Company	Nordecon AS
Type	Company Release
Category	Half-yearly financial report
Disclosure time	10 Aug 2017 08:00:00 +0300

Attachments:
- Nordecon_investor presentation Q2_2017.pdf (http://oam.fi.ee/en/download?id=3120)
- Nordecon_Aruanne_2Q_2017.pdf (http://oam.fi.ee/en/download?id=3121)
- Nordecon_investor presentation Q2_2017.pdf (http://oam.fi.ee/en/download?id=3122)
- Nordecon_interim_report_Q2_2017.pdf (http://oam.fi.ee/en/download?id=3123)

Currency

Title 2017 II quarter and 6 months consolidated interim report (unaudited)

This announcement includes Nordecon AS's consolidated financial statements for the second quarter and six months of 2017 (unaudited), overview of the key events influencing the period's financial result, outlook for the market and description of the main risks.

Interim report is attached to the announcement and is also published on NASDAQ Tallinn and Nordecon's web page (http://www.nordecon.com/for-investor/financial-reports/interim-reports).

Period's investor presentation are attached to the announcement and are also published on Nordecon's web page (http://www.nordecon.com/for-investor/investor-presentations).

Condensed consolidated interim statement of financial position

EUR '000	30 June 2017	31 December 2016
ASSETS		
Current assets		
Cash and cash equivalents	8,101	9,786
Trade and other receivables	37,946	21,055
Prepayments	1,837	1,644
Inventories	29,300	22,992
Total current assets	77,184	55,477
Non-current assets		

Investments in equity-accounted investees	1,686	1,640
Other investments	26	26
Trade and other receivables	11,041	10,816
Investment property	4,929	4,929
Property plant and equipment	12,221	11,111
Intangible assets	14,644	14,623
Total non-current assets	44,547	43,145
TOTAL ASSETS	121,731	98,622
LIABILITIES		
Current liabilities		
Borrowings	19,329	6,297
Trade payables	43,151	29,811
Other payables	5,838	5,389
Deferred income	6,767	4,128
Provisions	589	753
Total current liabilities	75,674	46,378
Non-current liabilities		
Borrowings	9,626	13,102
Trade payables	96	98
Other payables	119	117
Provisions	948	881
Total non-current liabilities	10,789	14,198
TOTAL LIABILITIES	86,463	60,576
EQUITY		
Share capital	19,720	19,720
Own (treasury) shares	-1,550	-1,550
Share premium	564	564
Statutory capital reserve	2,554	2,554
Translation reserve	1,675	1,549
Retained earnings	10,817	13,091
Total equity attributable to owners of the parent	33,780	35,928
Non-controlling interests	1,488	2,118
TOTAL EQUITY	35,268	38,046
TOTAL LIABILITIES AND EQUITY	121,731	98,622

Condensed consolidated interim statement of comprehensive income

EUR ‘000	H1 2017	Q2 2017	H1 2016	Q2 2016	2016
Revenue	103,501	61,897	73,829	46,098	183,329
Cost of sales	-100,362	-59,382	-69,676	-43,098	-172,350
Gross profit	3,139	2,515	4,153	3,000	10,979

Marketing and distribution expenses	-334	-221	-218	-115	-413
Administrative expenses	-3,078	-1,621	-2,782	-1,490	-6,106
Other operating income	54	12	97	56	362
Other operating expenses	-107	-19	-460	-448	-614
Operating loss/profit	-326	666	790	1,003	4,208
Finance income	204	101	235	111	463
Finance costs	-428	-259	-466	-27	-1,088
Net finance costs/income	-224	-158	-231	84	-625
Share of profit of equity-accounted investees	193	146	484	365	609
Loss/profit before income tax	-357	654	1,043	1,452	4,192
Income tax expense	-540	-465	-245	-245	-259
Loss/profit for the period	-897	189	798	1,207	3,933
Other comprehensive income					
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translating foreign operations	126	75	112	-176	191
Total other comprehensive income/expense	126	75	112	-176	191
TOTAL COMPREHENSIVE EXPENSE/INCOME	-771	264	910	1,031	4,124
Loss/profit attributable to:					
- Owners of the parent	-890	197	426	996	3,044
- Non-controlling interests	-7	-8	372	211	889
Loss/profit for the period	-897	189	798	1,207	3,933
Total comprehensive expense/income attributable to:					
- Owners of the parent	-764	272	538	820	3,235
- Non-controlling interests	-7	-8	372	211	889
Total comprehensive expense/income for the period	-771	264	910	1,031	4,124
Earnings per share attributable to owners of the parent:					
Basic earnings per share (EUR)	-0.03	0.01	0.01	0.03	0.10
Diluted earnings per share (EUR)	-0.03	0.01	0.01	0.03	0.10

Condensed consolidated interim statement of cash flows

EUR ‘000	H1 2017	H1 2016
Cash flows from operating activities		
Cash receipts from customers1	111,059	74,740
Cash paid to suppliers2	-102,900	-66,264
VAT paid	-2,029	-2,480
Cash paid to and for employees	-10,997	-9,831
Income tax paid	-200	-170
Net cash used in operating activities	-5,067	-4,005
Cash flows from investing activities		
Paid on acquisition of property, plant and equipment	-147	-103
Paid on acquisition of intangible assets	-3	-18
Proceeds from sale of property, plant and equipment	0	28
Disposal of a subsidiary	0	6
Loans provided	-34	-35
Repayment of loans provided	20	31
Dividends received	147	153
Interest received	27	0
Net cash from investing activities	10	62
Cash flows from financing activities		
Proceeds from loans received	7,399	5,703
Repayment of loans received	-496	-470
Finance lease principal paid	-1,149	-894
Interest paid	-376	-321
Dividends paid	-2,007	-1,068
Net cash from financing activities	3,371	2,950
Net cash flow	-1,686	-993
Cash and cash equivalents at beginning of period	9,786	6,332
Effect of movements in foreign exchange rates	1	-3
Decrease in cash and cash equivalents	-1,686	-993
Cash and cash equivalents at end of period	8,101	5,336

1 Line item Cash receipts from customers includes VAT paid by customers.

2 Line item Cash paid to suppliers includes VAT paid.

Financial review

Financial performance

Nordecon Group ended the first half of 2017 with a gross profit of 3,139 thousand euros (H1 2016: 4,153 thousand euros) and a gross margin of 3% (H1 2016: 5.6%). The gross margin weakened year on year, mostly due to growth in the input prices for materials and labour. Our performance is increasingly influenced by the insufficient availability of skilled labour and the resulting shortage of subcontractors in the building construction segment where activity (the number of buildings under construction) is currently high for the Estonian market. This allows subcontractors to raise their prices, which puts pressure on general contractors’ profit margins. We have drawn attention to the fact that market changes are undermining profitability since the second half of 2016 already. We earned the period’s gross profit from building construction even though the gross margin of our Buildings segment dropped to 4.2% (H1 2016: 9.2%). The segment’s margin decrease is partly attributable to the loss of the Swedish subsidiary, which incurred some costs in the final stage of its first building construction contract which could not be foreseen on entering the new market. Although the performance of our Infrastructure segment improved, its gross margin rising from -5.3% for the comparative period to 0.1% for the reporting period, it cannot be considered satisfactory.

Administrative expenses for the first half of 2017 totalled 3,078 thousand euros. Compared with a year earlier, administrative expenses grew somewhat (H1 2016: 2,782 thousand euros). Despite structural streamlining and sustained investment in foreign markets, which inevitably increase administrative expenses in the start-up phase, our cost-control measures continued to produce good results and we were able to keep administrative expenses below the target ceiling of 4% of revenue. The ratio of administrative expenses to revenue (12 months rolling) was 3.0% (H1 2016: 3.7%).

Operating loss for the first half of 2017 amounted to 326 thousand euros (H1 2016: operating profit of 790 thousand euros). EBITDA was positive at 664 thousand euros (H1 2016: positive at 1,714 thousand euros).

The Group’s exchange losses from adverse movements in the euro/Ukrainian hryvnia exchange rate were similar to a year earlier. In the first half of 2017, the Ukrainian currency weakened against the euro by around 4.6%, which meant that Group entities whose functional currency is the hryvnia had to restate their euro-denominated liabilities. Exchange losses reported in finance costs totalled 121 thousand euros (H1 2016: 115 thousand euros). The same movements in the exchange rate increased the translation reserve in equity by 126 thousand euros (H1 2016: 112 thousand euros) and the net effect of exchange differences on the Group’s net assets was a gain of 5 thousand euros (H1 2016: a loss of 3 thousand euros).

The Group’s net loss amounted to 897 thousand euros (H1 2016: a net profit of 798 thousand euros), of which net loss attributable to owners of the parent, Nordecon AS, was 890 thousand euros (H1 2016: net profit attributable to owners of the parent amounted to 462 thousand euros).

Cash flows

In the first half of 2017, operating activities produced a net cash outflow of 5,067 thousand euros (H1 2016: a net outflow of 4,005 thousand euros). Although cash receipts from customers exceeded cash paid to suppliers, operating cash flow proved negative, mostly due to VAT paid and payments to and for employees. Negative operating cash flow is typical of the first half-year and stems from the cyclical nature of the construction business. Operating cash flow is also strongly affected by the fact that neither public nor private sector customers are required to make advance payments while the Group has to make prepayments to subcontractors, materials suppliers, etc. In addition, cash inflow is reduced by retentions which extend from 5 to 10% of the contract price and are released by customers at the end of the construction period only.

Investing activities produced a net cash inflow of 10 thousand euros (H1 2016: an inflow of 62 thousand euros). The largest items were payments made for property, plant and equipment of 147 thousand euros (H1 2016: 103 thousand euros) and dividends received of 147 thousand euros (H1 2016: 153 thousand euros).

Financing activities generated a net cash inflow of 3,371 thousand euros (H1 2016: an inflow of 2,950 thousand euros). Our financing cash flow is strongly influenced by loan and finance lease transactions. Proceeds from loans received amounted to 7,399 thousand euros, consisting of the use of overdraft facilities and development loans (H1 2016: 5,703 thousand euros). Loan repayments totalled 496 thousand euros (H1 2016: 470 thousand euros) consisting of scheduled repayments of long-term investment and development loans.

Compared with a year earlier, there was slight growth in finance lease payments which totalled 1,149 thousand euros (H1 2016: 894 thousand euros). The rise in finance lease payments is attributable to large-scale investments in road construction equipment (including the acquisition of a new asphalt concrete plant) made in the second quarter of 2016. Dividends paid amounted to 2,007 thousand euros (H1 2016: 1,068 thousand euros).

At 30 June 2017, the Group’s cash and cash equivalents totalled 8,102 thousand euros (30 June 2016: 5,336 thousand euros). Management’s commentary on liquidity risks is presented in the chapter Description of the main risks.

Key financial figures and ratios

Figure/ratio for the period	H1 2017	H1 2016	H1 2015	2016
Revenue (EUR ‘000)	103,501	73,829	69,211	183,329
Revenue change	40%	7%	3%	26.0%
Net loss/profit (EUR ‘000)	-897	798	243	3,933
Net loss/profit attributable to owners of the parent (EUR ‘000)	-890	426	397	3,044
Weighted average number of shares	30,756,728	30,756,728	30,756,728	30,756,728
Earnings per share (EUR)	-0.03	0.01	0.01	0.10

Administrative expenses to revenue	3.0%	3.8%	3.2%	3.3%
Administrative expenses to revenue (rolling)	3.0%	3.7%	3.3%	3.3%
EBITDA (EUR ‘000)	664	1,714	1,732	6,017
EBITDA margin	0.6%	2.3%	2.5%	3.3%
Gross margin	3.0%	5.6%	4.4%	6.0%
Operating margin	-0.3%	1.1%	1.2%	2.3%
Operating margin excluding gain on asset sales	-0.3%	1.0%	0.8%	2.2%
Net margin	-0.9%	1.1%	0.4%	2.1%
Return on invested capital	-0.1%	2.3%	1.3%	8.5%
Return on equity	-2.4%	2.2%	0.7%	10.6%
Equity ratio	29.0%	34.5%	33.8%	38.6%
Return on assets	-0.8%	0.8%	0.2%	4.2%
Gearing	32.5%	33.2%	39.6%	16.7%
Current ratio	1.02	1.05	1.03	1.20

As at	30 June 2017	30 June 2016	30 June 2015	31 Dec 2015
Order book (EUR ‘000)	130,601	131,363	70,837	131,335

Revenue change = (revenue for the reporting period / revenue for the previous period) – 1 * 100
Earnings per share (EPS) = net profit or loss attributable to owners of the parent / weighted average number of shares outstanding
Administrative expenses to revenue = (administrative expenses / revenue) * 100
Administrative expenses to revenue (rolling) = (past four quarters’ administrative expenses / past four quarters’ revenue) * 100
EBITDA = operating profit or loss + depreciation and amortisation + impairment losses on goodwill
EBITDA margin = (EBITDA / revenue) * 100
Gross margin = (gross profit or loss / revenue) * 100
Operating margin excluding gain on asset sales = ((operating profit or loss – gain on sales of non-current assets – gain on sales of real estate) / revenue) * 100
Net margin = (net profit or loss for the period / revenue) * 100
Return on invested capital = ((profit or loss before tax + interest expense) / the period’s average (interest-bearing liabilities + equity)) * 100
Return on equity = (net profit or loss for the period / the period’s average total equity) * 100
Equity ratio = (total equity / total liabilities and equity) * 100
Return on assets = (net profit or loss for the period / the period’s average total assets) * 100
Gearing = ((interest-bearing liabilities – cash and cash equivalents) / (interest-bearing liabilities + equity)) * 100

Operating margin = (operating profit or loss / revenue) * 100	Current ratio = total current assets / total current liabilities

Performance by geographical market

In the first half of 2017, Nordecon earned around 7% of its revenue outside Estonia, the figure remaining stable compared with the same period last year. In terms of foreign markets, the strongest revenue contributor was Sweden where we completed two apartment buildings and continued the design and construction of a third, an 8-floor apartment building in Stockholm. The share of our Ukrainian revenues decreased year on year because our business volumes in the Ukrainian market decreased somewhat: in the first half-year we worked mainly on one large building construction project. Our Finnish revenues resulted from concrete works in the building construction segment.

	H1 2017	H1 2016	H1 2015	2016
Estonia	93%	93%	96%	93%
Sweden	4%	4%	0%	4%
Finland	2%	1%	1%	1%
Ukraine	1%	2%	3%	4%

Geographical diversification of the revenue base is a consciously deployed strategy by which we mitigate the risks resulting from excessive reliance on one market. However, conditions in some of our selected foreign markets are also volatile and have a strong impact on our current results. Increasing the contribution of foreign markets is one of Nordecon’s strategic targets. Our vision of the Group’s foreign operations is described in the chapter Outlooks of the Group’s geographical markets.

Performance by business line

Segment revenues

We strive to maintain the revenues of our operating segments (Buildings and Infrastructure) in balance as this helps disperse risks and provides better opportunities for continuing construction operations in more challenging circumstances when the operating volumes of a sub-segment fall sharply.

Nordecon’s revenue for the first half of 2017 amounted to 103,501 thousand euros, a roughly 40% increase on the 73,829 thousand euros generated in the first half of 2016. Although revenue increased in both the Buildings and the Infrastructure segment, the main growth driver was the Buildings segment where growth was underpinned by a rise in contracts secured from the private sector. The downturn in infrastructure construction, which is affecting the whole Estonian construction market (and the Group's chosen strategy) has also left its mark on our revenue structure. In the first half of 2017, our Buildings segment and Infrastructure segment generated revenue of 84,582 thousand euros and 17,860 thousand euros respectively. The corresponding figures for the first half of 2016 were 58,317 thousand euros and 14,269 thousand euros (see note 8). Our order book has a similar structure: at the end of the first half-year 72% of contracts secured but not yet performed was attributable to the Buildings segment (H1 2016: 71%).

Operating segments*	H1 2017	H1 2016	H1 2015	2016
Buildings	81%	79%	68%	73%
Infrastructure	19%	21%	32%	27%

* In the Directors' report, projects have been allocated to operating segments based on their nature (i.e., building or infrastructure construction). In the segment reporting presented in the financial statements, allocation is based on the subsidiaries' main field of activity (as required by IFRS 8 Operating Segments). In the financial statements, the results of a subsidiary that is primarily engaged in infrastructure construction are presented in the Infrastructure segment. In the Directors' report, the revenues of such a subsidiary are presented based on their nature. The differences between the two reports are not significant because in general Group entities specialise in specific areas except for the subsidiary Nordecon Betoon OÜ that is involved in both building and infrastructure construction. The figures for the parent company are allocated in both parts of the interim report based on the nature of the work.

Sub-segment revenues

In the Buildings segment, the strongest revenue contributors were the apartment buildings and the public buildings sub-segments where the Group earned most of its revenue as a general contractor. In Estonia, a substantial share of our apartment building projects is located in Tallinn. In the first half-year, the largest projects included the Meerhof 2.0 apartment building complex at Pirita tee 20a and apartment buildings at Kopli 4a, Kopli 6 and Virbi 10. The contribution of foreign markets also sustained growth. In Ukraine, we continued to build a residential quarter in the city of Brovary in the Kiev region. In Sweden, we completed two apartment buildings and continued the design and construction of a third, an 8-floor apartment building in Stockholm.

We continue to build our own housing development projects (reported in the apartment buildings sub-segment) in Tartu and Tallinn. In the Tammelinn project in Tartu, we completed phase 5, which consists of a four-floor building with 24 apartments, and continued work on phase 6 (www.tammelinn.ee). We also completed the fifth and last terraced house in our Magasini 29 development project in

Tallinn (www.magasini.ee). In the Hane street project in Tallinn, we continued the construction of two apartment buildings with a total of 30 apartments and the preliminary sale of the apartments. The period’s revenue from development operations amounted to 1,102 thousand euros (H1 2016: 1,882 thousand euros). In view of the projects’ completion schedule we expect a rise in development revenue in the second half-year, although this remains dependent on the overall market situation. In carrying out our development activities, we monitor closely potential risks in the housing development market which stem from rapid growth in the supply of new housing as well as growth in input prices.

The key factor which has influenced the results of the public buildings sub-segment is growth in the state’s investment in national defence. During the period, we completed and delivered to the customers the Lintsi warehouse complex, a depot at the Tapa military base, and Ugala Theatre in Viljandi. We continued the construction of infrastructure for armoured vehicles, a canteen and a barracks at the Tapa military base.

The revenues of the commercial buildings sub-segment grew considerably compared with the first half of 2016. We completed the renovation of the machinery hall of the historical Luther furniture factory into a modern office building and continued to build the office and commercial complex Viimsi Äritare and an office building at Lõõtsa 12 in Ülemiste City. Based on our order book, we expect the commercial buildings sub-segment to post year-on-year revenue growth.

The revenues of the industrial and warehouse facilities sub-segment decreased year on year. The period’s largest projects were the construction of Harmet’s production and warehouse facilities at Kumna, near Tallinn, a co-generation plant at Kehra, and the Metsä Wood plywood factory in Pärnu, and the reconstruction of phase 3 (fourth floor) of the pig fattening unit of Rakvere Farmid AS (EKSEKO).

Revenue breakdown in the Buildings segment	H1 2017	H1 2016	H1 2015	2016
Apartment buildings	31%	31%	18%	34%
Public buildings	26%	35%	13%	30%
Commercial buildings	25%	15%	59%	16%
Industrial and warehouse facilities	18%	19%	10%	20%

For a long time, the main revenue source in the Infrastructure segment has been road construction and in the first half of 2017 its revenue contribution grew even further. We expect road construction to remain the most important sub-segment in the Infrastructure segment also in 2017. In contrast to two previous years, when most of the sub-segment’s revenues resulted from small or medium-sized reconstruction or rehabilitation projects, this year we have three large contracts: the construction of a 2+1 road (a road with passing lanes) on the Ääsmäe-Kohatu section of the Tallinn-Pärnu-Ikla road which was secured at the end of 2016, the reconstruction of the Haabersti intersection in Tallinn and the construction of a 2+1 road on the Valmaotsa–Kärevere section of the

Tallinn–Tartu–Võru–Luhamaa road which were secured in 2017. We continued to render road maintenance services in Järva and Hiiu counties and the Keila and Kose maintenance areas in Harju county. A substantial share of the period's revenues also resulted from forest road improvement services provided to the State Forest Management Centre.

The contracts secured by the environmental engineering and other engineering (utility network construction) sub-segments are small and growth of the sub-segments' revenues is unlikely. At the date of release of this report, there is no sign of any major hydraulic engineering projects to be announced and demand for other complex engineering work also tends to be irregular.

Revenue breakdown in the Infrastructure segment	H1 2017	H1 2016	H1 2015	2016
Road construction and maintenance	84%	82%	82%	86%
Other engineering	12%	14%	10%	9%
Environmental engineering	4%	4%	7%	5%
Specialist engineering (including hydraulic engineering)	0%	0%	1%	0%

Order book

At 30 June 2017, the Group's order book (backlog of contracts signed but not yet performed) stood at 130,601 thousand euros, roughly at the same level as a year ago. In the second quarter, we secured new contracts of 50,010 thousand euros.

As at	30 June 2017	30 June 2016	30 June 2015	31 Dec 2016
Order book (EUR '000)	130,601	131,363	70,837	131,335

At the reporting date, contracts secured by the Buildings segment and the Infrastructure segment accounted for 72% and 28% of the Group's order book respectively, the proportions remaining stable compared with a year earlier (30 June 2016: 71% and 29% respectively).

Compared with the first half of 2016, the order book of the Buildings segment has grown by around 2%. The order books of the commercial buildings and the industrial and warehouse facilities sub-segments have increased substantially, the first one primarily through contracts for the construction of multi-storey car parks at Sepise 8 and Lõõtsa 11 in Ülemiste City in Tallinn and the Martens house in Pärnu, and the design and construction of a 14-floor commercial and residential building at Mustamäe tee 3 in the WoHo quarter in Tallinn. In the first quarter of 2017, we secured a contract for building a plywood factory for Metsä Wood in Pärnu, which increased the order book of the industrial and warehouse facilities sub-segment. Orders placed by the agricultural sector have increased as well. The order books of the public buildings and the apartment buildings sub-segments have decreased but the order book of the apartment buildings sub-segment is still the second-largest after that of the commercial buildings sub-segment. The order book of the apartment buildings sub-segment is influenced by large contracts secured in 2016, including those for the construction of the Meerhof 2.0 apartment building complex at Pirita tee 20a, and apartment buildings at Virbi 10 and Sõjakooli 12 in Tallinn, and five apartment buildings in the city of Brovary in the Kiev region in Ukraine. At the beginning of 2017, we also secured a contract for building an eight-floor apartment building (Väsby Terrass) in Sweden. The largest contracts in the order book of the public buildings sub-segment are those for the construction of infrastructure for armoured vehicles, a canteen and a barracks for the Tapa military base.

Compared with a year ago, the order book of the Infrastructure segment has decreased by around 6%. 83% of the segment’s order book is made up of work awarded to the road construction and maintenance sub-segment whose order book has also decreased slightly compared with a year earlier. The largest projects in the road construction order book are the contracts signed in 2017 for the reconstruction of the Haabersti intersection in Tallinn and the construction of a 2+1 road (a road with passing lanes) on the Valmaotsa–Kärevere section of the Tallinn–Tartu–Võru–Luhamaa road. We continue to provide road maintenance services in four road maintenance areas: Keila, Järva, Hiiu, and Kose. The order book of the environmental engineering sub-segment has been supplemented with a contract for the construction of a water treatment plant in Kiev, Ukraine. According to our projections, in 2017 the volume of public investment will not increase substantially compared with 2016. Nevertheless, based on the order book as at the reporting date as well as the contracts signed after the reporting period we hope that in 2017 revenue generated by the Infrastructure segment will grow slightly compared to 2016 (for further information, see the Business risks section of the chapter Description of the main risks).

Based on the size of the Group’s order book and known developments in our selected markets, we forecast year-on-year revenue growth for 2017. In an environment of exceptionally stiff competition, we try to avoid taking unjustified risks whose realisation in the contract performance phase would have an adverse impact on the Group’s results. Despite this, where suitable opportunities arise, we strive to combat market-triggered margin compression with certain portfolio growth. Our preferred policy is to keep fixed costs under control and monitor closely market developments.

Between the reporting date (30 June 2017) and the date of release of this report, Group companies have secured additional construction contracts in the region of 31,466 thousand euros.

People

Employees and personnel expenses

In the first half of 2017, the Group (the parent and the subsidiaries) employed, on average, 737 people including 423 engineers and technical personnel (ETP). The number of employees, particularly the ETP staff, has increased year on year by around 10% in connection with growth in the Group’s business operations.

Average number of the Group’s employees (at the parent and the subsidiaries)

	H1 2017	H1 2016	H1 2015	2016
ETP	423	365	351	381
Workers	314	305	342	303
Total average	737	670	693	684

Our personnel expenses for the first half of 2017 including all taxes totalled 9,945 thousand euros (H1 2016: 9,631 thousand euros), a roughly 3% increase year on year. The growth in personnel expenses is mainly attributable to a larger headcount.

The service fees of the members of the council of Nordecon AS for the first half of 2017 amounted to 73 thousand euros and associated social security charges totalled 24 thousand euros (H1 2016: 69 thousand euros and 23 thousand euros respectively).

The service fees of the members of the board of Nordecon AS amounted to 199 thousand euros and associated social security charges totalled 66 thousand euros (H1 2016: 178 thousand euros and 59 thousand euros respectively).

Labour productivity and labour cost efficiency

We measure the efficiency of our operating activities using the following productivity and efficiency indicators, which are based on the number of employees and personnel expenses incurred:

	H1 2017	H1 2016	H1 2015	2016
Nominal labour productivity (rolling), (EUR ‘000)	296.5	222.9	225.8	268.0
Change against the comparative period	33.0%	-1.3%	0.7%	27%
Nominal labour cost efficiency (rolling), (EUR)	10.2	7.8	8.4	9.0
Change against the comparative period	30.3%	-6.8%	5.8%	12.8%

Nominal labour productivity (rolling) = (past four quarters' revenue) / (past four quarters' average number of employees)
Nominal labour cost efficiency (rolling) = (past four quarters' revenue) / (past four quarters' personnel expenses)

The Group's nominal labour productivity and labour cost efficiency increased year on year, mainly through revenue growth (see the section Employees and personnel expenses).

Description of the main risks

Business risks

The main factors which affect the Group's business volumes and profit margins are competition in the construction market and changes in the demand for construction services.

Competition continues to be stiff in all segments of the construction market and in 2017 public investment is not expected to grow substantially compared with 2016. Thus, builders' bid prices are under strong competitive pressure in a situation where the prices of construction inputs have been trending upwards moderately but consistently for several quarters. Bidders include not only well-known general contractors but also former subcontractors. This is mainly attributable to the state and local governments' policy to keep the qualification requirements of public procurement tenders low, which sometimes results in the sacrifice of quality to the lowest possible price. We acknowledge the risks inherent in the performance of contracts signed in an environment of stiff competition and rising input prices. Securing a long-term construction contract at an unreasonably low price in a situation where input prices cannot be lowered noticeably and competition is tough is risky because negative developments in the economy may quickly render the contract onerous. In setting our prices in such an environment, we focus on ensuring a reasonable balance of contract performance risks and tight cost control.

Demand for construction services continues to be strongly influenced by the volume of public investment, which in turn depends on the co-financing received from the EU structural funds. Total support allocated to Estonia during the current EU budget period (2014-2020) amounts to 5.9 billion euros. Although the amount exceeds the figure for the previous financial framework, the amounts earmarked for construction work are substantially smaller. Projects supported by the EU began to have some impact on the construction sector in the second half of 2016 and in the next periods the process is expected to accelerate.

In the light of the above factors, we see some opportunities for achieving year-on-year business growth in 2017: business growth in Estonia is supported by positive developments in our selected foreign markets. Our action plan foresees flexible resource allocation aimed at finding more profitable contracts and performing them effectively. According to its business model, Nordecon operates in all segments of the construction market. Therefore, we are somewhat better positioned than companies that operate in one narrow (and in the current market situation particularly some infrastructure) segment.

Our business is also influenced by seasonal changes in weather conditions, which have the strongest impact on infrastructure construction where a lot of work is done outdoors (road and port construction, earthwork, etc.). To disperse the risk, we secure road maintenance contracts that generate year-round business. Our strategy is to counteract the seasonality of infrastructure operations with building construction that is less exposed to seasonal fluctuations. Our long-term goal is to be flexible and keep our two operating segments in relative balance (see also the chapter Performance by business line). Where possible, our entities implement different technical solutions that allow working efficiently also in changeable conditions.

Operational risks

To manage their daily construction risks, Group companies purchase contractors' all risks insurance. Depending on the nature of the project and the requests of the customer, both general frame agreements and special, project-specific insurance contracts are used. In addition, as a rule, subcontractors are required to secure performance of their obligations with a bank guarantee provided to a Group company or the Group retains part of the amount due until the contract has been completed. To remedy construction deficiencies which may be detected during the warranty period, Group companies create warranty provisions based on their historical experience. At 30 June 2017, the Group's warranty provisions (including current and non-current ones) totalled 1,051 thousand euros (30 June 2016: 1,122 thousand euros).

In addition to managing the risks directly related to construction operations, in recent years we have also sought to mitigate the risks inherent in preliminary activities. In particular, we have focused on the bidding process, i.e., compliance with the procurement terms and conditions, and budgeting. The errors made in the planning stage are usually irreversible and, in a situation where the price is contractually fixed, may result in a direct financial loss.

Financial risks

Credit risk

During the period, we recognised credit losses of 30 thousand euros. In the comparative period, credit losses totalled 424 thousand euros comprising impairment losses on trade receivables of 15 thousand euros and impairment losses on other receivables of 409 thousand euros. The overall credit risk exposure of receivables is low because the solvency of prospective customers is evaluated, the share of public sector customers is large, and customers' settlement behaviour is consistently monitored. The main indicator of the realisation of credit risk is settlement default that exceeds 180 days along with no activity on the part of the debtor that would confirm the intent to settle.

Liquidity risk

The Group remains exposed to higher than usual liquidity risk. At the reporting date, the Group’s current assets exceeded its current liabilities 1.02-fold (30 June 2016: 1.05-fold). The key factor which influences the current ratio is the classification of the Group’s loans to its Ukrainian associates as non-current assets and the banks’ general policy not to refinance interest-bearing liabilities (particularly overdrafts) for a period exceeding twelve months.

Because the political and economic situation in Ukraine is still complicated, we believe that the Group’s Ukrainian investment properties cannot be realised in the short term. Accordingly, as at the reporting date the Group’s loans to its Ukrainian associates of 8,795 thousand euros are classified as non-current assets.

For better cash flow management, we use overdraft facilities and factoring by which we counter the mismatch between the settlement terms agreed with customers and subcontractors. Under IFRS EU, borrowings have to be classified into current and non-current based on contract terms in force at the reporting date. At 30 June 2017, the Group’s short-term borrowings totalled 19,329 thousand. Based on our prior experience with banks, out of the above amount contracts of 18,603 thousand euros will be extended when their maturity dates arrive.

At the reporting date, the Group’s cash and cash equivalents totalled 8,101 thousand euros (30 June 2016: 5,336 thousand euros).

Interest rate risk

Our interest-bearing liabilities to banks have both fixed and floating interest rates. Finance lease liabilities have mainly floating interest rates. The base rate for most floating-rate contracts is EURIBOR. During the period, interest-bearing borrowings grew by 3,157 thousand euros year on year. Loan and factoring liabilities increased whereas finance lease liabilities decreased slightly (see also the section Liquidity risk). At 30 June 2017, interest-bearing borrowings totalled 28,955 thousand euros (30 June 2016: 25,798 thousand euros). Interest expense for the first half of 2017 amounted to 304 thousand euros (H1 2016: 314 thousand euros).

The main source of interest rate risk is a possible rise in the variable component of floating interest rates (EURIBOR, EONIA or the creditor’s own base rate). In the light of the Group’s relatively heavy loan burden this would cause a significant rise in interest expense, which would have an adverse impact on profit. We mitigate the risk by pursuing a policy of entering, where possible, into fixed-rate contracts when the market interest rates are low. As regards loan products offered by banks, observance of the policy has proved difficult and most new contracts have a floating interest rate. We have entered into a derivative contract to manage the risks resulting from changes in the interest rates of the finance lease contract for the acquisition of a new asphalt concrete plant.

Currency risk

As a rule, the prices of construction contracts and subcontracts are fixed in the currency of the host country, i.e., in euros (EUR), Ukrainian hryvnias (UAH), and Swedish kronas (SEK).

The exchange rate of the hryvnia has been unstable because the political and economic environment in Ukraine continues to be complicated due to the conflict between Ukraine and Russia which broke out at the beginning of 2014 and at the beginning of 2015 the National Bank of Ukraine decided to discontinue determination of the national currency’s indicative exchange rate. In the first half of 2017, the hryvnia weakened against the euro by around 4.6%. For our Ukrainian subsidiaries, this meant additional foreign exchange losses from the translation of their euro-denominated loans into the local currency. Relevant exchange losses totalled 121 thousand euros (H1 2016: 115 thousand euros). Exchange gains and losses on financial instruments are recognised in Finance income and Finance costs respectively. Translation of receivables and liabilities from operating activities did not give rise to any exchange gains or losses.

The reciprocal receivables and liabilities of our Ukrainian and non-Ukrainian entities which are related to the construction business and denominated in hryvnias do not give rise to exchange losses. Nor do the loans provided to the Ukrainian associates in euros give rise to exchange losses that ought to be recognised in the Group’s accounts.

Due to movements in the Swedish krona/euro exchange rate in the first half of 2017, translation of operating receivables and payables resulted in an exchange loss of 1 thousand euros (H1 2016: an exchange loss of 13 thousand euros). The exchange loss has been recognised in Other operating expenses.

We have not acquired derivatives to hedge currency risk.

Outlooks of the Group’s geographical markets

Estonia

Processes and developments characterising the Estonian construction market

-- In 2017, public investment should grow slightly but the extent to which relevant projects can be realised is still unclear. Although in the

2014-2020 EU budget period the support allocated to Estonia will increase to 5.9 billion euros (2007-2013: 4.6 billion euros), the portion that will influence the construction market will not increase. Instead, compared with the previous period, there will be a rise in allocations to intangible areas.

-- In the context of the market as a whole, investments made by the largest public sector customers (e.g., state-owned real estate company Riigi Kinnisvara AS and the National Road Administration) which reach signature of a construction contract in 2017 will not increase substantially. The Ministry of Defence has been a positive exception for builders as its activities in carrying out new procurement tenders have made, and hopefully will continue to make, a significant contribution to market revival. Hence, the Estonian construction market as a whole (particularly infrastructure construction segments) will remain in relative stagnation. So far, the situation has been mitigated by the positive level of private investment in building construction but the latest developments reflect a certain slowdown also in the latter.

-- The long and painful process of construction market consolidation will continue, albeit slowly. In particular, this applies to general contracting in building construction where the number of medium-sized general contractors (annual turnover of around 15-40 million euros) is too large. Based on the experience of the last major crisis it is likely that in an environment of stiff competition and rising input prices some general contractors may run into difficulties which will be passed on to several other market participants.

-- Competition remains stiff across the construction market, intensifying in different segments in line with market developments. The rise in the average number of bidders for a contract reflects this. It is clear that in the new environment of rising input prices which has emerged in the past year, efficiency is the key to success. Regrettably, the number of materials producers, suppliers, and subcontractors that are trying to survive or succeed in a difficult environment by dishonest means, e.g., by supplying goods with concealed defects or considerably lower quality than the one recorded in the product certificate, has increased quite rapidly. If the trend continues, both construction service providers and end-customers will have to apply strict and thorough quality control measures to make sure that the outcome meets their expectations. Unfair competition is putting visible pressure on prices and the quality of the construction service. Unfortunately, the problem is also underpinned by the customers’ (including state institutions’ and state-owned companies’) increasing tendency to lower the bidders’ qualification requirements and prioritise quality more on paper than in practice.

-- In new housing development, the success of a project depends on the developer’s ability to control the input prices included in its business plan and, thus, set sales prices that are affordable for prospective buyers. Although new apartments are relatively expensive compared to the standard of living and the banks’ lending terms are strict, the housing market sustained growth also in the second quarter of 2017, accounting for a somewhat disproportionately large share of the total construction market and thereby amplifying associated risks.

- There is a growing contrast between the stringent terms of public contracts, which require the builder to agree to extensive obligations, strict sanctions, various financial guarantees, long settlement terms, etc., and the modest participation requirements. Lenient qualification requirements and the precondition of making a low bid have made it relatively easy for an increasing number of builders to win a contract but have heightened the risks taken by customers in terms of funding, deadlines and quality during the contract performance phase and the subsequent warranty period.
- The past year has brought a rise in the prices of construction inputs, particularly in building construction. At first, general contractors tried to absorb the cost increase by making margin concessions but their capacity for doing this has been practically exhausted. The construction market includes an increasing number of areas where changes in the environment (including materials producers' rapid and successful entry into foreign markets) may trigger a sharp price increase. The rise in housing construction has lengthened the supply terms of various essential materials and services considerably, making it impossible to carry out all processes in the former optimistic timeframes. As a result, activities require more extensive planning or may need to be postponed.
- The persisting shortage of skilled labour (including project and site managers) is restricting companies' performance capacities, affecting different aspects of the construction process including quality. Labour migration to the Nordic countries will remain steady and the number of job seekers who return to the Estonian construction market is not likely to increase considerably. All of the above sustains pressure for a wage increase, particularly in the category of the younger and less experienced workforce whose mobility and willingness to change jobs is naturally higher.

Ukraine

In Ukraine, we offer general contracting and project management services to private sector customers in the segment of building construction. Political and economic instability continues to restrict the adoption of business decisions but construction activity in Kiev and the surrounding area has not halted. In 2017, we will continue our operations in Ukraine primarily in the Kiev region. Based on our order book as at the end of 2016, we expect that in 2017 our operating volumes will remain at a level comparable to 2016. Despite the military conflict in eastern Ukraine, for Nordecon the market situation in Kiev has not deteriorated compared with a year or two ago. Hard times have reduced the number of inefficient local (construction) companies and when the economy normalises we will have considerably better prospects for increasing our operations and profitability. The Ukrainian government's recent crackdown on cash-in-hand work is definitely a step in the right direction, which in the long term should also improve our position in the Ukrainian construction market. We assess the situation in the Ukrainian market regularly and critically and are ready to restructure our operations as and when necessary.

Should the crisis in eastern Ukraine spread to Kiev (which at the date of release of this report is highly unlikely), we can suspend our operations immediately. We continue to seek opportunities for exiting our two real estate projects which have been put on hold or signing a construction contract with a prospective new owner.

Finland

In Finland, we have provided mainly subcontracting services in the concrete segment but, based on experience gained, have started preparations for expanding into the general contracting market. The local concrete work market allows competing for projects where the customer wishes to source all concrete works from one reliable partner. Our policy is to maintain a rational approach and avoid taking excessive risks.

Sweden

We entered the Swedish market in July 2015, when we acquired a 100% stake in SWENCN AB, a company registered in the Kingdom of Sweden. In the Swedish market we intend to offer mainly the construction of residential and non-residential buildings, particularly in central Sweden. On gaining experience in the new market, we have prioritised quality and the observance of deadlines and have therefore accepted lower profitability. As regards our longer-term goals and the plan to build a viable and strong organisation that would compete successfully in the Swedish market, we are positive about the developments so far and see potential for sustaining business growth and operating profitably in a large market when we have been able to stabilise order book growth at the desired level.

Nordecon (www.nordecon.com) is a group of construction companies whose core business is construction project management and general contracting in the buildings and infrastructures segment. Geographically the Group operates in Estonia, Ukraine, Finland and Sweden. The parent of the Group is Nordecon AS, a company registered and located in Tallinn, Estonia. In addition to the parent company, there are more than 10 subsidiaries in the Group. The consolidated revenue of the Group in 2016 was 183 million euros. Currently Nordecon Group employs close to 740 people. Since 18 May 2006 the company's shares have been quoted in the main list of the NASDAQ Tallinn Stock Exchange.

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