Pihlajalinna

Half-year financial report H1/2020

Joni Aaltonen, CEO
14 August 2020

Q2 2020: Revenue and profitability declined due to the coronavirus epidemic

- Revenue amounted to EUR 114.7 (129.7) million – a decrease of 11.6%
- Adjusted EBITDA was EUR 9.0 (10.8) million – a decrease of 16.2%
- Adjusted EBIT was EUR 0.6 (2.1) million
- IFRS 3 costs and amortisation related to M&A had a negative effect of EUR 0.8 (1.4) million on operating profit
- Earnings per share (EPS) was EUR -0.03 (-0.02)
- The voluntary tender offer by Mehiläinen Yhtiöt Oy is expected to be completed in the third quarter of 2020.

Q2 2020: Main points by region

EUR million	4–6/2020	%	4–6/2019	%	change	change %
Southern Finland	23.2	18	30.0	21	-6.8	-22.6
Mid-Finland	73.1	56	80.8	56	-7.6	-9.5
Ostrobothnia	28.7	22	29.1	20	-0.4	-1.5
Northern Finland	3.3	3	3.8	3	-0.5	-11.9
Other operations	2.2	2	1.8	1	0.5	27.0
Intra-Group sales	-15.9		-15.7		-0.2	
Total consolidated revenue	**114.7**	**100**	**129.7**	**100**	**-15.1**	**-11.6**

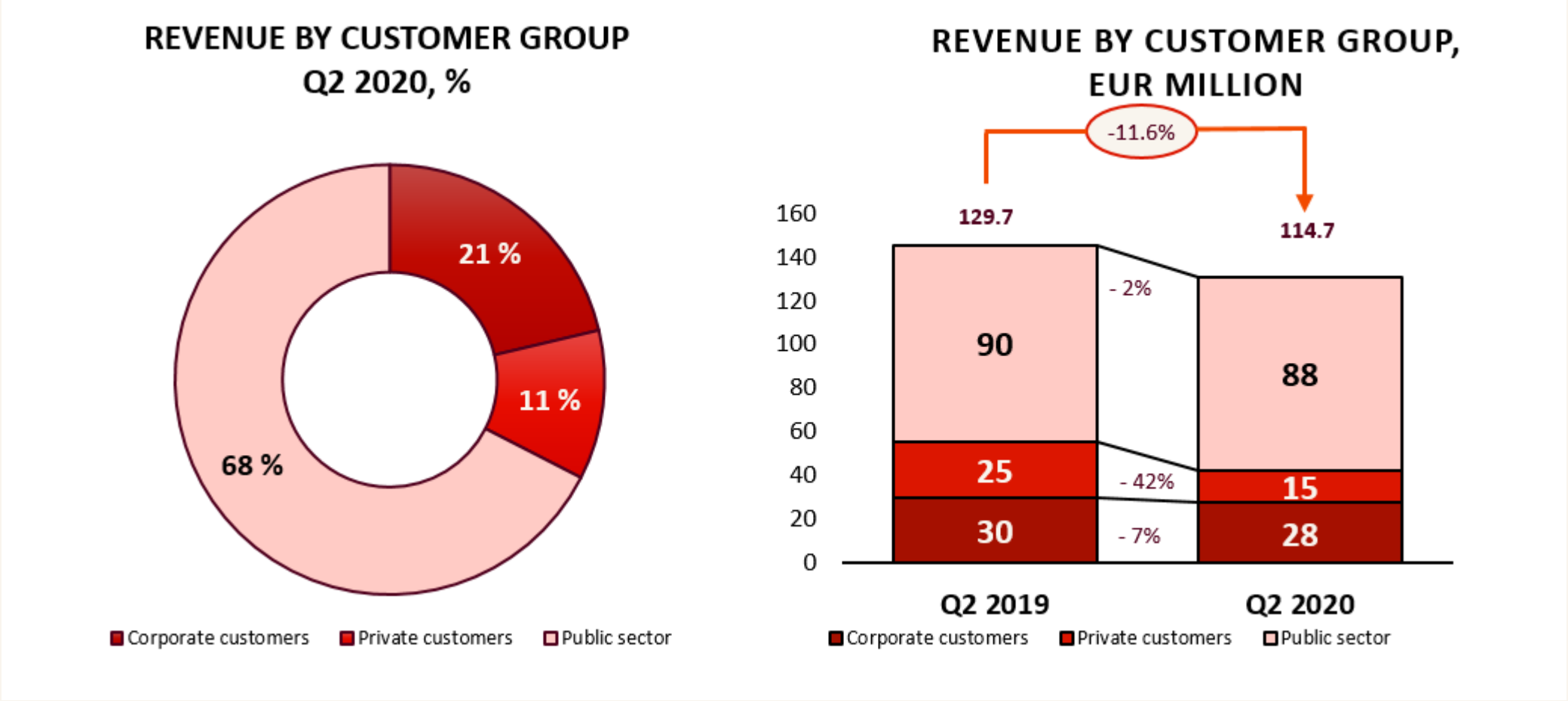
- **Southern Finland: –22.6%.** The revenue of Forever fitness centre chain decreased by 84% due to the closure of the centres. Revenue decreased by approximately 43 per cent in dental health services, 19 per cent in private clinics and 14 per cent in surgical operations. Revenue from occupational healthcare grew by nearly 10 per cent thanks to the growth of the customer base and fixed-price agreements.
- **Mid-Finland: –9.5%.** The revenue of private clinics decreased by 27 per cent as a result of the coronavirus epidemic, occupational healthcare by 14 per cent, oral health by 51 per cent, fitness centres by 68 per cent and surgical operations by 8 per cent. The expiration of the agreement with Hattula as well as agreements concerning reception centre operations also contributed to the decrease in revenue. Complete outsourcings of social and healthcare services account for a significant proportion of the region’s revenue, which kept the revenue of the region stable.
- **Ostrobothnia: –1.5%.** A complete outsourcing agreement kept the revenue stable in spite of the coronavirus epidemic. The revenue of private clinics decreased by 21 per cent, oral health by 36 per cent and fitness centres by 84 per cent. Revenue from occupational healthcare rose by more than 11 per cent thanks to the growth of the customer base, while revenue from surgical operations increased by 26 per cent due to an increase in surgeries in Seinäjoki.
- **Northern Finland: –11.9%.** The revenue of private clinics decreased by 23 per cent, oral health by 41 per cent, occupational healthcare by 6 per cent and surgical operations by 21 per cent.

Q2 2020: Main points by customer group

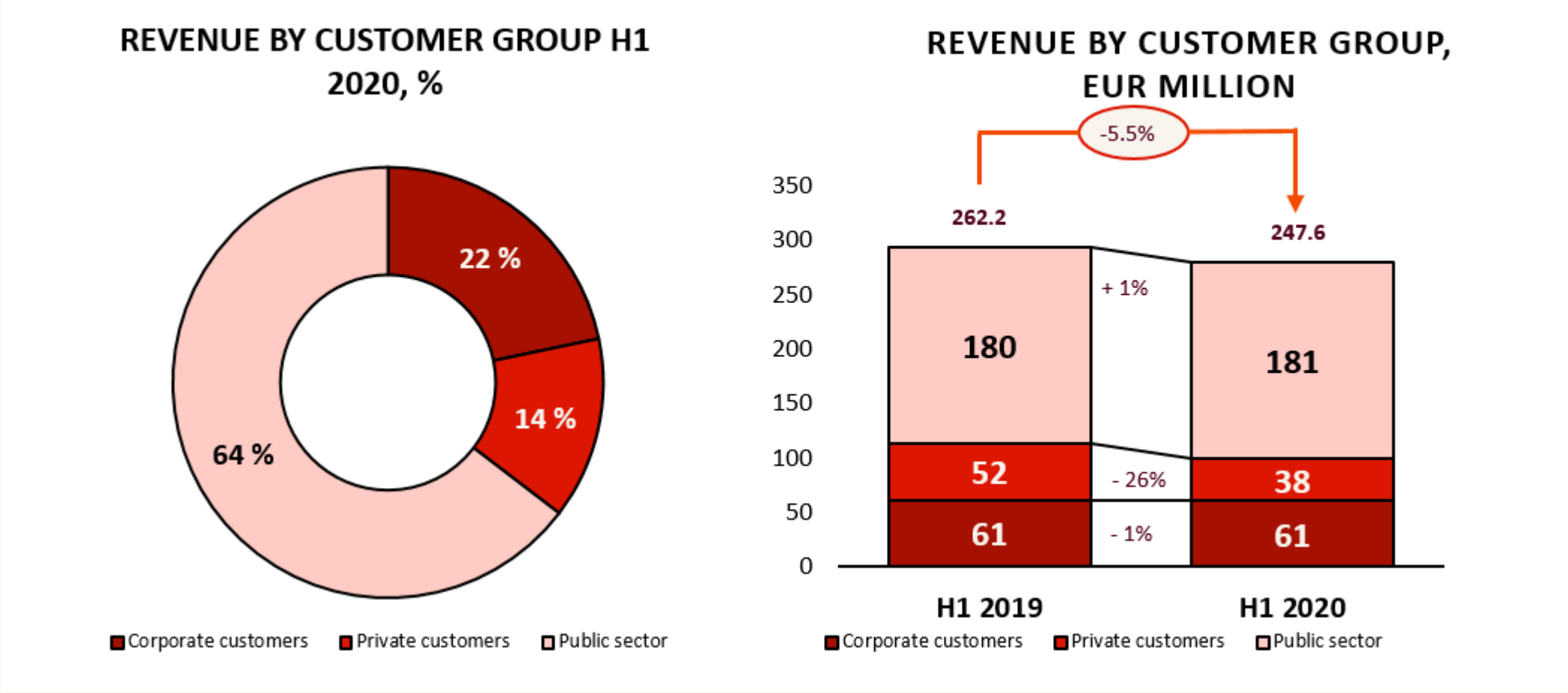
EUR million	4–6/2020	%	4–6/2019	%	change	change %
Corporate customers	27.8	21	30.1	21	-2.2	-7.4
of which insurance company customers	6.6	5	6.7	5	-0.1	-1.4
Private customers	14.7	11	25.4	17	-10.8	-42.4
Public sector	88.1	67	89.9	62	-1.8	-2.0
Intra-Group sales	-15.9		-15.7		-0.2	
Total consolidated revenue	**114.7**	**100**	**129.7**	**100**	**-15.1**	**-11.6**

- **Corporate customers: –7.4%.** Sales to insurance company customers decreased by EUR 0.1 million, or 1.4 per cent. Occupational healthcare invoicing and other corporate invoicing declined as the coronavirus epidemic affected volumes. The demand for staffing services among industry operators was substantially reduced due to the epidemic.
- **Private customers: –42.4%.** Revenue from Forever fitness centres decreased by EUR 3.9 million, or 83 per cent, year-on-year due to the closure of the centres. The demand for private clinic services and oral health services among private customers declined significantly due to the coronavirus-related restrictions and the coronavirus situation in general. The epidemic did not affect the demand for fertility treatments.
- **Public sector: –2.0%.** Complete outsourcings of social and healthcare services represent the majority of the revenue. Revenue remained stable in spite of the coronavirus situation thanks to the steady recognition of revenue from complete outsourcing agreements and annual price adjustments. The expiration of the agreement with Hattula as well as agreements concerning reception centre operations had a negative effect on revenue. Demand increased slightly for public sector occupational health services, responsible doctor services and surgical operations.

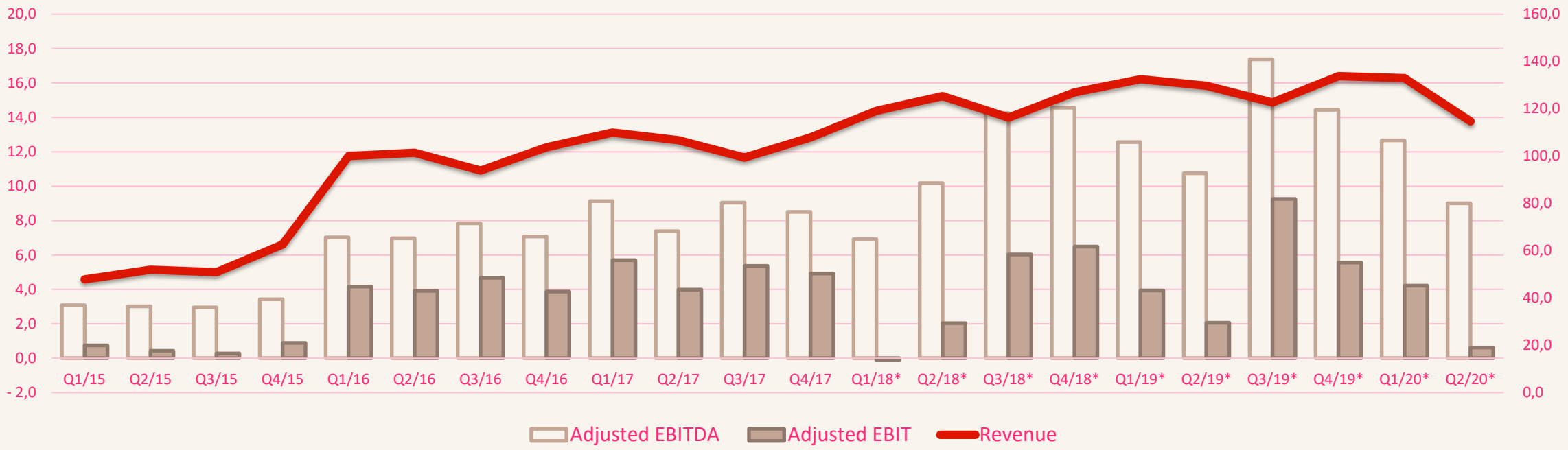
Revenue by customer group Q2 2020



Revenue by customer group H1 2020



Development of profitability, EUR million



* Pihlajalinna adopted the new IFRS 16 Leases standard fully retrospectively on 1 January 2019. Restated comparable financial figures were published on 18 April 2019 for each reporting period in 2018.

Consolidated income statement excluding IFRS 16 effect

EUR million	H1 2020 excluding IFRS 16 effect	IFRS 16 effect	H1 2020 Published, i.e. IFRS 16 compliant figures
Revenue	247.6		247.6
Other operating income	1.4	-0.2	1.3
Materials and services	-96.9		-96.9
Employee benefit expenses	-108.7		-108.7
Other operating expenses	-30.5	7.8	-22.7
Share of profit in associated companies and joint ventures	0.0		0.0
EBITDA	**13.0**	**7.6**	**20.6**
Depreciation, amortisation and impairment	-9.7	-7.5	-17.2
Operating profit (EBIT)	**3.3**	**0.2**	**3.4**
Financial income	0.1	0.0	0.1
Interest expenses on right-of-use assets	-0.4	-0.6	-1.0
Financial expenses	-1.4		-1.4
Profit before taxes	**1.5**	**-0.4**	**1.1**
Income tax	-0.6	0.1	-0.5
Profit for the period	**0.9**	**-0.3**	**0.6**
Total comprehensive income for the period	0.9	-0.3	0.6
Total comprehensive income for the period attributable:			
To the owners of the parent company	1.0	-0.3	0.7
To non-controlling interests	-0.1	-0.1	-0.1
Earnings per share (EPS)	0.04	**-0.01**	0.03

Outlook for 2020

Due to the coronavirus epidemic, Pihlajalinna has temporarily withdrawn its outlook for 2020.

Pihlajalinna estimates that it will issue an updated outlook for 2020 later this year, or when issuing an outlook statement is possible.

The business impact of the coronavirus epidemic (1/2)

- The aim of the restrictions and recommendations issued by the authorities in response to the coronavirus epidemic is to prevent the spread of the epidemic to minimise its negative impacts on people, businesses, society and the realisation of basic rights. The Finnish Government began to gradually lift its coronavirus restrictions and recommendations starting from the beginning of June. The Emergency Powers Act was lifted on 16 June 2020 after it had been in effect for three months.
- Pihlajalinna temporarily closed all of its fitness centres to slow down the spread of the coronavirus epidemic on 20 March 2020. Fitness centres were opened to a limited extent on 4 May 2020. Fitness centre services and opening hours returned to normal on 1 August 2020.
- The coronavirus epidemic and the related restrictions reduced customer flows the most in Pihlajalinna's fitness centres, private clinics and dental clinics. In practice, most oral health operations were suspended due to the recommendations issued by the authorities.
- The personnel adjustment measures were implemented in several stages. The aim was to return service operations to normal as quickly as possible when a recovery in customer flows occurs.
- Pihlajalinna Plc did not pay dividends and made a critical examination of the company's fixed costs (lease negotiations, opening hours or temporary closures of clinics, critical review of investments, a temporary adjustment to the covenants of the financing arrangement)

The business impact of the coronavirus epidemic (2/2)

- Well over half of Pihlajalinna's business volume remained stable in spite of the coronavirus epidemic, as fixed-price invoicing (such as social and healthcare outsourcings) is associated with stable revenue recognition over time.
- The coronavirus epidemic did not have a significant impact on the demand for housing services for the elderly, recruitment services, public surgical operations and fertility treatments.
- The development of occupational health services has been positive and fixed-price services have supported profitability during the exceptional circumstances this past spring and summer.
- The customer flows of insurance company partners improved in the first quarter and we expect that customer flows will also support demand in the autumn season that is now beginning.
- In private clinic operations, demand is expected to normalise when responsible behaviour becomes the new normal and the strategy based on testing, tracing and isolation works effectively.
- In Pihlajalinna's business, it currently appears that the dip in demand has passed for the time being. In June, the demand for services reached — and, in some areas, exceeded — the volumes seen in June in the previous year.
- The number of upper respiratory tract infections has started to rise since mid-July.
- The amount of suspected coronavirus infections and the new confirmed coronavirus infections started to rise since the turn of July/August.

The epidemic impairs the predictability of business

- Although the coronavirus situation in Finland is calm and the number of new infections has remained low, the epidemic continues to overshadow and complicate the predictability of Pihlajalinna's business.
- The financial impacts cannot be fully determined at present, as they depend on the duration and scope of the measures taken to reduce the spread of the virus.
- Globally, the pandemic is not yet over, and a second wave of the pandemic is possible in Finland according to the forecasts of the Finnish Institute for Health and Welfare.

Long-term financial objectives remain the same

- The trends and megatrends that accelerate the growth of Pihlajalinna's business operations have not changed because of the coronavirus epidemic.
- The use of digital services and the structural changes in the production of social services and healthcare may even increase because of the coronavirus epidemic.
- Pihlajalinna's long-term objectives — net debt less than 3 times EBITDA and operating profit over seven per cent of revenue — remain the same.

Schedule of the tender offer

- Mehiläinen Yhtiöt Oy's voluntary cash tender offer for all shares in Pihlajalinna Plc was published on 5 November 2019.
- **The tender offer period will run until 14 September 2020.**
- The European Commission referred the handling of the combination between the companies to the Finnish Competition and Consumer Authority (FCCA) on 28 January 2020.
- Mehiläinen Yhtiöt Oy submitted a formal merger control notification regarding the public tender offer to the FCCA on 10 February 2020.
- The FCCA completed the first phase of its investigation on 12 March 2020. **The FCCA has initiated the second phase of the investigation, which will be completed on 27 August 2020 at the latest, unless the Finnish Market Court grants, upon application, an extension to the FCCA for investigating the case. The maximum statutory extension is a total of 69 working days, of which 23 have now been spent.**
- Based on currently available information, the tender offeror expects to complete the tender offer in the third quarter of 2020.

The Group's operational projects

	WHAT WE PROMISED	WHAT WE DID	WHAT WE PROMISE
MAIN	• Health application and the social and health nurse telephone service introduced in Kuusiolinna and Jämsän Terveys	• Health application and the social and health nurse telephone service introduced in Kuusiolinna. Deployment is currently being prepared in Jämsä.	• Social and health nurse telephone service and health application made available to residents in Jämsän Terveys • Expansions of mobile use of occupational healthcare services
MID	• Consultation channel between professionals implemented in cooperation with the Heart Hospital • Care pathways for customers with long-term illnesses	• Consultation channel between professionals implemented • Care pathways for customers with long-term illnesses	• Development of work ability reporting in occupational healthcare • New service packages in the responsible doctor model • New services for sleep patients
LOW	• Chat function for online booking • Adding an eKanta interface for customers in the health application	• Chat function for online booking deployed • Infection and emergency and on-call services incorporated into booking	• Improvements to the bonus agreement for sports clubs • Pilot of a structured agreement on occupational healthcare • Diversification of payment methods in health application

**Postponed due to the coronavirus epidemic.*

The operating environment

- The unprecedented scale and speed of the changes make it difficult to reliably assess and predict the business impact of the coronavirus epidemic in the social and healthcare service sector.
- The comprehensive assessment of the financial impact of the coronavirus epidemic is also difficult because pent-up demand for social services and healthcare as well as non-urgent care in wellness services is estimated to have accumulated during the spring and summer, and demand is expected to again grow as the situation returns to normal.
- According to a forecast published by the Bank of Finland on 9 June, the Finnish economy will contract by approximately 7 per cent in 2020 due to the coronavirus pandemic. The report states that the forecast involves exceptional uncertainty due to the coronavirus pandemic and that, depending on the development of the situation, the Finnish economy may contract by as little as 5 per cent or as much as 11 per cent this year.
- Also in May, the European Commission published country-specific recommendations aimed at providing economic policy guidance for Member States under the circumstances created by the coronavirus pandemic. The country-specific recommendations for Finland mention challenges related to the resilience of the healthcare system. According to the Commission’s forecast, the fragmentation of service provision and the unequal access to social and primary healthcare services is expected to remain an issue after the coronavirus epidemic subsides.

The operating environment – healthcare and social welfare reform

- The Finnish Government's draft legislation on the reform of healthcare and social services was circulated for consultation on 15 June.
- According to the draft, which is aimed at creating a harmonised social and healthcare service structure, a total of 21 health and social services counties would be established in Finland, with the responsibility for organising social and healthcare services as well as rescue services transferred from municipalities to these counties. The services entrusted to the future health and social services counties would be produced primarily as public services, complemented by the private sector and the third sector.
- The draft proposes that health and social services counties could purchase social and healthcare services from private service providers if doing so is necessary for the provision of legally required and equal services and the appropriate performance of duties.
- The draft estimates that the current complete outsourcing agreements could potentially be invalidated for being in violation of the Constitution of Finland. The draft states that, based on this, the health and social services counties' responsibility for organising social and healthcare services would not be fulfilled in the case of complete outsourcing agreements.

Trends and megatrends that boost business growth

The situation in the public sector

Finland's economic situation has been weak for years and the public sector has become indebted. Especially municipalities have run into difficulties as the costs of care have increased and, at the same time, tax revenue has decreased. Economic difficulties have led to the public sector's willingness to outsource services and seek more efficient ways to produce effective services.

Ageing

In Finland, the population is ageing faster than in any other European country. According to the forecast of Statistics Finland, the number of citizens over 65 will total almost 1.3 million by 2020 and reach 1.5 million by 2030. As those over 65 use the majority of social and healthcare services, the demand for and the costs of the services are expected to increase.

Lifestyle diseases and the distribution of wellbeing

Previously, people fell ill with viral and infectious diseases, for instance, while nowadays the most common diseases among Finns are lifestyle-related. For the working-age population, the most common factors leading to death are tumours, diseases of the circulatory system and use of alcohol. In Finland, health inequalities are relatively large and depend on the level of education, among other factors. In order to curb costs, there needs to be emphasis on prevention and rapid access to care.

Interest in health and wellbeing

On average, Finns smoke less, eat more healthily and exercise more in leisure time. Wellness trends also drive consumer habits, such as nutrition-related choices and the use of health and sports services. The development of lifestyle choices has been fastest among those with higher education.

The increase in the number of voluntary insurance policies

The number of voluntary medical expenses insurance policies has clearly increased in recent years. The reasons behind this include concern about the availability of public services and the need to ensure rapid access to care. At the beginning of 2018, nearly 1.2 million Finns had a voluntary medical expenses insurance policy. We assume that the demand for voluntary insurance policies will continue to grow at least until 2020.

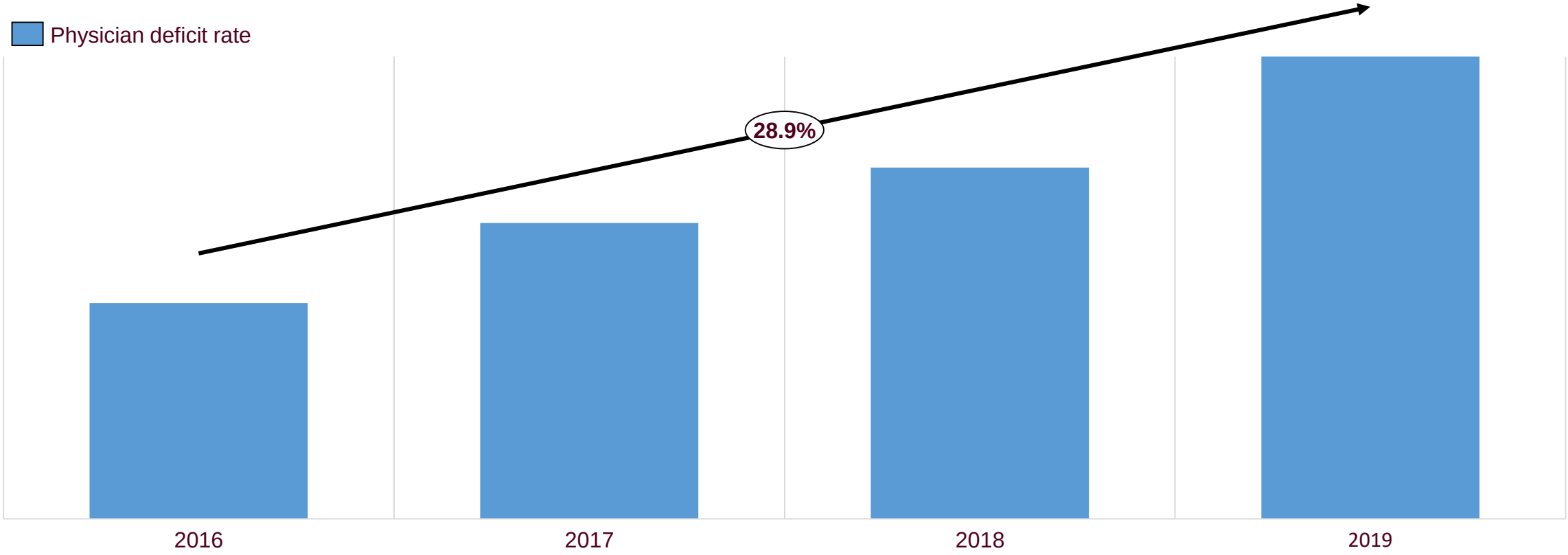
Individuality, freedom of choice and expression of will

People expect healthcare services to be more effective and of higher quality. The need for individual solutions has increased and technology has strengthened this trend. The majority of Finns want to increase freedom of choice in social and healthcare services. An increasing number of people have sought to ensure their freedom of choice with a medical expenses insurance policy, for instance.

Problems with the shortage of health centre physicians has exacerbated considerably over the last four years

Physician deficit indicates the percentage of unfilled physician positions of all physician positions – the physician positions are vacant but have not been filled

Physician deficit rate in Finnish health centres 2016–2019

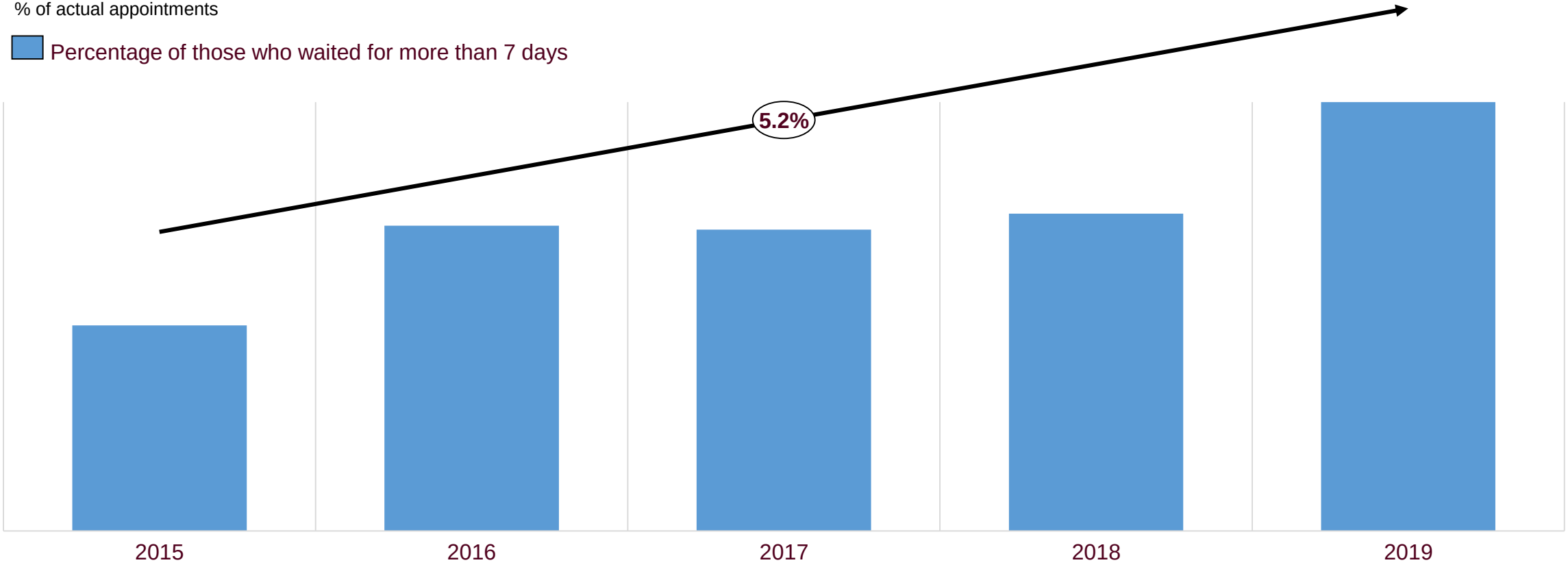


Sources: Finnish Medical Association, VALOR analysis

Waiting times for non-urgent appointments with physicians in primary care are clearly getting longer – the aim of the Government's planned 7-day care guarantee is to make a stop to this development

Waiting time to a non-urgent physician's appointment in outpatient primary care over 7 days from the assessment of the need for care in Finland

% of actual appointments

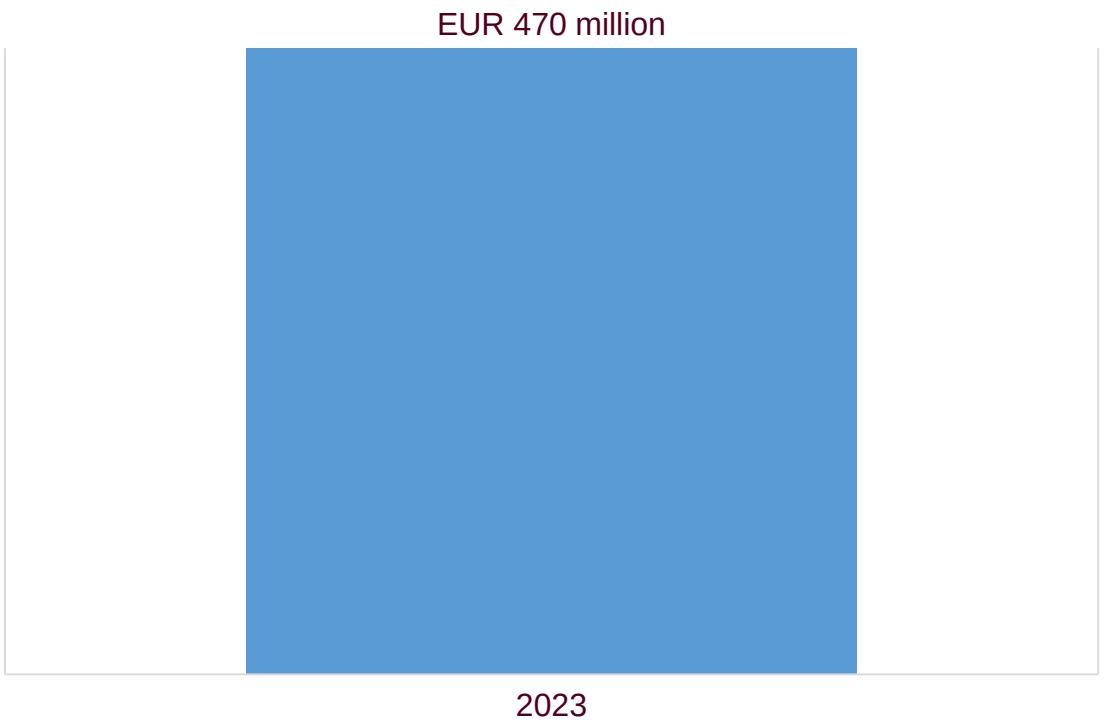


Sources: Sotkanet, VALOR analysis

The implementation of a nursing ratio of 0.7 in elderly care and 7-day care guarantee would increase the annual social and healthcare service expenses of municipalities by up to EUR 680 million

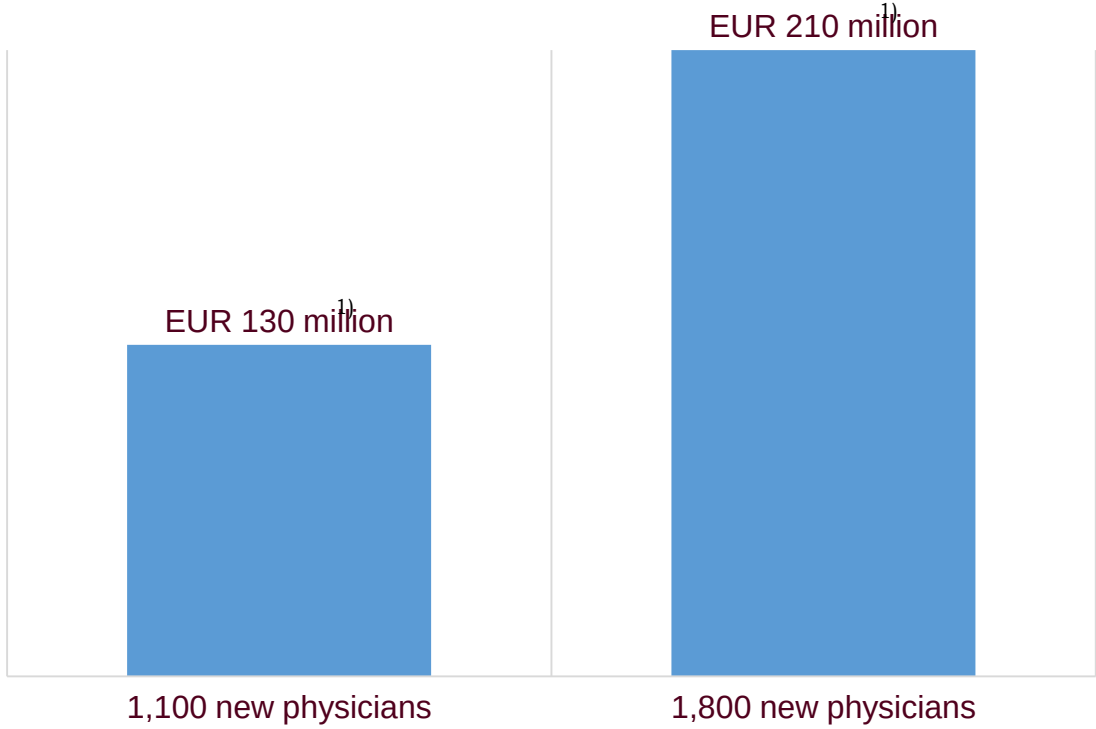
The nursing ratio of 0.7 in elderly care is estimated to cause additional costs of EUR 470 million to municipalities in 2023

EUR million



The 7-day care guarantee in primary care will require 1,110–1,800 new health centre physicians in Finland

Estimate of the annual salary costs of new physicians incurred by municipalities, EUR million



1) The average salary of a health centre physician is estimated at EUR 6,550/month, social security expenses at 40% on top of salary and holiday pay as 0.5 months' salary – the calculated cost of one physician is thus approximately EUR 115,000/year.

Sources: Association of Finnish Local and Regional Authorities, Finnish Medical Association, VALOR analysis

Cooperation with Pihlajalinna has been very successful for partner municipalities

1. Stopping the growth in municipalities' social and healthcare service expenses and even a decrease in expenses
2. Significant dividends and revenue recognition through sales of shares have balanced the finances of municipalities
3. Systematic improvement of municipalities' annual margins following the cooperation illustrates the development of municipal finances
4. Very strong customer satisfaction across all joint ventures – Pihlajalinna focuses on customer satisfaction
5. Extremely strong quality of services and extensive availability – Pihlajalinna has succeeded in strengthening local services and the availability of services

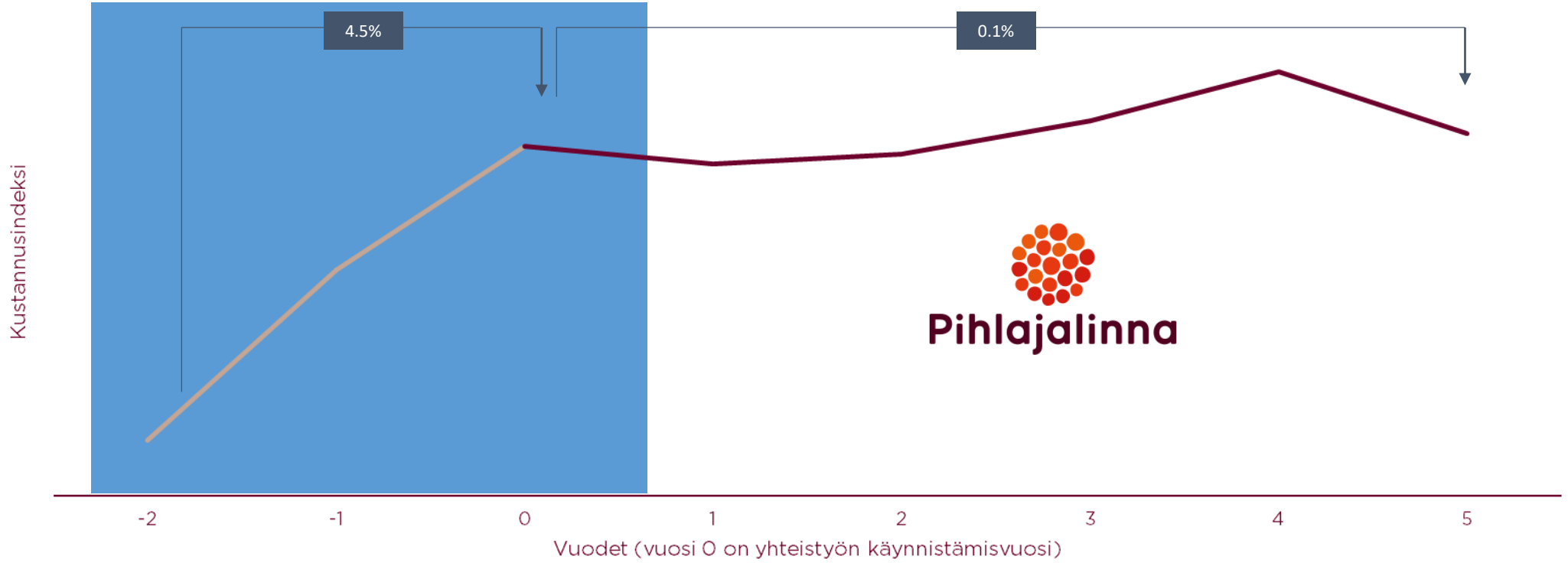
Pihlajalinna

Growth in the net operating costs of social and healthcare services of partner municipalities has slowed down considerably after the start of cooperation

Average development of the net operating costs[1] of social and healthcare services in Pihlajalinna's partner municipalities before and after the start of cooperation

Three years before cooperation and five years after the start of cooperation, net operating cost of social and healthcare services index and CAGR[2]

Social and healthcare services were not yet outsourced to the joint venture



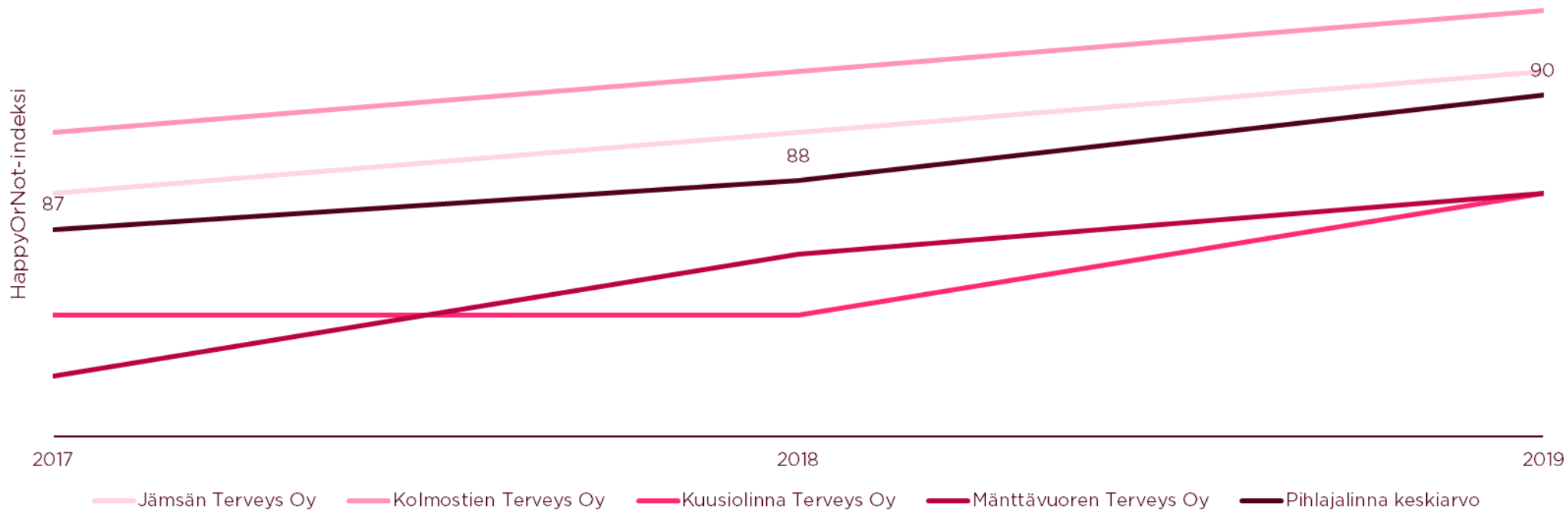
1) FIHW's reporting of net operating costs of social and healthcare services was amended in 2015, when early childhood education was omitted from net operating costs of social and healthcare services. Therefore, the costs of early childhood education have also been omitted from the net operating costs of social and healthcare services prior to 2015.
2) CAGR = compound annual growth rate

Sources: Sotkanet, VALOR analysis

The customer satisfaction of Pihlajalinna's joint ventures is at an excellent level, 90/100, and it has been successfully improved by 1.3% each year

Pihlajalinna invests in the continuous development of customer satisfaction and facilitates continuous measurement and monitoring of customer satisfaction for municipalities.

Results of Pihlajalinna's joint ventures' HappyOrNot indices in 2017–2019



Sources: Pihlajalinna, VALOR analysis

Maintaining the control of social and healthcare services is the biggest benefit of a Pihlajalinna joint venture to a municipality compared with complete or partial outsourcing

Main differences between the joint venture model, complete outsourcing and partial outsourcing

Pihlajalinna joint venture	Complete outsourcing	Partial outsourcing
1. **Control** is strongly retained by the municipality – the joint venture has integrated control processes for the municipality 2. **The development and integration of services** is natural – the joint venture model guides the service provider to long-term development 3. **The economic outcome** is comprised of net social and healthcare service costs and any dividends and income from share sales – a well-functioning outsourcing is visible in the result of the joint venture – the municipality automatically gains its share of the success through dividend and increase in share price	1. **Control** is fully based on contractual guidance – the municipality has very limited means of control 2. **The development and integration of services** is natural – complete outsourcing guides the service provider to minimising its costs 3. **The economic outcome** is directly visible in net social and healthcare service costs – financially, the municipality cannot benefit from the increased efficiency of social and healthcare services more than the price agreed upon – determining the correct price involves a major risk in concluding the agreement	1. **Control** is fully based on contractual guidance – the municipality has very limited means of control 2. **The development and integration of services** is not comprehensive – in partial outsourcing, partial optimisation of service production is inevitable 3. **The economic outcome** is directly visible in net social and healthcare service costs – financially, the municipality cannot benefit from the increased efficiency of social and healthcare services more than the price agreed upon – determining the correct price involves a major risk in concluding the agreement

Pihlajalinna’s financial reporting in 2020

- Interim report January–September: Wednesday, 4 November 2020

Thank you!