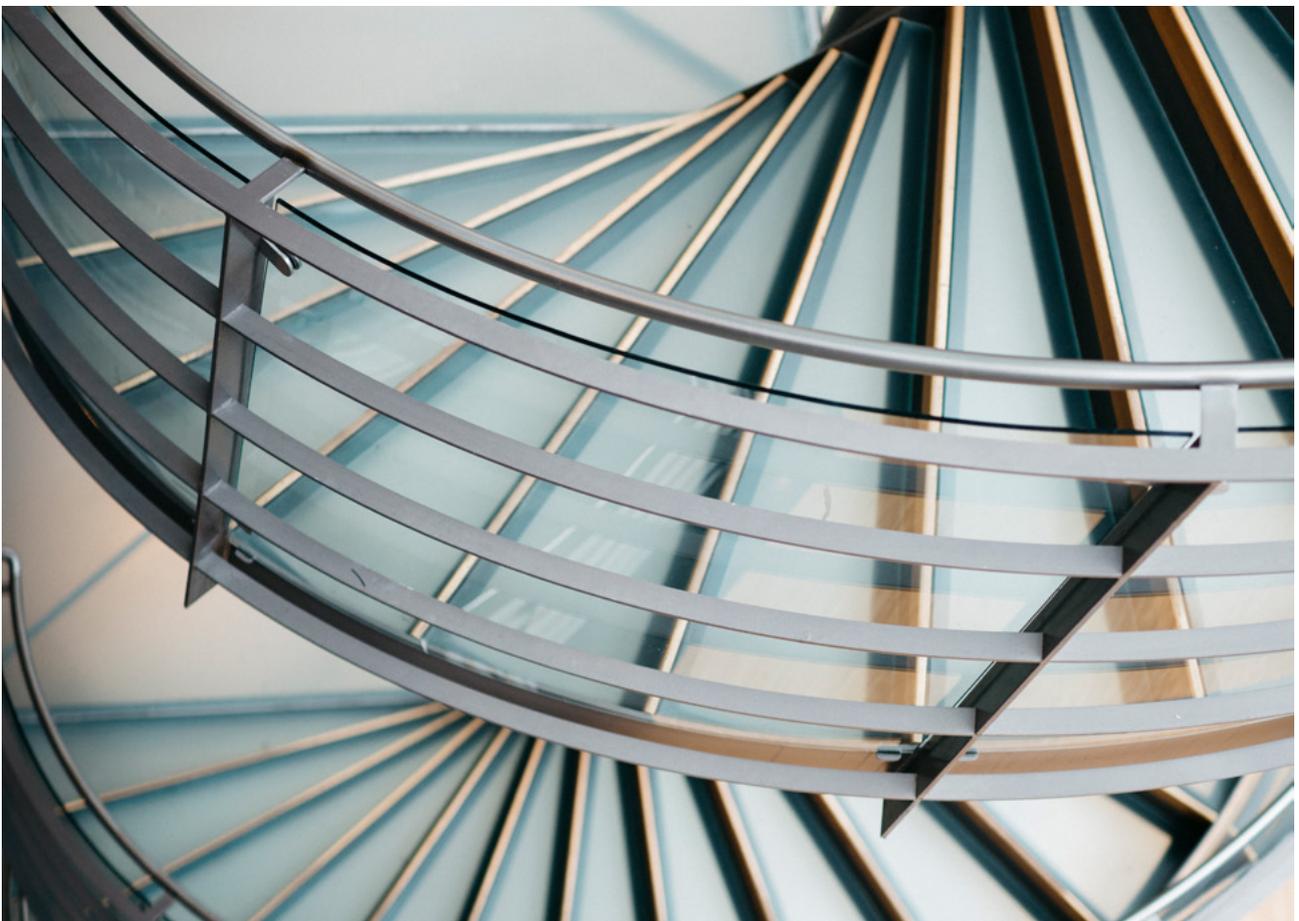




Suomen Teollisuussijoitus Oy

Report by the Board of Directors 2018



Report by the Board of Directors 2018

BUSINESS ENVIRONMENT

Finland's economy continued to be buoyant in 2018, enjoying in particular a clear improvement in employment rate. At the end of the year, the market sentiment was, however, depressed by a marked decline in many key indicators: consumer confidence, exports, industrial investment, new building permits, and both household and corporate demand for credit. Consequently, economists lowered Finland's expected growth rate over the next few years to be substantially below the figures published in summer 2018.

Confidence in the global economy was hit in the last quarter of the year. This was reflected particularly on the stock markets, reacting strongly to the accumulating concerns. The main issues were: escalation of trade war; a slowdown in China's and Europe's economic growth; uncertainty about the true figures for China's growth rate and debt level and, finally, the increased political uncertainty in Europe (the economic and budgetary situation in Italy, Brexit, social unrest and the demonstrations generated by it).

A particularly noteworthy feature of the European investment market was the continued positive development of the venture capital segment. A clear trend in fund-raising has been increasing average sizes of venture capital funds, which in turn has resulted in larger financing rounds and partly also in rising valuation of portfolio companies. The overheating of the venture capital market has been also fuelled by a constantly increasing supply of funds from corporate venture capital, a trend that has been visible in financing rounds for Finnish, as well as other European, companies. In most cases, the objective of corporate venturing is to support the renewal and innovation activities of the industrial parent company.

The highlight of the year for Nordic VC/PE investment was Spotify's successful listing on the New York stock exchange at a market value of over €20 billion. The continuation of exit activity is, however, very dependent on the general risk sentiment of global capital markets.

Finnish growth companies again set a record in raising venture financing from investors. According to our preliminary estimates, the total sum raised in 2018 exceeded €350m. Some €240m of this comprised large (over €10m) rounds, of which there were altogether nine. Between 2013 and 2018, there were altogether 27 financing rounds exceeding €10m in Finland, in out of which Tesi was involved in 20 either directly or through its portfolio funds.

Finnish buyout funds, investing in companies in a later stage of development, still have abundant capital for new investments. This investment capacity plays an important role for Finland's business structure – the growth and internationalisation of medium-sized companies, an increase in their numbers, and buyouts. The SME segment has also seen increasing demand for minority investments. The proportion of minority investments has varied over the last three years, accounting for 10-14 per cent of total investments.

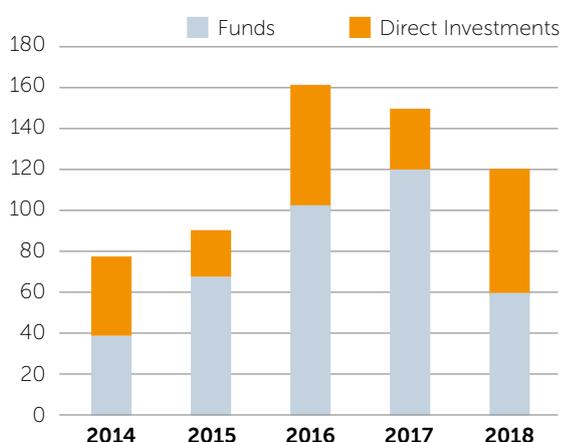
During the year, there was further evidence of radical transformation within traditional business sectors, caused by changes in consumer behaviour and the effect of digitalisation. Growth companies supported by VC/PE investors are often driving these inevitable changes in the market economy with their disruptive and commercially successful innovations.

INVESTMENT OPERATIONS

Tesi's objective is to make responsible venture capital and private equity investments that are profitable and create positive socio-economic impact. This impact is, in addition to the financial growth of the portfolio companies, manifested through the development of the private equity and venture capital market in Finland and through active ownership. Tesi's vision is to raise Finland to the next level of growth and internationalisation, and Tesi's mission is to operate in support of this goal.

During 2018, Tesi signed new commitments to venture capital and private equity funds and made new investments in companies amounting to €121m (€149m in 2017).

NEW INVESTMENTS, €M



Commitments totalling €59m (€60m) were made to eight venture capital and private equity funds, of which five commitments were to venture capital funds and three commitments to growth and buyout funds.

Other capital amounting to €195m was also invested in Finnish funds in which Tesi invested, representing roughly 6 times the amount of Tesi's commitment. Tesi made four commitments to international funds that complement the Finnish VC/PE market with their special focus or expertise.

Tesi paid out altogether €84m (€59m) to funds in capital calls. Correspondingly, the funds returned a total of €156m (€77m) to the company.

Altogether €62m (€29m) was invested in 26 companies during 2018. Tesi made initial investments totalling €52m in altogether 13 companies and follow-on investments totalling €10m in 13 companies. Initial investments included Nosto, Oura Ring and Kaiku Health in scale-up phase. Science-based high technology investments include Dispelix and ICEYE. Tesi and Sentica completed a buyout of Super-Park Oy. Conventional growth and minority investments included Zsar, Uusioaines and GRK. Viafin Services was a new initiative for assisting the IPO of a growth company.

Overall, a total of almost €250m in new risk capital was channelled into these portfolio companies, representing over

four times the amount invested by Tesi. Of this total amount, some €61m came from international investors. Investment programmes promoting growth and the renewal of industrial structures form the core for Tesi's direct investments.

The €75m **Circular Economy** investment programme was launched at the end of 2018. One direct investment, Uusioaines Oy, and one fund investment, Environmental Technologies Fund III, were made from the programme.

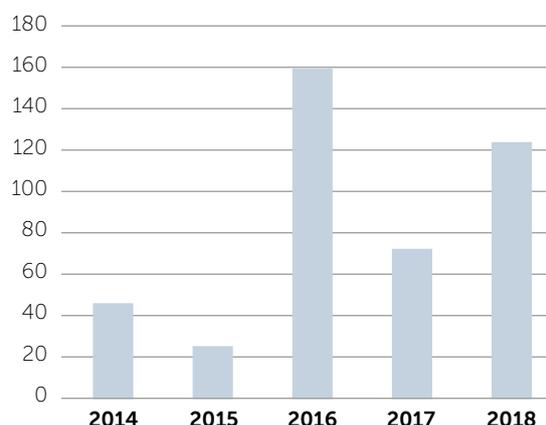
The strategic priorities for the **Industrial Renewal** investment programme are cleantech, bioeconomy, health technology and digitisation. Investments amounting to over €175m were made in 14 companies through the Industrial Renewal investment programme. The largest investments were in Kotkamills, Rauma Marine Constructions and Viria Plc. Altogether, investments totalling €96m have been made in 24 companies within the programme.

Through Tesi, the **International Co-investors** investment programme acts as a catalyst in attracting international capital and expertise into Finnish growth companies. In 2018, some €21m was invested in 10 companies through the programme. Investment targets in the programme included companies such as BCB Medical, MariaDB Corporation and ICEYE. At year's end, investments amounting to over €40m had been made in altogether 14 companies. These companies have raised a total of €216m in capital from investors, of which €144m came from international investors. The programme was fully invested in 2018.

The **Mining Cluster** investment programme ended during the financial year and the portfolio companies were transferred to the Finnish Minerals Group.

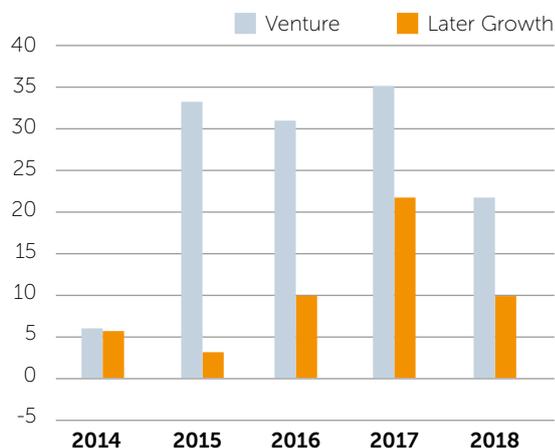
Tesi's objective is to internationalise Finland's venture capital and private equity market. In 2018, Tesi's international investor network invested altogether €123m in Finnish growth companies, of which €63m came from Tesi's international portfolio funds. Investors also provided Finnish companies with highly valuable international business management expertise as well as contact networks, in addition to investment capital.

CHANNELLING OF INTERNATIONAL CAPITAL, €M



Tesi focuses attention on active ownership and portfolio companies' growth. The aggregated net sales of direct portfolio companies grew on average by 19% (median) during the financial year. The aggregated net sales of venture-capital phase companies grew in general by 22% (median), and of later-stage companies by 10% (median).

GROWTH IN DIRECT INVESTMENTS, % (MEDIAN)



Exits reached record levels in 2018, especially in the venture capital segment. Altogether €165m was returned from investments during the year, of which €155m was from funds and €10m from direct investments.

Tesi exited from six direct investments. In the exit market, industrial buyers were particularly prominent. Tesi also exited from four fund investments that had reached the end of their term, and from eight fund investments by selling the fund interests in the secondary market.

In addition to the Group's own investment operations, Tesi manages the FoF Growth I, II and III funds. The investment operations of FoF Growth III started in 2018 as planned, and investments were made in four funds during the year. The FoF Growth funds' portfolio now comprises 24 funds, both venture capital and growth & buyout.

The model for the FoF Growth concept has over the last ten years proven to be very successful, while also having a positive impact on Finland's economy. FoF Growth has already accelerated the growth of over 150 companies, and future investments by FoF Growth II and FoF Growth III will raise this figure to 300.

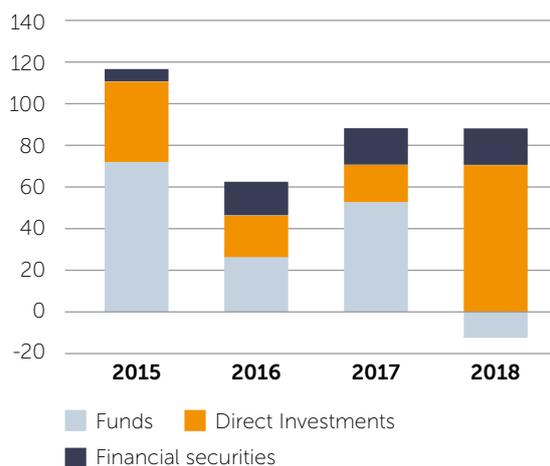
The European Investment Bank (EIB) and Tesi agreed upon a programme for channelling financing from the EU's European Fund for Strategic Investment (EFSI) into Finnish companies' growth. Managed by Tesi, total financing of €100m will be targeted at promising companies. In each financing round, private investors will provide at least the same amount of capital as EIB and Tesi.

FINANCIAL PERFORMANCE

Consolidated profit/loss

Despite the increasingly uncertain outlook for the global economy at the end of the year, 2018 was yet one year of strong financial performance. Profits were especially boosted by realised gains from VC/PE investments. Consolidated profit for the financial year declined slightly compared to the previous year, amounting to €55m (€66m in 2017).

NET GAINS, €M



The Group's net gains from private equity and venture capital investments totalled €90m (€69m). Net gains from private equity and venture capital funds were €72m (€53m). The increase in net gains was largely owing to numerous successful exits from fund portfolio companies (such as Spotify, iZettle, Ekahau, Solita) and a general rise in valuation levels.

Net gains from direct investments amounted to €18m (€15m). Net gains comprised exits from investments, of which there were 7 during the financial year. Overall, portfolio companies enjoyed favourable growth and profitability development. The weakening economic outlook at the end of 2018 have been considered as far as possible, when estimating the fair value of unrealised investments.

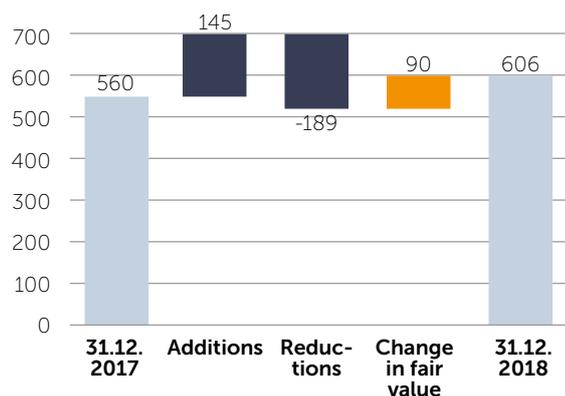
Other operating income includes net losses (gains) from financial securities, amounting to €-14m (€+18m). The last quarter of 2018 was globally difficult for both listed equities and fixed income investments. The major part of the financial securities consisted of fixed income investments.

Operating expenses were €8m (€7m). The higher expenses can largely be explained by the upgrading of information systems and of one-off advisory fees relating to the sale of a fund interests. Expenses per balance sheet total were 0.7% (0.6%). The operating profit amounted to €68m (€80m).

Balance sheet and financial position

Non-current assets were €646m (€569m) at the end of the year, of which €606m (€560m) consisted of private equity and venture capital investments recognised at fair value in the statement of comprehensive income. Volumes of private equity and venture capital investment grew by €46m during 2018. Of the venture capital and private equity investments at the end of the year, €371m (€372m) was invested in VC/PE funds and €235m (€189m) in direct investments.

CHANGE IN VC & PE INVESTMENTS, €M

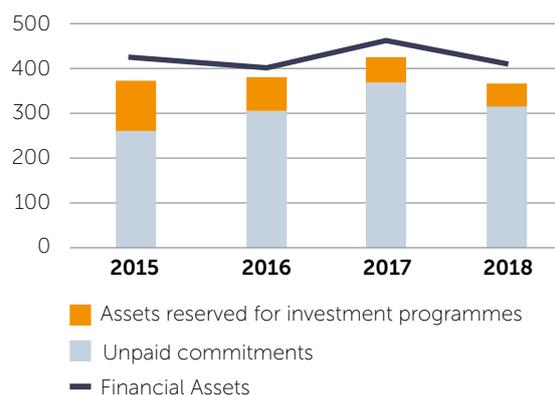


More detailed information about the determination of fair value is given in note 4 of the Notes to the Accounts.

The figure for current assets, €385m (€452m), includes €378m (€445m) of financial securities recognised at fair value in the statement of comprehensive income. The figure for non-current assets also includes €25m (€0m) of financial securities recognised at fair value in the statement of comprehensive income.

Financial securities safeguard the continuity in the company's investment operations and its ability to meet unpaid commitments. At the end of 2018 unpaid commitments totalled €316m (€367m). Unpaid commitments consist almost entirely of commitments given to venture capital and private equity funds with an average expected maturity of four years. In addition to unpaid commitments to funds, some €121m has been reserved for implementing the company's ongoing investment programmes.

FINANCIAL ASSETS AND UNPAID COMMITMENTS, €M



The Group's balance sheet totalled €1,031m (€1,020m) on 31 December 2018. Shareholders' equity grew to €996m as a result of the net profit of €55m for the financial year. The Group's equity ratio was 96.6% (95.9%). The Group did not hold any interest-bearing liabilities at the end of 2018.

RISKS AND RISK MANAGEMENT

Tesi's operations are governed by a special law and a government decree relating to it, which define the company's main principles for risk-taking. Tesi promotes the development of Finnish private equity and venture capital market as well as the growth and internationalisation of Finnish companies. The company's operations therefore involve bearing higher than usual risks in certain geographic areas and specific sectors. The company's investment activities must nevertheless be managed as a whole in a way that ensures investments are adequately diversified and that the primary legal obligation for profitable operation over the long term is met.

Tesi has a risk management policy, confirmed by the Board of Directors. The policy sets out the principles for risk management, specifies risk definitions and risk classifications and also defines the main roles and divisions of responsibilities as well as the monitoring and reporting procedures. The goal for risk management is to ensure that risks borne by the company are commensurate with its risk taking capacity. The aim is to ensure that the risks attached to the company's business operations are identified and assessed, that the company responds to those risks, and that they are managed and monitored.

The Board of Directors confirms the company's strategy and action plan, in which the targets for different investment allocations are prioritised and specified. In order to reduce risks, investments are diversified to different allocation classes, different industries, and also geographically, while taking into account the company's mission. The Board makes the company's investment decisions and supervises the implementation of investments.

Risk management supports achievement of the goals set in the company's strategy and action plan by monitoring that the risks taken are commensurate with risk-taking capacity. Risk-taking capacity is managed through carefully planned investment operations and by managing

investments with the aim of assuring achievement of the targets set for return on capital and profitability.

Tesi's main risks are related to venture capital and private equity investments, and to investments in financial securities. Both involve various investment risks, including valuation risks, market risks, liquidity risks, financing risks, credit risks, currency risks, interest risks, et cetera.

A higher business risk is associated with direct industrial investments used as a tool to deploy the industrial policy set by the Government of Finland. Direct industrial investments represent about one-third of the entire portfolio of direct investments and 10% of the whole VC/PE investment portfolio.

The value of private equity and venture capital investments at the end of the financial year amounted to €606m. Investments are subject to the risks stated above that, if they were realised, could substantially affect the future value of the investments. The table below presents the possible euro-denominated impacts of relative changes in valuations on the value of the private equity and venture capital investment portfolio.

The risks related to each private equity and/or venture capital investment are managed by predictive generation of the deal flow, careful analysis in the screening phase, participating through board work in the business development of portfolio companies, proactive interaction with managers of private equity and venture capital funds, and positive action in the exit stage.

Managing financing risks ensures that the company always has adequate financing available for its business operations (unpaid investment commitments). The company's liquidity and cash flows are continuously monitored. When preparing new investments, the effect of the investments on liquidity and financial position is taken into account. Most of the company's cash flows and investments are denominated in euros.

Investments in financial securities are made at the selected risk level in compliance with the investment policy confirmed by the company's Board of Directors. Investments in financial securities aim to ensure the company has adequate assets for private equity investing and other payment transactions. Investments in financial securities are spread mainly between investments in bond funds, investments in equity funds, and alternative investments. The market volatility of financial securities is regularly monitored. The counterparty risk attached to investing in financial securities is managed with a thorough partner selection procedure.

Other risks to which Tesi is exposed include strategic risks, operational risks, risks of loss or damage, and risks for reputation. Strategic risks are managed by regularly evaluating the company's operations and operating environment. Operational risks are managed by good corporate governance and internal instructions, and these risks are covered by insurances.

At the end of 2018 the ratio of the company's total investments (fair value) and investment commitments to shareholders' equity was 93%.

More detailed information about risks and risk management is given in note 3 of the Notes to the Accounts.

IMPACT OF CHANGES IN VALUE OF VC & PE INVESTMENTS ON INVESTMENT PORTFOLIO (€606M), €M

Direct investments (fair value €235m)	Fund Investments (fair value €370,5m)				
	0 %	-5 %	-10 %	-15 %	-20 %
0 %	0	-19	-37	-56	-74
-10 %	-24	-42	-61	-79	-98
-20 %	-47	-66	-84	-103	-121
-30 %	-71	-89	-108	-126	-145
-40 %	-94	-113	-131	-150	-168

CORPORATE GOVERNANCE

Group structure

The Group's subsidiaries are FEFSI Management Oy (parent company's ownership 100%), Tesi Fund Management Oy (parent company's ownership 100%), Tesi Industrial Management Oy (parent company's ownership 100%) and Aker Arctic Technology Oy (ownership 66.4%).

Organisation and development of operations

At Tesi's Annual General Meeting on 6 March 2018, the following members were elected to the Board of Directors: Board Chairman, Esa Lager (LL.M., M.Sc. (Econ), born 1959); Marika af Enehjelm (Doctor of Technology, M.Sc. (Econ), born 1974); Pauli Kariniemi (Lic.Sc. (Econ), born 1970); Kimmo Jyllilä (M.Sc. (Econ), born 1972); Mika Niemelä, (M.Pol. Sc., born 1975); Annamarja Paloheimo, (Senior Lawyer, LL.M., born 1964), and Riitta Tiuraniemi (M.Sc. (Tech), born 1962). In 2018 the Board of Directors convened altogether 15 times and average attendance at the meetings was 95.2%.

The company's CEO was Jan Sasse (M.Sc. (Econ.), born 1967). The parent company employed an average 34 people during the year. Four new employees were recruited to permanent positions during the financial year. One person resigned from the company. At year's end 13 women and 23 men were permanent employees of the company.

Goal-setting and feedback discussions were held twice in 2018. The discussions help disseminate strategic targets to the team and individual level, and these targets are supported and monitored. In Tesi, personnel commitment and motivation strongly depend on employees being able to use and develop their skills and expertise in a versatile way. Skills development in 2018 focused on self-awareness and self-management, team dynamics and project management.

Personnel surveys are conducted regularly to monitor personnel motivation and job satisfaction. The survey

enquired into the implementation of Tesi's values, the flow of one's own work and of cooperation, supervisory work, and Tesi as an employer. The overall index was higher than for 2017.

Tesi follows the guidelines issued by the Prime Minister's Office regarding remuneration in state-owned companies. Salaries and remunerations in 2018 totalled €3.9m (€3.7m). The remuneration system is developed in line with evolving company objectives, in order to effectively support the company's business operations. More details about remuneration practices are given in the company's Corporate Responsibility Report.

A strategy project was launched in Tesi in autumn 2018 that still continues into early 2019. The entire organisation has participated in the project through various workshops and surveys.

Shares and share capital

The company has one class of shares and 41,710 shares. The share capital is €438,992,200.

Board's proposal for the distribution of profit

The parent company's distributable earnings (according to FAS financial statements) on 31 December 2018 amounted to €223,141,002. No significant changes in the company's financial position have occurred since the end of the financial year. The Board proposes to the Annual General Meeting that no dividend be distributed for the financial year 2018. The company's financial resources will be targeted for private equity and venture capital investments that promote the growth and internationalisation of Finnish companies and the development of Finland's venture capital and private equity market.

EVENTS AFTER THE FINANCIAL YEAR

After the end of the financial year, Tesi gave one investment commitment to a Finnish growth fund (details to be published later) and also participated in LeadDesk's successful listing on Helsinki's First North exchange.

PROSPECTS

The partially conflicting forecasts for the global economy during the last quarter and the uncertainty stemming from the outlook is affecting the market sentiment at the start of 2019. Corporate profitability development is still expected to remain buoyant, but it is difficult to predict what effect, for instance, trade disputes and Brexit will have on companies operating in the EU. Fixed income market is influenced by the question of when the prevailing historically low interest rates will start to steadily rise. Increasing uncertainty could well slow down the M&A market, as the gap between buyers' and sellers' price expectations increases.

In 2018, Tesi launched a process for updating its strategy and its implementation is scheduled for the spring 2019. The key strategic themes relate to active and responsible ownership; socio-economic impact; producing insights through data; and promoting companies' growth and internationalisation.

Tesi's mission is to help Finnish companies grow and internationalise through VC/PE investments and to support the further development of Finnish VC/PE market. The objective of the strategy is to define the market bottle-

necks where Tesi's presence is most needed, and then to identify and develop ways in which Tesi can most efficiently and effectively speed up the expansion and internationalisation of growth companies. Through development of the VC/PE market, Tesi plays a role that serves and supplements the market, and Tesi can fulfil that role by, for instance, producing useful market data. Tesi is also guided by its role in the market to invest with highest possible socio-economic impact in a profitable manner. Strategy process will result in a view of how Tesi can best fulfil its task over a 3-4-year cycle, as well as a vision of what the VC/PE market will look like over the next ten years.

Tesi will focus on broadening both the local and the international investor base on the Finnish market. This will provide VC/PE funds with more private capital and, hence, larger funds, allowing them to support their future target companies further down the life cycle of the companies. Several Finnish fund managers are currently in the process of fund-raising, and expected realise as new commitments during 2019.

In line with its current investment focus, Tesi will continue direct minority investments in SMEs seeking growth and in industrial investments. The Circular Economy will remain a key investment programme also in 2019.

Close cooperation with private players, the EIF and the EIB, in channelling EU funds into Finnish venture capital funds and growth companies, will continue in 2019.

As we enter a new financial year, Tesi has strong resources for long-term investment operations that promote the growth of Finnish companies.

Key figures

KEY FIGURES, GROUP	IFRS 2018	IFRS 2017	IFRS 2016	IFRS 2015	FAS 2014
Profit/loss for the financial year, €m	54,6	65,7	44,6	86,4	-25,7
Shareholders' equity, €m	996,0	978,2	912,5	867,9	676,5
Balance sheet total, €m	1030,5	1020,3	943,0	895,3	694,5
Unpaid commitments, €m	316,0	367,4	305,5	265,0	256,0
Investments at acquisition price, €m	545,1	496,0	526,2	503,4	528,6
Investments at acquisition price and commitments, €m	861,1	863,4	831,7	768,4	784,6
Investments at book value, €m	605,6	560,1	525,2	459,8	414,2
Ratio of investments and commitments to shareholder's equity	0,9	0,9	0,9	0,8	1,0
New commitments during financial year, €m	120,8	148,8	164,6	93,0	81,5
Return on equity	5,5 %	6,9 %	5,0 %	11,2 %	-4,2 %
Equity ratio	96,6 %	95,9 %	96,8 %	96,9 %	97,4 %
Expenses per investments under management	0,8 %	0,6 %	0,8 %	0,8 %	0,8 %
Personnel, average	36	32	34	31	31
Salaries and fees for the financial year, €m	3,9	3,7	3,9	3,6	3,2
Fund investments, total number	87	91	93	91	90
Funds, number of portfolio companies	712	660	677	617	544
Parent company, number of portfolio companies	45	37	36	37	42
Start Fund I Ky, number of portfolio companies	0	0	6	14	22
Tesi Industrial Management Oy, number of portfolio companies	3	5	4	2	2
Portfolio companies, total number	760	702	723	670	610