LEHTO

Q3 23

Lehto Group Plc's Business Review
1 January - 30 September 2023

Lehto Group Plc:

Business Review 1 January-30 September 2023

9 November 2023 at 7.30 a.m. (Finnish time)

Operating result without impairment on previous year's level, letter of intent regarding the sale of business operations signed

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.

Lehto Group Plc announced on 24 October 2023 that it has signed a letter of intent regarding the sale of its operative subsidiaries ("operations for sale"). The proposed transaction comprises in practice all of the business operations of Lehto Group and after the transaction the Group would only consist of parent company and subsidiaries that has no significant business ("continuing operations"). The Board of Directors of Lehto has initiated an assessment as to the business opportunities of the remaining parent company and expects to decide on the future strategy of Lehto by the time of the consummation of the Transaction.

In this report, financial information is presented for the operations for sale and continuing operations separately and together with previous periods for comparability.

Group including operations for sale and continuing operations	**7-9/ 2023**	**7-9/ 2022**	**1-9/ 2023**	**1-9/ 2022**	**1-12/ 2022**
Net sales, EUR million	39.9	86.1	154.5	250.1	344.8
Change in net sales, %	-53.7%	15.8%	-38.2%	-2.9%	-14.7%
Operating result without impairment, EUR million	-5.2	-6.4	-23.4	-27.9	-42.2
Operating result without impairment, % of net sales	-13.0%	-7.4%	-15.2%	-11.1%	-12.2%
Result for the period, EUR million	-40.5	-7.5	-27.9	1.6	-26.7
Order backlog at period end, EUR million	90.9	246.4	90.9	246.4	205.9
Earnings per share, EUR	-0.08	-0.09	-0.32	0.02	-0.31
Cash and other liquid assets, EUR million	7.5	11.6	7.5	11.6	13.2
Interest-bearing liabilities, EUR million	22.6	38.7	22.6	38.7	33.9
Lease liabilities in interest-bearing liabilities, EUR million	62.6	84.0	62.6	84.0	77.8
Equity ratio, %	22.6%	32.8.%	22.6%	32.8%	27.0%
Net gearing ratio, %	201.1%	117.2%	201.1%	117.2%	147.9%
Equity ratio excluding IFRS 16 lease liabilities, %	35.0%	45.9%	35.0%	45.9%	38.7%
Net gearing ratio excluding IFRS 16 lease liabilities, %	39.0%	28.6%	39.0%	28.6%	31.0%

- In January–September, net sales from operations for sale and continuing operations were down 38.2% and amounted to EUR 154.5 (250.1) million. Net sales declined in both service areas, but especially in Business Premises. This decrease was due to the lower number of construction projects and termination of business premises project contracts in 2022.
- The operating result from operations for sale and continuing operations without impairment improved slightly and was EUR -23.4 (-27.9) million. The operating loss was impacted especially by developer-contracted projects sold at a loss as well as other low-margin or loss-making projects.
- At the end of the review period, there were 325 (1,662) units under construction, which all are related to projects for institutional investors.
- Cash and cash equivalents including cash from assets held for sale totalled EUR 7.5 million at the end of the review period (EUR 13.2 million on 31 December 2022). In addition to this, the company had EUR 2.2 million pledged cash deposits as collateral for the credit facility signed on June 30, 2022.
- Interest-bearing liabilities including interest-bearing liabilities from liabilities held for sale but excluding IFRS 16 lease liabilities amounted to EUR 22.6 million (EUR 33.9 million on 31 December 2022).
- The order backlog declined to EUR 90.9 million (EUR 205.9 million on 31 December 2022). The order backlog was down in both service areas due to the low order intake.

Net sales by service area,
operations for sale and continuing operations, total

EUR million	**7-9/ 2023**	**7-9/ 2022**	**Change Q3**	**1-9/ 2023**	**1-9/ 2022**	**Change**	**1-12/ 2022**
Housing	21.5	53.6	-59.9%	105.8	146.3	-27.7%	213.3
Business Premises	18.4	32.5	-43.5%	48.7	103.7	-53.1%	131.5
Total	**39.9**	**86.1**	**-53.7%**	**154.5**	**250.1**	**-38.2%**	**344.8**

The table below shows the official consolidated income statement as a reconciliation statement, which shows the impact of the operations intended for sale on the consolidated profit, including the total impairment of assets of 33.5 million euros.

Consolidated statement of income Reconciliation	1-9/2023			1-12/2022		
EUR million	Operations for sale and continuing	Operations for sale	Continuing operations	Operations for sale and continuing	Operations for sale	Continuing operations
Net sales	**154.5**	**154.5**	**0.0**	**344.8**	**344.5**	**0.3**
Other operating income and expenses	-177.9	-177.2	-0.8	-387.0	-385.9	-1.1
Operating result	**-23.4**	**-22.7**	**-0.7**	**-42.2**	**-41.4**	**-0.8**
Financial incomes and expenses	-4.3	-1.7	-2.6	-3.3	-1.4	-2.0
Result before taxes	**-27.8**	**-24.4**	**-3.3**	**-45.5**	**-42.8**	**-2.7**
Income taxes	-0.1	-0.2	0.1	-13.3	-7.8	-5.5
Result from continuing operations	**-27.9**	**-24.6**	**-3.2**	**-58.8**	**-50.5**	**-8.3**
Impairment from assets held for sale	-33.5	-33.5	0.0			
Result from earlier discontinued operations	-0.1		-0.1	32.1		32.1
Result for the period	**-61.4**	**-58.1**	**-3.3**	**-26.7**	**-50.5**	**23.9**

CEO Juuso Hietanen

"In the third quarter of the year, the construction market continued to be difficult, which was reflected, among other things, in the slowness of purchase decisions for business premises and housing sales. In particular, the uncertainty of consumers is increased by the general economic situation, the poor availability of loan financing and the increased interest rate.

Although the market has been challenging, we have sold a total of 263 apartments in January-September. At the end of the reporting period, Lehto had only 30 completed apartments for sale, and there are no apartments under construction with a risk of sale. Our ongoing housing projects are investor projects that generate a relatively steady cash flow. In the third quarter we started up Makita's Finnish headquarters and warehouses in Tuusula and completed local service centre in Kivistö.

In the third quarter, we continued the process we started at the beginning of the year to find structural or ownership partners. The goal of the process has been to secure funding for the implementation of the company's strategy and projects. Negotiations took place in the third quarter of the year closely, and at the end of October we signed a letter of intent to sell our operational subsidiaries to a European fund management company. The planned transaction comprises in practice all of the current business operations of Lehto Group.

As we told when publishing the letter of intent, through negotiations we found a solid and reliable contract partner who recognizes the future potential of our business. The contractual partner has significant financial resources and experience in investing in companies in the real estate industry. We believe that this planned transaction is the best possible arrangement currently feasible in this challenging construction industry market situation. In the last quarter of the year, our focus is on implementing the transaction and mapping the business opportunities of the remaining parent company."

Outlook for 2023

As Lehto announced in stock exchange release on 24 October 2023, due to the intended sale of its operative subsidiaries, the earlier outlook for 2023 is no longer valid, and it will not issue a new outlook regarding its net sales and operating result for 2023.

Structural arrangements and liquidity

A letter of intent regarding the sale of its operative subsidiaries

On 24 October 2023 Lehto Group Plc signed a letter of intent concerning the sale of all the outstanding shares in its 100% owned subsidiaries Lehto Asunnot Oy, Lehto Tilat Oy, Lehto Components Oy and Insinööritoimisto Mäkeläinen Oy. The target companies subject to the transaction comprise in practice all of the current business operations of Lehto Group. In connection with the transaction, also all assets, liabilities, resources, and personnel of the parent company that are material for the business of the target companies are contemplated to be transferred to the purchaser. The counterparty in the Letter of Intent is a regulated European fund management company that is specializing in the real estate sector.

According to the Letter of Intent, the debt-free value of the Target Companies is EUR 11.3 million the transaction is intended to be completed during the last quarter of 2023. After deducting the bank liabilities of Lehto, Lehto would receive a cash purchase price of approximately EUR 3 million for the sale of the target companies upon completion of the proposed transaction.

Since the net income generated for the parent company as a result of the consummation of the transaction would be lower than the net value of the assets classified as available for sale and the related liabilities, the transaction would result in a capital loss for the parent company and Lehto Group. As a result, the valuation of the assets that are the subject of the proposed transaction was subject to an impairment of EUR 34 million that is recognised in consolidated income statement and balance sheet for January-September 2023.

The signing of the final transaction agreement is subject to, among other things, the completion of the purchaser's due diligence review to the satisfaction of the purchaser, approval for the transfer of certain liabilities of Lehto to the target companies by Lehto's financing partners and the convertible bond holders' meeting supporting the transaction. The completion of the transaction is also subject to other uncertainties typical for M&A transactions. The Letter of Intent signed does not obligate the parties to complete the transaction or any similar arrangement.

The remaining Lehto Group

After completion of the proposed transaction the parent company would retain cash, sundry assets and sundry liabilities of approximately net EUR 5–8 million in the aggregate with cash and cash equivalents representing approximately EUR 1–2 million of such net figure. In addition, the parent company would retain the convertible bond of EUR 15 million. The company expects to summon a meeting of the convertible bond holders in relation to the proposed Transaction, and it is possible therein that the bond holders will vote on certain proposed amendments to the terms and conditions of the convertible bond, including a potential conversion of the convertible bond into equity of Lehto. Assuming that the convertible bond, or a material proportion thereof, will not be converted into equity of Lehto, the retained net assets of Lehto after completion of the proposed Transaction are expected to be negative.

The adequacy of cash reserves

Assuming Lehto will not receive any new financing or cash flow from new projects, Lehto estimates that its cash reserves will last until the end of December 2023. The adequacy of Lehto's cash reserves is subject to many uncertainties, including the timing of incoming cash flow from various building projects, the results of negotiations related to the payment schedule of some receivables and debts and the final results of the negotiations with the company's financing banks.

Lehto estimates that the consummation of the transaction is essential for the continuation of Lehto's business operations and without additional financing or cash flow from new projects, Lehto will not be able to meet its payment liabilities in the first quarter of 2024.

More information about issues is available on stock exchange releases published on 24 October 2023.

Business environment and business development in the review period

Development of the business environment

Lehto operates in Finland, and the construction sector is very sensitive to general economic cycles. The

Bank of Finland forecasted in the interim forecast in September that The Finnish economy is in mild recession in 2023. The rise in prices and interest rates, and weaker export demand, are weighing on the economy. The favorable trend in employment will come to a halt, but domestic inflation is now slowing rapidly. However, the economic recovery will take longer than previously estimated. The downside risks to economic growth have increased. According to the Bank of Finland's September 2023 interim forecast, GDP will contract by 0.2% in 2023. The economy will slowly start to recover from the recession in 2024. GDP growth in 2024 will be slower than projected in the Bank of Finland's June forecast, i.e. only 0.2%. In 2025, growth in the economy will gather pace, albeit only to 1.4%.

In its economic outlook published in September 2023, the Confederation of Finnish Construction Industries RT stated that the total number of housing starts is projected to drop to less than half of the previous year, with the start-ups of privately financed apartment buildings plummeting by as much as 80 percent compared to the previous year. Due to this housing production collapse, the number of completed homes is at risk of falling to the level seen in the 1940s in the next couple of years, and overall construction is expected to shrink by 10 percent this year. According to RT, the recovery of housing production hinges on the stabilization of interest rate prospects, the revival of existing home sales, and the absorption of the supply of new apartments. Additionally, the report mentions that consumer demand for homes may gradually pick up at the beginning of next year, as the need remains, and the fundamental drivers of consumer demand are in place. Urbanization has continued more robustly than anticipated, and available incomes are growing steadily. However, there are currently no economic conditions conducive to a significant recovery in investor demand.

The decrease in the construction market is also indicated by the reduction in building permits. Statistics Finland reported on October 24, 2023, that a total of 6.0 million cubic meters of building permits were issued for new construction between June and August 2023, which was 42% less than the previous year. The volume of completed construction projects decreased by 16% compared to the previous year.

Furthermore, Statistics Finland confirmed on October 13, 2023, that construction costs increased by 1.9% in September 2023 compared to the previous year. The costs of materials and inputs increased the most in thermal insulation (9.0%) and formwork and support (11.8%) year-on-year. The most significant cost reductions year-on-year occurred in wooden structures (-17.1%) and concrete elements (-10.3%).

Housing

Business development in the review period

The Housing service area’s net sales experienced a year-on-year decrease of 27.7% to EUR 105.8 (146.3) million. All net sales consist of operation for sale. During the review period, 263 apartments were sold, most of them in housing projects targeted at consumers. 80 apartments in one consumer project were sold to an investor client.

Sold housing units during the review period	**1-9/2023**	**1-9/2022**	**1-12/2022**
Investor projects	84	270	497
Consumer projects	179	189	261
Sold housing units during the review period, total	**263**	**459**	**758**

During the period, 902 (794) housing units were completed, but only one new housing project with 31 housing units was started up (454 units started up in 1-9/2022). There were 325 (1,662) housing units under construction at the end of the review period.

Housing units under construction	**1-9/2023**	**1-9/2022**	**1-12/2022**
Under construction at the beginning of the period	1,196	2 002	2 002
+ started up during the period	31	454	586
- completed during the period	902	-794	-1,392
Housing units under construction at period-end	**325**	**1,662**	**1,196**

At period end, the number of completed and unsold apartments stood at 30 (49). There were no unsold apartments under construction (221 units on 30 September 2022). In the challenging market situation, Lehto has kept the number of unsold apartments at a moderate level to safeguard cash flow. 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	**1-9/2023**	**1-9/2022**	**1-12/2022**
Under construction	-	221	181
Completed	30	49	73
Unsold housing units, total	**30**	**270**	**254**

The Housing service area's order backlog stood at EUR 58.3 million at the end of the review period (EUR 155.6 million on 31 December 2022). 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.

Business Premises

Business development in the review period

The service area's net sales experienced a year-on-year decrease of 53.1% to EUR 48.7 (103.7) million. All net sales consist of operations for sale. Net sales decrease is due to the decline in the number of projects.

Six business premises projects were completed and handed over during the review period (9 sites in 1-9/2022). At period-end, one (11) project was under construction, which is the Finnish headquarters of Makita, and a warehouse building in Tuusula. The Business Premises service area's order backlog decreased to EUR 32.6 million (EUR 50.3 million on 31 December 2022).

On 24 April 2023, Lehto announced that it had 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. 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.

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 has 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 significantly reduced the fixed costs of factory production. During the review period, the utilization rates of the factories have been very low.

Balance sheet and financial position

Lehto announced on 24 October 2023 that it has signed a letter of intent regarding the sale of its operative subsidiaries. The balance sheet values of the assets for sale on September 30, 2023 are subject to an impairment of 33.5 million euros since the net income generated for the parent company as a result of the consummation of the transaction would be lower than the net value of the assets classified as available for sale and the related liabilities.

The consolidated balance sheet below shows the Group's assets and liabilities before impairment and reclassification of balance sheet items:

Consolidated balance sheet before impairment and reclassification of balance sheet items, EUR million	**30 Sep 2023**	**30 Sep 2022**	**31 Dec 2022**
Non-current assets	21.4	44.9	27.7
Current assets			
Inventories, excluding IFRS 16 assets	55.2	121.4	101.2
Inventories, IFRS 16 assets	59.6	79.4	70.9
Current receivables	29.0	64.4	50.4
Cash and cash equivalents	7.5	11.6	13.2
Non-current assets held for sale	0.0	0.0	3.8
Assets total	**172.6**	**321.8**	**267.2**
Equity	38.6	94.8	66.6
Financial liabilities	22.6	38.7	33.9
Lease liabilities	62.6	84.0	77.8
Liabilities to customers for constructing contracts (advances received)	1.6	32.6	20.6
Other payables	47.2	71.6	68.4
Equity and liabilities total	**172.6**	**321.8**	**267.2**

The balance sheet total comparable to previous periods before impairment of assets and reclassification of balance sheet items was EUR 172.6 (267.2) million. According to this, the equity ratio (taking lease liabilities into consideration) stood at 22.6% (27.0%) and the net gearing ratio was 180.4% (147.9% on 31 December 2022). The equity ratio without the lease liabilities under IFRS 16 stood at 37.9% (38.7%) and the net gearing ratio was 42.0% (31.0%). The key figures for financial standing and indebtedness weakened, as shareholders' equity and cash and cash equivalents decreased due to the loss-making result. Cash and cash equivalents also decreased by repayments of financial liabilities.

The table below shows reconciliation of the official consolidated balance sheet which shows the assets and liabilities related to the operations for sale after the impairment of the assets of 33.5 million euros, reclassified separately from other assets and liabilities.

Consolidated balance sheet on 30 Sep, 2023 Reconciliation **EUR million**	Balance sheet items including assets and liabilities held for sale	Reclassification of balance sheet items to assets and liabilities held for sale	**Total (official)**
Non-current assets	21,4	-17,7	3,7
Current assets			
Inventories, excluding IFRS 16 assets	55,2	-55,1	0,1
Inventories, IFRS 16 assets	59,6	-59,6	0,0
Current receivables	29,0	-22,6	6,4
Cash and cash equivalents	7,5	-0,1	7,5
Non-current assets held for sale		121,4	121,4
Total assets	**172,6**	**-33,5**	**139,1**
Equity	38,6	-33,5	5,1
Financial liabilities	22,6	-2,4	20,2
Lease liabilities	62,6	-62,6	0,0
Liabilities based on customer contracts (advances received)	1,6	-1,6	0,0
Other payables	47,2	-45,1	2,1
Non-current liabilities related to assets held for sale		111,6	111,6
Total equity and liabilities	**172,6**	**-33,5**	**139,1**

Key financing agreements

Lehto has a Revolving Credit Facility (RCF) amounting to EUR 13.0 million with OP Corporate Bank plc and Nordea Bank Plc. The RCF is valid until 31 March 2024, and it 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. At the end of the review period, EUR 8.3 million of the credit facility was in use, and according to the conditions set in the agreement company is unable to use more funds from the facility. On September 30, 2023, the agreement was secured by, among other things, cash deposits of EUR 2.2 million. EBITDA for the review period was lower than the minimum level set in the RCF financing agreement and the company is engaging in constant dialogue discussion with its financier banks on the terms of the continuation of financing.

In June 2022, Lehto issued convertible bonds of EUR 15.0 million. The convertible bonds are convertible into new and/or existing shares in Lehto. The loan is fully subscribed and matures in June 2027. 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 513 (915 in 1-9/2022). The number of personnel at period-end was 409 (664 on 31 December 2022), with temporary layoffs amounting to about 210 person years.

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.

Events after the review period

On October 24, 2023, Lehto announced that it has signed a letter of intent regarding the sale of its operative subsidiaries. In the same context, the company announced this reason in a separate stock exchange release that it postpones the publication date of the January-September 2023 business review.

Also, the company issued a profit warning that the outlook for 2023 given in Lehto's half-year report on 27 July 2023 is no longer valid, and Lehto will not issue a new outlook regarding its net sales and operating result for 2023, and, in addition, stated that if Lehto will not receive any new financing or cash flow from new projects, Lehto estimates that its cash reserves will last until the end of December 2023.

Vantaa, 8 November 2023

Lehto Group Plc

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