company, so that the maximum quantity purchased be 5,800,000 shares. The shares shall be purchased through public trading organised by Nasdaq Helsinki in accordance with its rules or using another method. The consideration paid for the purchased shares shall be based on the market price. The authorisation entitles the Board of Directors to decide on the purchase of shares also otherwise than in proportion to the shares owned by the shareholders (directed purchase). Then, there shall be weighty financial reasons for the company to purchase its own shares. Shares may be purchased to implement arrangements linked to the company's business operations, to implement the company's share-based incentive programmes or otherwise to be transferred on or the shares may be cancelled. The purchased shares may also be held by the company. The Board of Directors is authorised to make decisions on all other terms and matters pertaining to the purchase of own shares. The purchase of own shares reduces the unrestricted equity of the company. The term of the authorisation extends until the Annual General Meeting 2020.

The Annual General Meeting authorised the Board of Directors to decide on the issue of a maximum of 5,800,000 shares through share issue or by granting option rights or other special rights entitling to shares in one or several instalments. The authorisation includes the right to issue either new shares or own shares held by the company either against payment or without consideration. Contrary to the shareholders' pre-emptive rights, new shares may be issued directly and own shares held by the company transferred directly if there is a weighty financial reason for it from the company's point of view or, in case of an issue without consideration, a particularly weighty financial reason from the company's point of view and considering the benefit of all its shareholders. The Board of Directors is authorised to decide on all other terms and matters pertaining to a share issue, to the granting of special rights entitling to shares, and to the disposal of shares. Among other things, the authorisation may be used to develop the capital structure, to expand the ownership base, as consideration in M&A transactions, when acquiring assets linked to the operations of the company, and to implement incentive programmes. The term of the authorisation extends until 31 October 2021. The authorisation shall replace the company's previous share issue and option right authorisations.

The Annual General Meeting resolved to amend the Rules of Procedure of the Shareholders' Nomination Committee in a way that the biggest shareholders would be selected on the last September date of public trading instead of such date in October.

Events after the review period

On 3 February 2020, after the end of the review period, Lehto specified its guidance for 2019 and outlook for 2020. Lehto reported that according to its unaudited calculations, net sales for 2019 saw a year-on-year decrease to about EUR 667 million and the operating loss amounted to about EUR 42 million, while fourth-quarter net sales were around EUR 270 million and the operating result was breakeven.

Annual General Meeting 2020

The Annual General Meeting of Lehto Group Plc will be held on Tuesday 14 April 2020 at 1.00 p.m. at Elektroniikkatie 8, Oulu.

Board proposal for the use of the profit shown on the balance sheet and for deciding on payment of dividends

The parent company's distributable funds on the balance sheet of 31 December 2019 are EUR 68,719,704.44, of which the operating result is EUR -99,211.31.

The Board of Directors will propose to the Annual General Meeting to be held on 14 April 2020 that no dividends be paid for the 1 January–31 December 2019 financial year.

Outlook for 2020

Lehto estimates that the Group's net sales in 2020 will be approximately 10 % lower than in 2019 and that operating result is positive.

The net sales outlook is based on estimation of decelerating housing market and declining volume in Lehto's school and care home business. Volumes in business premises are estimated to remain at the level of previous year.

The operating profit outlook is influenced by ending of loss-making complete renovation projects and other single loss-making projects as well as estimated positive effects of restructuring activities that were started in 2019 and are still being executed.

Vantaa, 19 February 2020

Lehto Group Plc
Board of Directors