Quality for Your Success

2018 Annual Report

For the sake of better readability, the masculine form is used in this document when referring to persons and using personal pronouns. In the interests of equal treatment, gendered terms generally refer to both genders. This abbreviated form of language is used for editorial reasons only and does not contain any assessments as to value.

LHI Management Board
Oliver Porr, Peter Kober, Jens Kramer, Robert Soethe (from left to right)

Foreword

Looking back at the beginning of 2018, we expected a year full of change. In particular, it was assumed that the first steps would be taken in the direction of turning away from low-interest policies. Looking back, we know that these expectations were not fulfilled. The European Central Bank has continued its monetary policy of low interest rates and the risks to the financial system have likewise not diminished. New risks have also arisen as a result of the weakening economy. Now that the ECB has largely exhausted its possibilities, it remains to be seen how it will deal with the new economic environment. This environment is characterised by increasing uncertainty within the European Union. Various neo-nationalist governments will contribute just as much to surprises as German unilateral efforts in climate policy. Questions surrounding Brexit and the hardly foreseeable outcome of the elections to the European Parliament also make contributions to the feeling of uncertainty. The forecasts for 2019 reflect these wide degrees of variation.

Once more, the ECB's loose monetary policy ensured that companies had sufficient capital available in 2018. For this reason, many of our customers did not focus on procuring financing. Despite this, we were able to discern increasing demand in the Structured Finance segment. Irrespective of the financing, structuring know-how was just as much in demand as solutions for individual goals.

In the area of investment management, we experienced sustained demand for tangible asset investments on the part of investors. The willingness of investors to invest was therefore not a limiting factor here, but rather the availability of suitable assets. This challenge will continue in 2019. However looking ahead to 2019, we will not depart from our belief that not every available asset is a suitable asset for our investors.

In point of fact, the same principle applies this year: For us, quality beats quantity. As a result, it may be the case that we need a little more time to find a suitable property, solar park or aircraft and make the corresponding decision. However, our investors know that the design of the investment and the selection of the asset are tailored to their requirements. We also make sure that opportunities and risks are balanced. Many of our investors prefer slightly lower returns knowing they have invested in assets with manageable risks.

We further expanded our investments in the renewable energies asset class in 2018. Our current portfolio of 21 wind farms and 28 solar parks produce a total rated output of 573 MW/MWp and saved around 294.000 tonnes of CO_2 during 2018. Renewable energies account for EUR 1.2 billion of the EUR 10.2 billion assets under management. LHI invested EUR 433 million in 2018, of which 63 % were invested in renewable energies and 37% in real estate. In Aviation, four DCM aircraft were booked as new business due to the extension of the fund term, new lessees and new financing. In the Structured Finance segment, we generated new business of EUR 639 million in 2018. The LHI Group's total new business volume of EUR 991 million is above the previous year's and target figures.

We can therefore look back with satisfaction on 2018. We are aware that such a successful year is only possible if our customers trust us and our employees deliver top performance. For this, we express our profound thanks.

Oliver Porr | Robert Soethe | Jens Kramer | Peter Kober

COMP ANY

Strategy and Positioning

The current macroeconomic environment is characterised by increasing uncertainty and a weakening economy. We therefore expect the financial markets to continue to be distorted and unsettled in future.

As part of our business and risk strategy, we essentially counter these risks with two principles:

1. Our diversified business model is based on two pillars: Structured Finance and Investment Management. We make decisions deliberately and with a sense of proportion. For us, long-term aspects are more important than short-term yield optimization. Maintaining our stable earnings base is a value in itself.

2. LHI has a strong equity base. In relation to our business activities, we have a high risk cover amount. This makes us less susceptible to crises than our competitors. In addition, we employ a conservative risk policy. We currently see the assumption of risks as often not being compensated fairly. We deliberately refrain from such transactions. Like every larger company, LHI is also integrated into an overall economic environment that is beyond our control. For example, our business model presupposes that the products we design may be refinanced at reasonable conditions. Although our equity strength and the number of credit lines available help here, this cannot replace refinancing at the project level in the long term. For this reason, we work with a large number of domestic and foreign credit institutions and incorporate secondary-level funds from institutional investors.

STRUCTURED FINANCE

INVESTMENT MANAGEMENT

WE MAKE DECISIONS DELIBERATELY AND WITH A SENSE OF PROPORTION. FOR US, LONG-TERM ASPECTS ARE MORE IMPORTANT THAN SHORT-TERM YIELD OPTIMIZATION.

This results in a link between the two pillars of our business model: We link the asset and liability sides. This generates the greatest possible benefit for both investors and property users. This integrated business model has also proven its worth in the years following the last financial crisis and will therefore be continued moving forward. The efficient management of special purpose companies likewise forms an integral part of our business model. LHI has a very robust IT infrastructure based on SAP HANA. Our software reflects the requirements of the business model as well as those of German and international commercial and tax law. This is how LHI differs from many other service providers. We not only design, but also implement and manage projects – in some cases, even more than 20 years. For third parties, we offer administrative services as part of our “Corporate Service Providing” product. This product is primarily aimed at foreign companies that have a special purpose company in Germany but are unable or unwilling to take on commercial management themselves. Together with our own special purpose companies, this gives us the advantage of generating stable fee income.

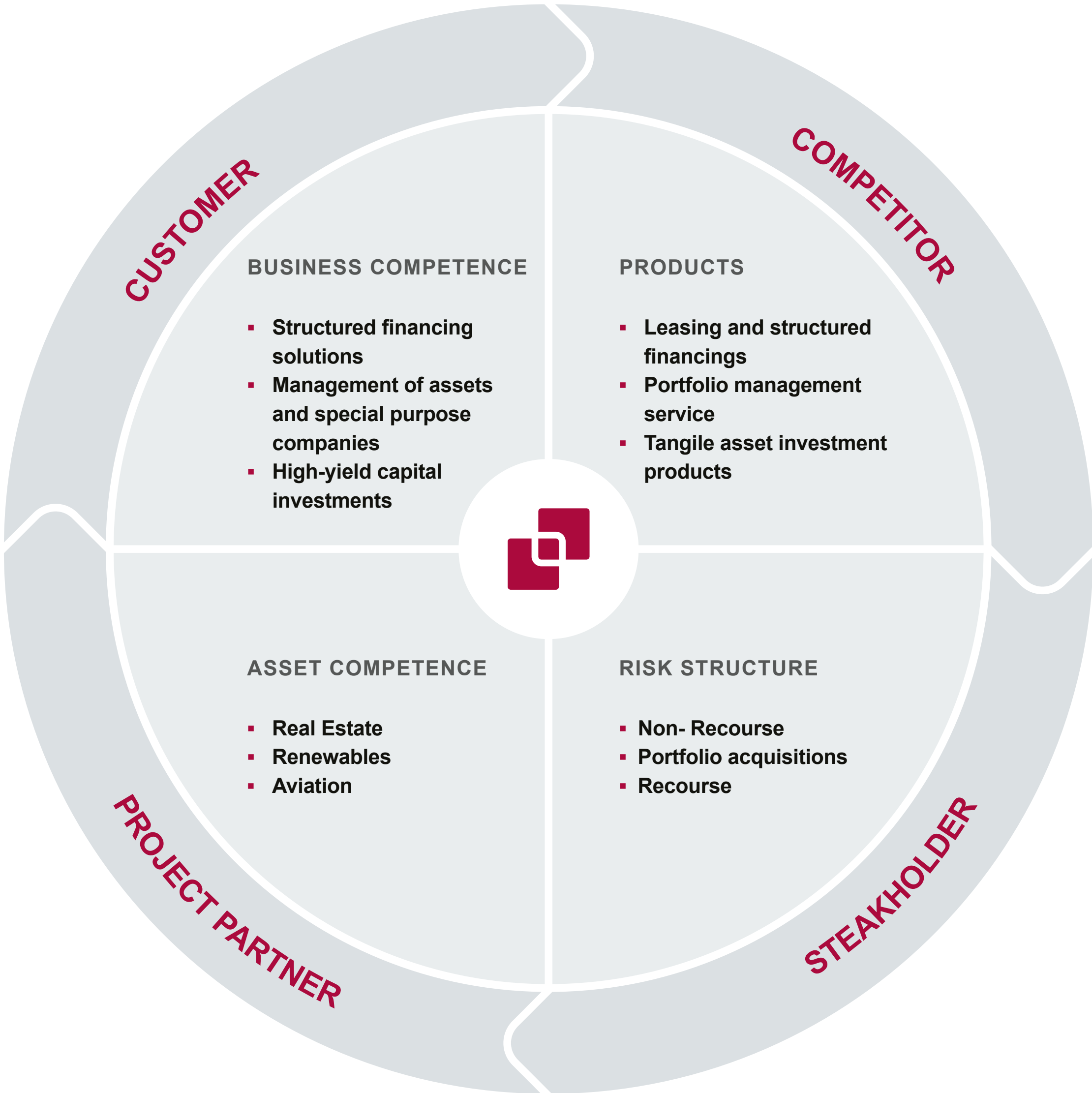
LHI acquired several leasing portfolios and one fund portfolio on several occasions in the past. We may continue to do so in future, but only if we are able to calculate the associated risks and foresee opportunities, such as cost degression.

We go far beyond traditional leasing solutions in the field of Structured Finance. We meet customer-specific requirements and goals with complex and highly individual structuring solutions. We design succession-oriented corporate structures for companies, for example, just as we optimise financial covenants or help to better meet accounting and regulatory requirements. Particularly in the area of investment financing, we pay attention to tax implications and make any necessary adjustments during the term of the contract.

We offer investment management services for the three asset classes Real Estate, Renewables/Infrastructure and Aviation. LHI’s products in these asset classes meet all the requirements of institutional investors. Conceptual design, asset management and fund management, including risk management and fund reporting, are handled entirely by LHI. An important part of our strategy in this area is to have investment concepts that precisely meet the individual requirements and needs of the respective investor group. We therefore see our focus in conducting business with institutional investors and family offices. We have made investments specifically-tailored for foundations, pension funds and insurance companies. This means that special requirements of each individual investor group can be better served during the term.

In addition to business with institutional investors, we also design products for private investors. The second public AIF with commercial real estate and a regional focus on Bavaria and Baden-Württemberg was placed at the end of 2018. Our strategy for private investor products is simple and clear: We only offer public AIFs if we believe that all the properties meet the parameters of a private investor product. We won’t launch a product simply because we can sell it.

WE WON’T LAUNCH A PRODUCT SIMPLY BECAUSE WE CAN SELL IT.


CUSTOMER
COMPETITOR
BUSINESS COMPETENCE
Structured financing solutions
Management of assets and special purpose companies
High-yield capital investments
PRODUCTS
Leasing and structured financings
Portfolio management service
Tangile asset investment products
ASSET COMPETENCE
Real Estate
Renewables
Aviation
RISK STRUCTURE
Non- Recourse
Portfolio acquisitions
Recourse
PROJECT PARTNER
STEAKHOLDER

LHI Group milestones

1973

FOUNDING

LHI was founded on 1 October 1973 as a leasing company for trade and industry. The focus was on financing real estate investment projects. Over the years, LHI has evolved from a provider of leasing solutions to a provider of structured finance.

1981

FIRST INVESTMENT PRODUCT

LHI launched its first fund for selected customers. The first mutual fund followed in 1994. This was the starting signal for further investment products designed for private as well as professional investors. This created the second pillar of LHI's business segments alongside Structured Finance.

2000

EXPANSION

LHI expanded its business strategy at the turn of the millennium. This was driven by acquisitions. In 2002, Bayerische Immobillienleasing was acquired, in 2006 SüdLeasing's real estate leasing division was integrated and in 2009, Movesta Lease and Finance was taken over.

2012

FOUNDING OF LHI CAPITAL MANAGEMENT GMBH

Upon the entry into force of the Financial Asset Brokerage and Investment Act, LHI founded a sales company for all investment products designed by LHI. As a partner for private and (semi-) professional investors, it also supports investors during the term of the investment.
LHI Capital Management GmbH is a wholly-owned subsidiary of LHI and is licensed in accordance with section 32 of the German Banking Act (KWG) by BaFin.

2013

FOUNDING OF LHI KAPITALVERWALTUNGSGESELLSCHAFT MBH

The German Investment Code became effective in 2013. In July 2013, LHI founded its own capital management company with a license from BaFin. It launches all new investment products from the LHI Group and also manages LHI fund structures that were launched before the KAGB came into force. It is likewise a 100% subsidiary of LHI.

2015

ACQUISITION OF LHI

By company management. The managing directors of LHI acquired all shares retroactively to 1 January 2014. LHI is thus an owner-managed company.

2016

FIRST FINANCING VIA CROWD-INVESTING-PLATFORM

In cooperation with the crowd-investing platform Exporo, LHI offered a smaller-scale refinancing tranche.

2018

DIGITAL INNOVATION LAB

The LHI Digital Innovation Lab was founded in mid-2018 in order to test the opportunities presented to LHI arising from the ongoing digitization process.


1973


2012


1981


2013


2018

Organisation of the LHI Group

SHAREHOLDER

LHI Holding GmbH

MANAGEMENT

LHI Leasing GmbH

Financial services institute, LHI Group management,
founded in 1973

LHI Leasing GmbH is a financial services institute and operates according to the provisions of the German Banking Act (Kreditwesengesetz). The company established risk management systems that meet these strict supervisory standards.

OPERATIONAL SERVICE COMPANIES

LHI Kapitalverwaltungs-gesellschaft mbH
Kapitalverwaltungsgesellschaft i.S. of KAGB, management of AIFs,
founded in 2013

LHI Capital Management GmbH
Sales/
Investor support,
founded in 2012

LHI Luxembourg Group

LHI Management Luxemburg S.A.
Fund issues and fund management according to Luxembourg law,
founded in 2009

LHI Securitization S.A.
Securitization vehicle in Luxembourg,
founded in 2017

LHI Versicherungsmakler GmbH
Consulting Services/
Insurance,
founded in 2005

LHI sp. z o.o. (Poland)
Polish subsidiary
based in Warsaw,
founded in 1995

LHI Real Estate Management GmbH
Construction support management services/construction management,
founded in 1988

MANAGEMENT OF SPECIAL PURPOSE COMPANIES

Intermediary holding companies
Various intermediary holding companies, including the acquisition of various leasing portfolios.

Special purpose companies
Special purpose companies' projects

Key figures

	31.12.2018 EUR '000	31.12.2017 EUR '000	31.12.2016 EUR '000	31.12.2015 EUR '000
Equity	41,697	41,697	41,697	41,697
Result from ordinary business operations	15,687	20,547	5,692	6,529
Result for the year*	14,341	20,430	5,501	5,865
Equity ratio in %	35.8 %	35.7 %	32.3 %	33.4 %
Economic result	21,312	23,478	14,640	6,650
New business volume approx.	991,000	523,000	1,020,000	280,000
Transaction volume approx.	1,500,000	1,500,000	700,000	–
Companies under management approx.	1,499	1,560	1,600	1,700
Investment volume under management approx.	16,400,000	18,000,000	17,350,000	18,730,000
Cumulative placed equity capital approx.	4,200,000	4,000,000	3,900,000	3,600,000
Cumulative fund volume approx.	10,200,000	9,700,000	9,300,000	8,800,000
Cumulative number of investors approx.	17,500	19,000	19,400	19,350
Average number of employees per year	249	251	248	258

*Transferred by profit and loss transfer agreement since 2015.

Human Resources

First-class market and industry know-how, experts with many years of experience and contacts who are up to date with the latest regulatory and industry-specific conditions – this is what companies and investors rightly expect from LHI. We live up to these expectations because human resources management at LHI means meeting LHI's strategic goals and the expectations of our business partners in equal measure. However, we do not come up short when it comes to our employees' expectations for a modern employer.

We shape the future together

For a company to be successful in the future, it needs the right employees as well as the right strategic decisions. This requires people who are developing solutions for today and tomorrow. Employees who above all want to help shape the future of a company and who are jointly following the path to the future of the organization.

LHI founded the "Digital Innovation Lab" in 2018 for just this reason. Employees, executives and management are jointly developing ideas about what the future may hold for LHI.

Lifelong learning as a success factor for everyone

Individual professional development is not the only factor that plays an important role at LHI. With "Polaris", LHI has once again launched a management development programme. Twelve employees have the opportunity here to learn what it means to be or become a manager.

Work with quality of life

Work with quality of life in mind is on display at LHI. The Pullach Campus has been awarded the platinum DGNB Certificate for sustainable building. Among other factors, this assessment takes social-cultural and functional quality into account. This includes, for example, the quality of experience indoors and outdoors, safety and accessibility.

We also make sure that we offer our employees a healthy and balanced diet. All dishes are freshly prepared daily in the company restaurant. We attach great importance to regional products as well as light and healthy food. In previous years, we offered an LHI Health Day. In 2018, Health Week was held so that all employees had the opportunity to take advantage of the various offers throughout the week. Workshops on nutrition, fitness courses or health checks were available to choose from.

Anyone who wants to can be active in sports with LHI, e.g. in the LHI football team, the LHI volleyball team or during the LHI ski weekend.

Human Resources in figures

About 14 years

Average length of service at LHI

5

Employees on the team Human Resources

Average

1,4

Advanced training days per employee for 2018

249

headcount for 2018 at LHI

Approx. EUR 200,000

Total investments in further education and training for 2018

Approximately 20 %

women in executive roles at LHI for 2018

Code of Ethics

LHI's success lies in its company-wide corporate culture, which is characterised by integrity, mutual appreciation and individual responsibility. We place our long-term economic success with the greatest possible benefit for our customers at the centre of our actions.

This Code of Ethics serves as a code of conduct for all LHI employees. It contains values, basic behaviour, attitudes and rules of conduct which are binding for all of us when dealing with our business partners, customers, competitors and authorities.

General principles

Compliance with laws and regulations
We undertake to comply with all applicable laws and other applicable regulations in countries in which we operate in all business activities and decisions.

Combating money laundering, financing of terrorism and corruption
We use internal security measures and mechanisms based on potential risk to prevent money laundering, to combat the financing of terrorism and to combat corruption.

Compliance with data protection requirements
The personal data of our business partners, customers and employees are protected against access and illegal use by means of various security standards.

Fair competition
We comply with applicable laws and regulations governing competition, and we want to protect and promote fair competition.

Principles for working together

Guiding principle
Our dealings with each other are characterized by the following values and basic attitudes: mutual respect, loyalty, reliability and commitment, correctness and fairness, authenticity and performance orientation as well as discretion. Our actions should be as transparent as possible.

Avoidance of conflicts of interests
We are committed to avoiding situations in which personal and/or business interests may conflict with those of our company.

We shall refrain from obtaining any advantages, in particular by accepting personal gifts or advantages resulting from business relationships.

Principles for working with business partners and customers

Business relationships
We advise and support our business partners and customers or potential business partners/customers respectfully and personally.

Handing confidential information
Within the scope of applicable laws and regulations, we commit to safeguard trade secrets or other confidential information and documents from business partners and customers disclosed to us.

Completeness of information
Information we communicate and disseminate is complete and understandable in itself in order to provide business partners and customers as well as potential business partners/customers with a basis for a long-term business relationship.

Quality
Our products and services are characterized by the highest quality standards and continuous adaptation to market developments and customer needs.

Principles of social responsibility

Occupational health protection
We guarantee occupational safety and health protection at the workplace in accordance with applicable regulations.

Environmental protection
We focus on sustainability and energy efficiency in the construction of our building.

Social responsibility
We behave in a manner that reflects the responsibilities of our company within society.

WE ADVISE AND SUPPORT OUR BUSINESS PARTNERS AND CUSTOMERS RESPECTFULLY AND PERSONALLY.


OVER
VIEW

Financial year 2018

THE COMPANY

LHI Leasing GmbH was founded in 1973 as a real estate leasing company. Since 2015, it is 100 % owned by LHI Holding GmbH. The four managing directors of LHI each hold a 25 % interest in LHI Holding GmbH.

The LHI Group offers structured financing solutions for companies, as well as real estate management, property management, insurance solutions and property valuation services. LHI designs investment products for private investors, foundations, family offices, pension funds, pension schemes and insurance schemes. Asset management, fund management and investor support are performed in-house.

Pursuant to section 1 (1a) no. 10 German Banking Act, LHI is a regulated company in the financial sector and is therefore subject to the provisions of the German Banking Act. With regard to capital procurement and the management of equity structures, major parts of the services are provided by two wholly-owned subsidiaries, LHI Capital Management GmbH (LHI CapMan) and LHI Kapitalverwaltungsgesellschaft mbH (LHI KVG). Both companies are also subject to German financial supervision, have their own staff and are linked to LHI by profit and loss transfer agreements.

LHI is domiciled in Pullach i. Isartal and has a branch in Pöcking and an office in Stuttgart. In addition, it holds indirect investments in Polish entity LHI sp. z o. o. and LHI Management Luxemburg S.A.

LHI is a member of the Bundesverband Deutscher Leasinggesellschaften e.V. and the Zentraler Immobilien Ausschuss e.V. (Central Real Estate Committee).

Company management

As a rule, LHI structures its financing solutions and investment products via special purpose companies. The LHI Group currently manages 1,499 such companies. In some cases, the application of applicable principles of commercial law results in the circumstance that commercial results are not reflected in the appropriate period in the LHI financial statement. Accordingly, the actual earnings situation or composition cannot always be directly derived from an exclusive consideration of LHI's income statement items.

To manage new business, LHI therefore uses a performance indicator that looks at the product in question over its entire term. All payment flows relevant to earnings are shown at the individual transaction level and their nominal earnings values are thus controlled. The financing volume of new business is not used for corporate management purposes, but plays a role in the market comparison of the leasing sector. The same applies to transaction volume under advisement, which likewise provides only indications of market significance but is not used for control purposes.

Existing business is mainly managed on the basis of the “sustainable cost recovery ratio”. This key figure corresponds to a expense / costs ratio tailored to the LHI business model using fixed costs and income flows. It is supported by a multi-level contribution margin accounting. Details of the key figures and instruments are presented in the Risk Report section.

In addition to the performance indicators mentioned above, various other indicators are used in LHI's business and risk strategy and formulated on the basis of these target values. The focus here is on achieving cost-income ratios in the range of 80% to 90% based on imputed or real full costs. The aim of monitoring and controlling these ratios is to generate a pre-tax return on equity of at least 10%. In order to ensure the achievement of this goal, it is not so much the considera-tion of an isolated key figure as the interaction of the key figures that is decisive. For example, the acquisition of a large real estate leasing portfolio could lead to a temporary violation of the strategic objective of keeping risk utilisation below 80%. For the past financial year, it may be reported that all the overall and individual targets formulated in the business and risk strategy were achieved. This statement also applies to the three previous financial years.

Participating interests and related companies

The LHI Group also includes other companies that complement or round-out the range of ser-vices offered. All of them have their own legal personality and are maintained as profit centres.

LHI Real Estate Management GmbH (LHI REM) supports the construction side of our financing projects. In doing so, it ensures construction and process quality, minimizing possible consequen-tial damage and identifying investment risks at an early stage. LHI REM also makes its range of services available to external third parties and generates additional fee income from these sources. LHI REM enjoyed a successful 2018. Book income was positive.

ATG Abrechnungs-Treuhand GbR (ATG) handles all payment transactions for the LHI Group and a large number of its affiliated property management companies. In this context, it also performs the function of cash pooling, which creates a foundation of cash and cash equivalents available over the long term. These funds are invested in accordance with a strictly formulated investment guideline and thus generate net income. The past financial year was a successful one for ATG in terms of earnings. The absence of current investment income was offset by surpluses from the sale of bonds prior to maturity. As long as no reinvestment of released liquidity takes place, ATG can therefore be expected to generate declining current interest income.

LHI sp. z o. o. serves the Polish market from Warsaw. In the past, LHI sp. z o.o. was primarily active in real estate leasing. Business activities have been realigned in recent years. Real estate development is now the focus of the business model. The course of business in 2018 reflects this process of change. For example, positive results were realised from the one-time participation in the successful closing of a real estate transaction. We also expect positive contributions to results in subsequent years as soon as the projects currently under development are sold on the market. Overall, however, the earnings situation has become more volatile following the change in business model.

At present, LHI Management Luxemburg S.A. primarily manages structures that we have set up for intra-group purposes. In addition, it provides management services for a Luxembourg special fund (FCP) for the real estate investments of a professional investor with a target volume of EUR 600 million. The special fund is still in the investment phase. The portfolio is being established by a third party outside the Group. Securitisation company LHI Securitization S.A., which is also located in Luxembourg, has been executing securitisation transactions since 2018. As a result, Luxembourg as a business location has gained in importance for the LHI Group, resulting in increased investments in space and human resources. Investments have enjoyed positive results.

LHI Versicherungsmakler GmbH is a joint venture between conTRact Versicherungsmakler GmbH and LHI Leasing GmbH. It acts as a competence centre for all insurance-related issues with the main task of optimising insurance cover for the property companies under management. The earnings trend is influenced by the receipt of brokerage commissions and may be described as good for the past financial year. Services from LHI Versicherungsmakler GmbH are also available to outside third parties. However, we are very selective in our when contacting potential customers. The extremely favourable claims history within the portfolio along with the associated insurance premiums, which are favourable compared with the market, should not be jeopardised.

ECONOMIC DEVELOPMENT

Macroeconomic and industry conditions

On 14 February 2019, the Statistical Office of the European Union, "Eurostat", updated its flash estimate for economic development in the European Union (EU28) and announced an increase in gross domestic product of 1.9 % for 2018. According to the Federal Statistical Office, German GDP rose by 1.5 % over the same period (1.5% even when adjusted for calendar effects). Economic output in 2018 was created by a working population averaging 44.8 million, 562,000 or 1.3 % more than in the previous year.

In addition to the economic environment, trends in interest rates also has a significant impact on the investment decisions of companies and investors. According to the "Long-term interest statistics for EU Member States", which is managed by the European Central Bank, the yield on German public-sector bonds fell from 47 basis points in January 2018 to 19 basis points at the end of the year. In January 2019, this key figure fell by a further six basis points.

According to the BDL, new business in the leasing sector reached a new all-time high of EUR 70 billion in 2018 (previous year: EUR 67 billion). The real estate leasing segment, which is decisive for LHI, also increased, reporting a volume of EUR 1.5 billion compared with the previous year (EUR 1.2 billion).

The market for closed public AIFs reported even stronger growth than real estate leasing. According to the rating agency Scope, the volume of prospectus offers rose from EUR 0.7 billion in 2017 to EUR 1.1 billion in 2018, thus reaching the level of 2016 once more. A total of 32 public AIFs were approved for sale by BaFin - three more than in 2017. The average fund size again grew significantly compared to the previous year. For example, the average equity volume in 2018 was around EUR 34 million (+44 %).

Corresponding publicly available figures for professional and semi-professional investors are not available. We assume that this will remain so in the long term, because many professional investors in particular are increasingly switching to product categories that are either not regulated at all (e.g. promissory note loans) or are regulated under a different legal framework (e.g. as SICAV vehicles under Luxembourg law). In general, LHI is experiencing consistently high demand for tangible investment products, as many investors are switching to alternative forms of investment as a result of the ongoing low-interest environment. Various media reports indicate that this market trend could intensify further if the low-interest trend continues.

BUSINESS DEVELOPMENT

The earnings situation and business development of LHI Leasing GmbH in the past reporting period may be assessed as good. With book results of EUR 14.3 million before profit transfer, we also significantly exceeded our strategic earnings target in 2018 as a result of one-off effects. The composition of the normalized result is well-diversified; the extraordinary effects are due to individual factors. Target achievement for nominal results in new business was 120 %.

New business

On the whole, with new business volume of EUR 991 million, we structured nearly twice the volume of transactions and added to our management as was the case in the previous year However, the volume of contracted transactions plays a subordinate role in the success of LHI, as there is hardly any relationship between volume and income.

The share of real estate projects in the new business segment remained roughly unchanged at 57 %. The trend of involving additional external investors in financing structures in addition to the classic bank financing has continued.

In the area of traditional investment products, we continue to concentrate on the asset classes real estate, renewable energies and aviation. In the real estate market, demand from foreign and domestic investors for German properties remains high. The increasing shortage of real estate is allowing prices to rise further, which further reduces yields that can be realised. Overall, however, growth rates are flattening. We continued to make selective use of this market situation in the past financial year and sold properties managed by us. In addition, we completed the structuring of a real estate fund focused on Bavaria and Baden-Württemberg. With BaFin approval, the public AIF fund was placed at the end of 2018.

In the renewable energies asset class, we increased a number of portfolio structures in the past financial year. In addition, we launched a new product aimed at institutional investors. The competitive tendering of projects in Germany since 2017 has reduced the supply of facilities that pay off for investors.

During the past financial year, we were able to conclude new rental agreements for several existing aviation funds. In addition, a new product was prepared for the market in this asset class. We expect to be able to structure further products for our customers in 2019. Since we focus on the most modern passenger aircraft and the freighter segment, we do not see any negative effects on our business model from recent airline bankruptcies.

Existing business

We use special purpose companies to implement our financing solutions and our investment vehicles. These companies are managed by us. LHI usually has no, or only a small percentage, interest in these companies. The administrative activity usually extends over periods of more than ten years, whereby we are remunerated in the form of service fees for these administrative services. In compliance with regulatory requirements, all products regulated under the German Investment Code ("KAGB") and the majority of products involving external investors are managed by LHI KVG. LHI, on the other hand, administers those special purpose companies focusing on the financing aspect and which are not regulated in accordance with KAGB.

We also offer some services to third parties. In the past, we also purchased portfolios from other providers and placed them under our own administration. This applies to both real estate leasing and fund portfolios. During the past financial year, LHI did not acquire any portfolio items or any new external management commissions. One management commission was extended for a further ten years.

In 2018, 1,499 companies were managed by LHI. The original total investment costs of the financing structures for these companies amount to some EUR 16.4 billion (previous year: EUR 18 billion).

The reduction is due in part to the scheduled phasing-out of some large-volume media funds.

As companies are phased out, the fee income generated from the portfolio also declines. This effect is mainly due to the fact that companies from high-volume years (1995-2005) have reached the end of their regular life cycle. In this respect, the terminations are easy to plan, which in turn facilitates the adjustment of administrative capacities. Accordingly, the division's business performance in the past financial year was in line with our expectations. We consider the further trend to be stable, because on the earnings side we expect that we will be able to largely compensate for the effects of the termination process with incoming new business.

SITUATION OF THE COMPANY

During the 2018 financial year, LHI generated pre-tax earnings of EUR 12.7 million (previous year: EUR 20.5 million). This represents a decrease of EUR 7.8 million compared with the previous year. One-off effects in the previous year were the decisive trigger for the significant decline. In 2017 and 2018, LHI reversed parts of its existing provision for possible loan losses. At EUR 6.5 million, the amount of the reversal in 2017 was EUR 3.6 million higher than in 2018. In addition, at EUR 10.2 million, ATG's net income from financial investments was unusually high in 2017 (2018: EUR 3.9 million) on the basis of extraordinary dividends from special funds. Compared to budgeting for 2018, however, earnings almost tripled as a result of one-off effects.

Current remuneration for the management of special purpose companies and the result from ATG's financial assets are reported under "Other operating income". Due to the aforementioned factors, this item fell significantly from EUR 47.4 million to EUR 37 million.

Income from investments including profits and losses from profit and loss transfer agreements rose from EUR 15.7 million to EUR 20.3 million, income from profit and loss transfer agreements rose to EUR 3.9 million (previous year: EUR 3 million). Investment income from partnerships decreased by EUR 2.2 million. Income from investments in 2018 includes non-recurring effects from investments of EUR 6 million.

Net commission income rose year-on-year from EUR 3.6 million to EUR 4.1 million. The increase mainly attributable to higher income from the early termination of leasing arrangements. In return, lower commissions were generated for conceptual design and capital procurement.

Net interest income improved to EUR 0.9 million (previous year: EUR 0.6 million). This was mainly due to higher interest income for new or increased interim financings as well as a one-off interest income from a tax refund. The accounting rule for discounting provisions for pension commitments that was modified in 2015 continues to have an inverse effect.

Total personnel expenses fell from EUR 24.4 million to EUR 22.5 million. The average number of employees over the year remained at the previous year's level. The main factors for this trend comprise the variable remuneration components linked to company results and lower allocations to pension provisions.

Other administrative expenses and other operating expenses rose from EUR 22.1 million to EUR 24.1 million. The change mainly results from allocations to the provision for loan losses.

For the first time in 2018, LHI made allocations to a fund for general risks according to section 340g German Commercial Code.

The actual earnings situation and composition for LHI may not be directly discerned from the income statement items in all cases. Therefore, earnings and cost figures derived from the management income statement in accordance with business management principles are used for management purposes. During the preceding financial year, costs were 13 % higher and revenues 47 % higher than budgeted. Accordingly, the CIR was well below the budget corridor.

In the current environment, we assess the earnings situation as good. The same assessment applies to the entire LHI Group. Although the annual result for 2018 was again marked by one-off effects, it is again within the strategically planned corridor after adjustment for these effects. The level of earnings in 2018 is not a suitable yardstick for forecasting longer-term developments. Although one-off effects are again foreseeable for 2019, in our medium-term planning calculations we continue to assume a return on equity of 10 % to 15 % and thus annual results in the range of EUR 4 million to EUR 6 million. Earnings in 2019 may again be higher than strategically planned due to expected one-off effects.

Capital structure

There is a profit and loss transfer agreement between LHI and LHI Holding GmbH, so that the annual result does not change LHI's equity situation. Accordingly, the company's equity remained unchanged at EUR 41.7 million. In addition, an open contingency reserve in the form of a fund endowed with EUR 3 million for general banking risks was in place for the first time as at 31 December 2018. At EUR 116.3 million, the balance sheet total remained virtually unchanged. (previous year: EUR 116.9 million). The equity ratio stabilized at 35.8 % (previous year: 35.7 %), rising to 38.4 % taking into account the open contingency reserve in accordance with Section 340g German Commercial Code.

Investments

The assets side of the balance sheet is characterised by investments in own structures and cash and cash equivalents as of the balance sheet date. Some of the investments are short-term in nature and will be repaid upon external placement. Long-term receivables and investments in financial structures have a strategic character or had to be taken over by the Company after the end of the placement phase.

We are also planning short- and medium-term investments in our own structures for the coming years. However, total volume will tend to decline. At the end of each year, we continue to expect a high level of liquidity on the balance sheet date.

Refinancing and liquidity

Medium- and long-term investments are financed by a bearer bond issued by LHI in the amount of EUR 10 million (previous year: EUR 15 million) and by the Company's own funds. In addition, we took out an annuity loan of EUR 9.1 million with a bank in 2015. On the reported date, this loan had an outstanding balance of some EUR 4.9 million and a residual maturity of 3.75 years. LHI has not entered into any other long-term liabilities in addition to the bearer debt obligation and the annuity loan.

We fund our ongoing business operations and interim financing for products to be placed using company funds and, as needed, by drawing on credit lines at four banks in the current amount of EUR 40 million. The credit line from one of our financing partners, which expires on 31 December 2018, was replaced on the same terms. On 31 December 2018, borrowed funds of EUR 24.9 million were freely available from these credit lines.

Our solvency was assured at all times in 2018. By means of a rolling liquidity forecast based on conservative standards, we monitor and control our funds commitment on an ongoing basis. Based on a 12-month horizon, our liquidity available for new business will not fall below EUR 25.8 million (previous year: EUR 36.8 million) provided our funding options remain unchanged.

Off-balance sheet liabilities that could have an effect on liquidity upon occurrence include guarantees and warranties for which LHI is responsible. The equivalent value of these items fell from EUR 57.5 million to EUR 39.1 million. In addition, there are placement and acquisition obligations amounting to EUR 4.4 million (previous year: EUR 4.2 million). The sole reason for this change is the increased euro equivalent of a placement guarantee denominated in US dollars that has been in place since 2007. Furthermore, there are off-balance sheet liabilities related to outstanding capital contribution obligations in the amount of EUR 6.7 million (previous year: EUR 23 million).

The financial position of LHI is in order. As in the past, the main items on the assets side of the balance sheet are receivables from customers amounting to EUR 45.7 million (previous year: EUR 48.1 million), investments and shares in affiliated companies amounting to EUR 41.1 million (previous year: EUR 37.2 million) and other assets amounting to EUR 27.7 million (previous year: EUR 29.7 million), which mainly comprise cash equivalent items. For part of the short-term investments in proprietary products, the corresponding project financings were repaid. Investments and shares in affiliated companies increased as a result of share purchases and the granting of capital reserves. At EUR 26.9 million at year-end 2018, cash and cash equivalents were slightly lower than in the previous year (EUR 28.9 million).

In addition to equity and the fund for general banking risks, these balance sheet items are mainly offset on the liabilities side by provisions of EUR 28.7 million (previous year: EUR 29.4 million) and other liabilities of EUR 12.1 million (previous year: EUR 19.3 million), which primarily comprise the profit or loss to be transferred to the shareholder. In addition, there was a securitised liability of EUR 10 million at the balance sheet date (previous year: EUR 15 million). Furthermore, liabilities to banks amounting to EUR 20.3 million (previous year:EUR 11 million) have been recognised, of which EUR 15.4 million are of a short-term nature. We currently do not use any other financial instruments.

FORECAST, RISKS AND OPPORTUNITIES

Forecast

From our perspective, the ongoing low interest rate environment and the still favourable investment environment in Europe and the USA on the one hand, as well as the latent inflation fears over the medium-term on the other, will shape future market developments. In our view, this presents both risks and opportunities in equal measure. Overall, we expect the global economy to slow. In its annual report for 2019, the German Federal Ministry for Economic Affairs and Energy, for example, only expects economic growth of 1 % in 2019.

We do not expect general political developments (Brexit, imminent trade wars, etc.) to have any direct impact on our business model, although we see growing uncertainty in this regard. Accordingly, we will continue to adhere to the key data for our current planning and maintain our conservative business policy moving forward.

We continue to regard trends in asset prices as problematic, as they are increasingly hampering the purchase of properties with an adequate risk/return profile. Even though the willingness of banks to provide financing remains high, we expect that the banks' propensity to fully finance our financial structures – leasing specific – may decline.

An additional important factor that influences business activities on the part of LHI comprises developments in the legal environment. At present, we assume that regulatory density will continue to increase. The complexity of regulation is still manageable and economically viable for a medium-sized enterprise such as the LHI Group. However, we will have to critically review individual business activities. In this environment, LHI KVG's initial task is to fully invest existing capital commitments in existing products. New products are targeted at institutional investors and wealthy private clients. For this reason, the product range for these target groups will continue to be the focus of LHI CapMan's sales of equity capital projects. In addition, we assume that we will expand our activities in Luxembourg in line with demand.

The decline in our portfolio business will continue at a slower pace. We assume that the resulting effects on fee volumes can be offset by new business and other income components. We do not expect to acquire further leasing or fund portfolios in the foreseeable future.

In terms of risk, we assume that the utilisation of the risk cover funds will not be exceeded in the base scenario (< 80 %) and stress scenario (< 100 %) in subsequent years either. We expect the nominal results from new business to be within target. The long-term coverage ratio will remain at the target level of between 75 % and 85 %. Under the general conditions described above, we assume long-term book results of between EUR 4 million and EUR 6 million (return on equity of between 10 % and 15 %). Results for 2019 are expected to be higher due to one-off effects.

Overall, we consider the achievement of our earnings targets to be ambitious but realistic. External factors such as the slowdown in the economy and a further increase in regulatory density are included in our expectations. We do not currently see any exogenous shocks, such as a failure of the euro zone. We analyse the effects of such scenarios in the form of stress tests, etc., but they are not part of the planning premises set out here.

Risks

Risk management

Every entrepreneurial activity involves taking risks. These risks can arise at any location within the company and it is impossible to anticipate and/or quantify every risk. In order to minimise the risks of “day-to-day” business operations, LHI takes precautions such as

- Employee training and awareness-raising
- The publication of action plans (contingency plans, working instructions)
- Purchasing insurance policies (risk mitigation)
- The duplication of resources (substitution rules, technical backup procedures, etc.)

These preventive measures can thus be seen as an integral part of risk management in the broader sense. They are, however, so specific that they largely elude standardized control at a higher level. In order to make these risks identifiable or to keep them manageable, LHI uses instruments such as internal auditing to check certain circumstances or the establishment of standard controls within the framework of an internal control system (ICS).

Risk management in the narrower sense means dealing with the risks that LHI assumes or must assume in order to generate profits. The preparation of such decisions takes place in the form of an original risk assessment by the relevant operational departments. In this context, the process sequence at LHI ensures that functional segregation required for regulatory purposes is provided for within the decision making process. The process sequence is designed in such a way that all risk-related decisions are ultimately made by LHI management in the form of a second risk assessment.

In addition to decision making, analysis of a risk situation comprises a second important aspect of functional segregation. In this context, LHI distinguishes between the risk management and risk controlling functions. While the risk controlling function is performed by an independent organisational unit, the risk management function is organised on a decentralised basis. In this context, the tasks of risk management are characterised by the following features:

- Close relationship to the individual transaction or for the individual transaction
- Operational relationship (e.g business acquisition, maintenance, workout)
- Dealings with customers, investors or project partners (high external impact)

During the risk controlling process

- Risk analyses for the company as a whole carried out (portfolio view)
- Risk potentials calculated (no operative handling of risks)
- Primarily relates to corporate management (little or no external impact)

Risk management and risk controlling are interlinked via so-called risk control committees. Risk managers regularly meet in these committees to analyse the current risk situation and to determine further procedures on this basis.

LHI’s risk management and risk controlling process encompasses the entire LHI Group. LHI KVG has an independent risk controlling unit. This unit performs the risk controlling function both for LHI KVG itself and for the AIF products it manages. The data and information obtained as part of this process is discussed with the corresponding unit within LHI and then presented in a Group-wide risk report.

The audit in the risk management and risk controlling processes at LHI is regularly included in the internal audit department's audit plan. The most recent review of the risk control processes carried out by the internal audit department again showed that the existing roles, guidelines and regular reporting ensure that LHI's risks are managed appropriately and identified in good time.

Risk categorisation

When assigning the individual risk types to the risk categories, LHI is guided by its business model, i.e. risk types are assigned on the basis of the business activities that essentially cause the risks. Risk reporting distinguishes between six risk categories.

Property price risks

Property price risks include risks resulting from business with equity-based structures. In this business segment, properties are regularly acquired (real estate, wind and solar parks, etc.), that are then embedded in fund structures and then placed on the market. In this phase, there is a risk that the value of the properties will change and that LHI will suffer a financial loss as a result. In the worst-case scenario, the property may even become unsaleable, so that LHI must remain invested over the longer term. Due to the specific character of individual properties, these risks are assessed using scoring procedures tailored to the respective properties.

Market price risks

By definition, market price risks arise exclusively within ATG which handles payment transactions for the majority of the companies affiliated with the LHI Group. In this function, ATG has at its disposal a deposit of free cash and cash equivalents that can be invested within the framework of narrow investment guidelines. The resulting opportunities and risks (interest rate risks, borrower credit risks and share price risks) are borne by LHI. Risk quantification is based on a simulation involving historical data.

Counterparty default risks

Counterparty default risks result from the fact that fixed fee agreements are concluded with their customers (lessees) for the management of property companies. If a lessee becomes insolvent, the fees are not paid and the costs for the administration of the special purpose company continue to run. The quantification of this risk is based on the method of determining credit default risks by calculating expected and unexpected losses at the level of individual transactions and portfolios, whereby the default probabilities of the lessees are determined using rating procedures and the future fees are used to measure the credit equivalent amounts.

Investment risks

Investment risks are risks arising within the scope of material investments for the LHI Group. Material investments are companies that either have a high risk exposure and are therefore materially relevant to risk or are of particular significance for the business model of the LHI Group (or parts thereof). Due to the particular characteristics of the business models, property price, market price and counterparty default risks are not individually relevant or negligible in these companies. The investment risks therefore primarily comprise operational risks and other risks of the companies. The basic indicators for the quantification of these risks in the individual companies are predominantly fee obligations or cost totals for the calendar year. The associated weighting factors are determined within the framework of scoring procedures. Occasionally, other risks are also identified by means of blanket assessments within the framework of expert estimates.

Operational risks
Operational risks result from general business operations, so that allocation to specific business activities is only possible in individual cases. Quantification of this type of risk is based on the standard approach prescribed by the regulatory authorities. The “relevant indicator” is the sum of all fee obligations over the next twelve months, while the weighting rate is determined on the basis of a scoring model.

Other risks
Other risks comprise a collective item in which all risks are shown that occur only temporarily, i.e. that are not a regular component of the LHI risk profile. These comprise essentially structural liquidity risks (liquidity shortfall in the liquidity maturity statement) and strategic business risks. Quantification is carried out by means of an expert estimate.

All material sub-risk types are grouped into these categories. Operational risks, for example, also include legal risks. The aforementioned risk control committees were also set up on the basis of the above-mentioned risk categories.

Risk reporting

MaRisk AT 4.1 requires institutions to ensure that all material risks are covered by the risk cover potential and that proof of risk-bearing capacity must be provided. Accordingly, the analysis of the risk-bearing capacity comprises the nucleus of risk reporting at LHI.

The risk report is prepared by Risk Controlling and discussed regularly by the Management Board. The requirements of the risk strategy and its compliance are also reviewed as part of the risk reporting process, in addition to the risk-bearing capacity.

Apart from its risk-bearing capacity, the availability of liquidity represents another significant risk for LHI. To manage this risk, a rolling liquidity forecast is prepared every 14 days and discussed by LHI management. Within the framework of this forecast, all known material liquidity outflows for the coming twelve months are determined and compared with the available liquidity including the committed free credit lines.

The liquidity forecast reliably indicates whether a structural liquidity shortfall can occur within the period under review. The risk strategy stipulates that this is to be avoided. If a shortfall occurs nevertheless, a corresponding risk value (liquidity at risk) is calculated on the basis of the liquidity shortage amount, which must then be backed by risk capital in the risk-bearing capacity model. In addition, the cycle for preparing the liquidity forecast must be shortened in such a case.

Risk-bearing capacity

The risk-bearing capacity model is based on the going concern assumption. The methods used for risk quantification tend to be strictly pronounced in this model (e.g. no application of risk-mitigating correlation or diversification effects). Thus, the conservative assumption is assumed in model theory that all risks are taken at the same time. The basic structure of the risk-bearing capacity model is designed in such a way that the risk potential in the above risk categories is calculated in two scenarios (basic and stress scenario) and compared with the risk cover funds. In a first step, the risk potential of each individual transaction/risk carrier is calculated, e.g. in the basic scenario on the basis of a value at risk with a confidence level of 95 % and a holding period of one year. The risk potential of all individual transactions is then first added together within the respective risk category and then aggregated across all risk categories to form overall risk for LHI.

LHI's business model is characterised by the fact that frequently, investments are made in tangible assets and thus in illiquid assets (illiquid in the sense that no daily trading occurs and thus no high-frequency market data are available for these assets). In addition, the assets are very specific (e.g. location, condition, age and intended use of a property), so that a valuation can only be carried out regularly on the basis of a mark-to-model approach (e.g. a property valuation).

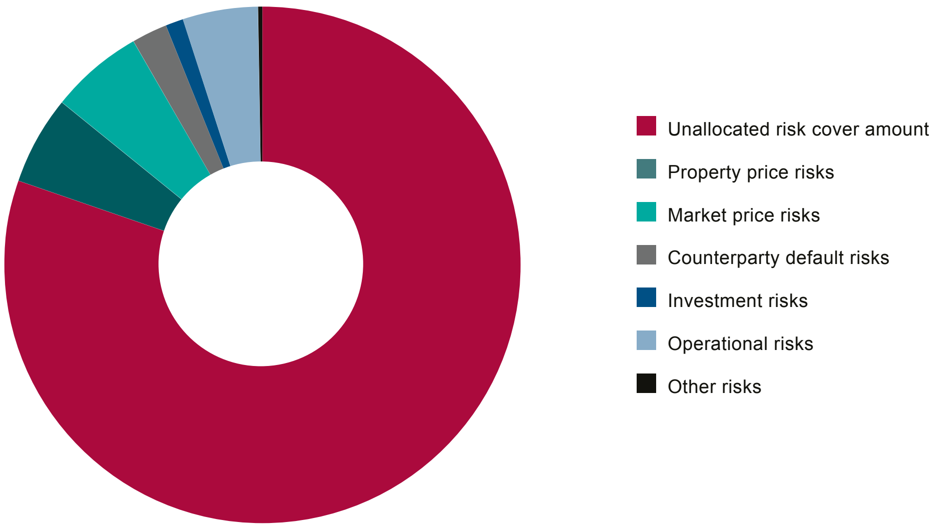
The risk cover funds taken into account in the risk-bearing capacity model comprise the share capital, the fund in accordance with section 340g HGB, the profit reserves and the risk provision to shield against losses in both the basic and stress scenarios. All methods and procedures used to calculate risk exposures or cover funds are described in a method manual, regularly reviewed and adjusted if necessary.

The risk-bearing capacity was maintained at all times during the reporting period, and all requirements of the risk strategy were complied with. As of the reporting date, risk utilisation was calculated at approx. 20 % in the basic scenario and approx. 38 % in the stress scenario. Compared to the beginning of the year, risk utilisation is thus falling.

Reduced risk utilisation is essentially attributable to three factors:

- Property price risks: Due to high investor demand, purchased assets could be converted into investment vehicles even earlier.
- Market price risks: Sales of investments with above-average risk exposure and expansion of the risk-related hedging of securities investments.
- Other risks: Risk exposures in specific cases were recognised in full through profit and loss through the formation of risk provisions.

LHI's risk profile as of 31 December 2018 was dominated by market price risks and property price risks. As of the reporting date, these accounted for approximately 30 % and 28 %, respectively, and thus together just under three-fifths of the total risk potential. The following categories comprise operational risks with a contribution of approx. 24 %, followed by counterparty default risks with approx. 12 %. The remainder (6 %) is distributed among the other risk categories listed above. The risk-strategic objective of avoiding structural liquidity shortfalls was met at all times during the reporting period. Accordingly, parts of the risk cover amount were not exposed to liquidity risks at any time. LHI's risk profile in the basic scenario is as follows:



It can be seen from the chart that in the basic scenario approx. 80 % of the risk cover amount is not utilised by risks and that the risk-bearing capacity is therefore assured.

The appropriateness of the risk evaluation is reviewed once a year by means of backtesting. The risks effectively observed in a calendar year are compared with the forecast values applied in the individual risk categories. Backtesting carried out in spring 2018 for the 2017 calendar year revealed that the risk forecast for each risk category exaggerated the risks that had actually materialised in each case. This confirms the conservative approach used in determining the risk values to be applied.

Opportunities

Observing the market, customer requirements, and monitoring the development of our own company as well as the economic and legal environment comprise integral parts of our daily work. In institutionalised management meetings with selected second-tier employees, for example, the business model is regularly scrutinised from a critical standpoint and, if necessary, adjusted, and optimisation potential or market opportunities are identified.

In principle, the LHI Group’s business model has proven to be very robust against cyclical fluctuations and market crises. This is evidenced by the fact that LHI has never closed a financial year with a loss for accounting purposes since it was founded. We see one of the reasons for this success over many years as being the fact that we have succeeded in diversifying the income side with the three business segments of structured financing, equity-supported products and the management of special purpose companies.

In the area of structured finance, we see particular opportunities through our structuring expertise. This enables us to tailor the transaction structures both to the needs of the customers (e.g. lessees) and to the needs of professional and semi-professional investors (e.g. insurance companies and other capital collectors). This gives us a unique selling proposition from which new business approaches can be developed on a regular basis. For example, we see the new leasing accounting standard (IFRS 16), which will come into force in 2019, as an opportunity to use our structuring expertise to develop advantageous solutions for our customers in the future as well.

In the area of equity-supported products, we are benefiting from the continuation of slow interest rate environment, favourable investment conditions in Europe and the USA, and the latent outlook for inflation fears over the medium-term. These circumstances continue to make investments in tangible assets attractive for many investors. In addition, we assume that the quality of the initiator of an investment product will also remain of great importance in the future, with continuity and a successful market presence over many years remaining the decisive criteria in investment decisions and the choice of financing partner. The high level of regulation also contributes to professionalisation and transparency in the markets relevant to the LHI Group. We believe we are well-equipped for the resulting quality-based competition.

In the context of managing special purpose companies, we generally see an opportunity to further stabilise this business by taking on management commissions. Accordingly, we remain open to the assumption of outside service commissions and cannot rule out the purchase of further leasing or fund portfolios.

Figures from the balance sheet and income statement

	31.12.2018 EUR '000	31.12.2017 EUR '000	31.12.2016 EUR '000	31.12.2015 EUR '000
Receivables from customers	45,687	48,110	32,014	49,137
Investments and shares in affiliated companies	41,076	37,178	48,923	45,662
Cash equivalents	26,892	28,900	41,620	18,933
Liabilities to banks	20,300	11,036	26,550	15,236
Reserves	28,726	29,372	32,859	32,703
Equity	41,697	41,697	41,697	41,697
Total assets	116,335	116,916	129,088	124,871
INCOME STATEMENT				
Current income from investments and affiliated companies as well as income from profit and loss transfer agreements	20.,323	15,701	8,785	9,295
Income from current fees and remuneration	25,702	25,002	27,902	27,906
Personnel expense	-22,472	-24,434	-20,520	-21,191
Other administrative expenses	-19,996	-19,897	-20,263	-22,652
Result for the year*	14,341	20,430	5,501	5,865
Annual net profit	0	0	0	0

*Transferred by profit and loss transfer agreement since 2015.

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LHI Leasing GmbH
Emil-Riedl-Weg 6
82049 Pullach i. Isartal
P.O. Box 212
82043 Pullach i. Isartal

Telephone +49 89 5120-0
Fax +49 89 5120-2000

info@lhi.de . www.lhi.de