

Ponsse

Extensive report

5/17/2021



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✓ Inderes corporate customer

This report is a summary translation of the report “Konekauppa käy, mutta kurssi jo korkeuksissa” published on 05/17/2021 at 5:14 am

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Machines are selling but share price has rocketed

We lower our recommendation for Ponsse to Reduce (previously Accumulate) with a new EUR 45.50 (previously EUR 46.50) target price. The company's outlook is good from the viewpoint of market development, Ponsse's own market position and profitability but we feel this is already fully discounted in the current share price. The share's valuation level is challenging with various indicators and leaves no room for disappointments.

Brisk market growth ahead

The main demand drivers for Ponsse's products are growing global logging volumes, progressing automation in logging and increase in the market share of the cut-to-length method. Of factors affecting logging volumes, growth estimates for construction after a weak comparison period in 2020 are clearly positive and the pulp market is expected to continue growing by some 3% p.a. The forest machine market dipped by some 20 % in 2020 due to COVID, which also explains the high 9% annual growth we expect in 2021-2024. We expect Ponsse's market share to rise heavily in 2021 thanks to a modern product line and still ongoing investments among its main competitors but to even out after this. Ponsse's used machine and service operations will grow a bit slower than new machine sales in 2021-2024 but the Group's growth rate is still fast in the forecast period, 11% (CAGR).

Reasonable upside in margins

Ponsse's cost structure is flexible and operational leverage thus small. Our expectation of stable and slightly improving relative profitability is, however, supported by the company's strong historic track record of transferring growing material costs to its own product prices. In addition, part of the operating cost savings in the COVID year 2020 and especially marketing and travel costs will be made permanent. We estimate that the operating margin will rise from 11.5% in 2021 to 12.1% in 2024. Even though the combined capacity of the large manufacturers in the sector is growing, we do not expect price competition to tighten substantially and generate margin pressure as the demand outlook is good. Ponsse's expected average earnings growth (CAGR) for 2021-2024 is very strong at 20%. Good profitability and strong balance sheet and cash flow create good preconditions for Ponsse to distribute growing dividend.

Share valuation is already challenging

The share's valuation has risen to a level where justified upside is very low. Undervaluation relative to peer group has in practice disappeared as the 2022 P/E ratio (15x) is now only 8% below the peer group median and the EV/EBIT ratio (11x) is on par with the peer group median. With our new target price, the valuation multiples are in line with the share's own historic median multiples. When examining valuation multiples one should also note that our estimates are optimistic both in terms of the entire forest machine market and Ponsse's market share and margin development. Other valuation methods support the view of a challenging valuation as the share's expected total return is below the return requirement and the upside to the DCF value is narrow. Even though we do not think the share is overpriced, the current valuation level cannot handle any disappointments in the development of the target market or in Ponsse's performance.

Recommendation

Reduce
(previous Accumulate)
EUR 45.50
(previous EUR 46.50)
Share price:
43.00

Recommendation	Risk		
	High	Low	
Buy			
Accumulate			
Reduce			
Sell			

Key indicators

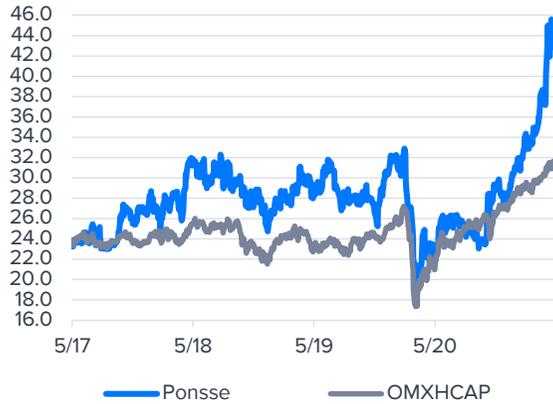
	2020	2021e	2022e	2023e
Net sales	637	796	872	923
growth %	-5 %	25 %	10 %	6 %
EBIT adjusted	57.1	91.3	101.6	110.7
EBIT % adjusted	9.0 %	11.5 %	11.6 %	12.0 %
Net profit	32.3	69.5	78.9	86.2
EPS (adjusted)	1.58	2.52	2.82	3.08
P/E (adjusted)	18.5	17.0	15.3	14.0
P/B	3.2	3.9	3.4	3.0
Dividend yield %	2.1 %	2.4 %	3.0 %	3.4 %
EV/EBIT (adjusted)	14.2	12.8	11.1	9.9
EV/EBITDA	9.9	10.2	9.0	8.1
EV/Sales	1.3	1.5	1.3	1.2

Source: Inderes

Guidance

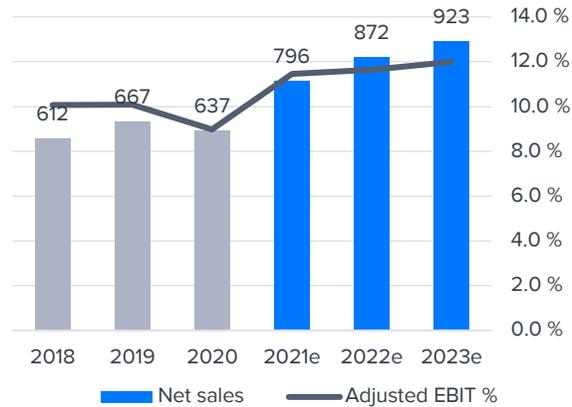
Group's euro-denominated operating result in 2021 is expected to be slightly higher than in 2020.

Share price



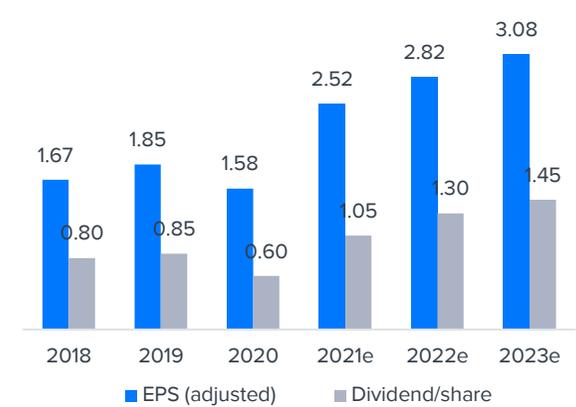
Source: Thomson Reuters

Net sales and EBIT %



Source: Inderes

EPS and dividend



Source: Inderes



Value drivers

- Solid position in the growth segment of the forest machine market
- Strong hold on customers
- Large after market potential
- Progressing digitalization in logging
- Good profitability and strong cash flow

Risk factors

- General cyclicity of forest machine market
- Competitors' increasing aggressiveness in marketing
- One factory and low degree of outsourcing in manufacturing can be a risk in case of various disruptions

Valuation

- The risk-adjusted return expectation is weak.
- Share's multiple-based valuation on par with peers
- Upside to DCF value is modest

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Ponsse in brief

Ponsse is one of the leading manufacturers of cut-to-length method-based forest machines in the world whose businesses also includes service and used machine operations. International operations' share of net sales around 80%.

1970

Year of establishment

1995

IPO

some 30%

Global market share in rubber-tire cut-to-length forest machines

+9.3% 2011-2020

Average annual net sales growth

EUR 7.1 million (9.0% of net sales)

Operating profit 2020

1,782

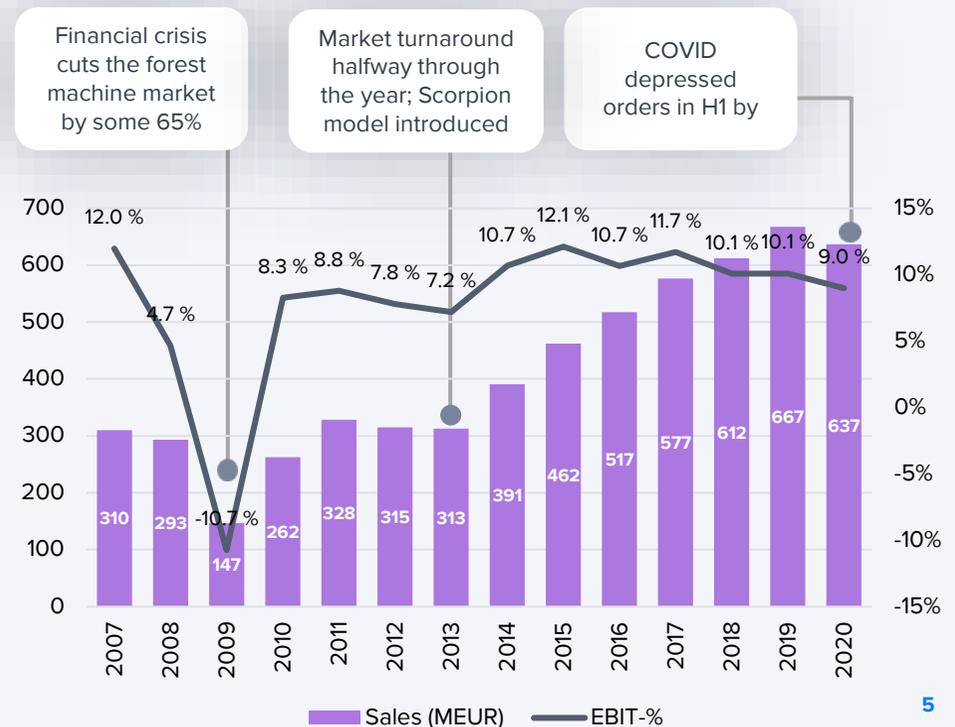
Personnel 12/2020

Main products

Harvesters



Forwarders



Company description

Forest machine company with centralized focus and production

Ponsse is an engineering company that manufactures forest machines based on the cut-to-length method and offers related accessory and support services like forest machine data systems, maintenance services, used machine services and training.

Product manufacturing is centralized in Finland and one factory in Vieremä. The aim of the low degree of outsourcing is better overall process optimization. The company's international service network (including resellers and licensed repair shops) consists of some 200 service and spare part points.

Ponsse feels its competitive advantages are the newest and most extensive product offering on the market with the most innovative solutions (e.g. stability and visibility from the driver's viewpoint), productivity/efficiency of products, most versatile customer tailoring and extensive maintenance services.

New forest machine sales

Ponsse sells harvesters and forwarders that it has developed and manufactured to over 2,000 forest machine contractors to some 40 countries. The customer risk is highly fragmented, and a typical forest machine contractor only has 1-2 machines.

The number of forest machines sold per year has been 1,100-1,200 in recent years divided almost evenly between harvesters and forwarders. The price range for harvesters is EUR 350,00-550,00 and for forwarders EUR 300,00-400,000 per machine. A majority of demand comes from repeat purchases as

Ponsse has since the start of its operations delivered over 16,000 forest machines of which an estimated 12,500 is still in use.

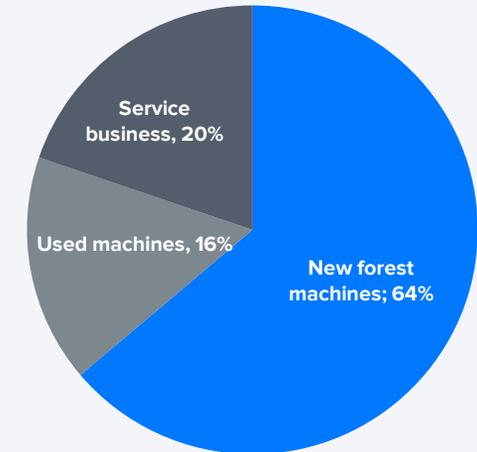
In addition to new forest machines, Ponsse separately sells harvester heads mainly for various manufacturer's excavators. This business only represents around 3% of Ponsse's net sales but it is very profitable and growing faster than forest machine sales.

Aftermarket services

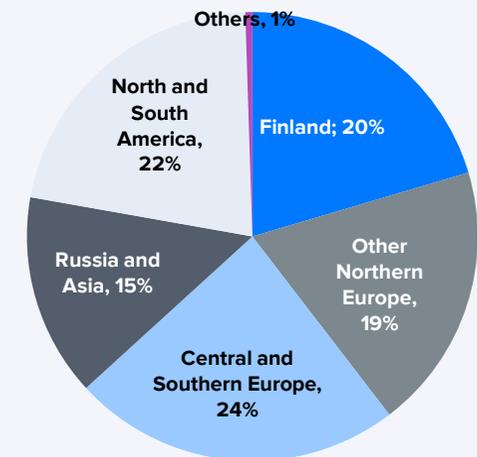
Ponsse's aftermarket services consist of service center operations (20% of net sales) and used machine operations (estimated 16% of net sales). Ninety percent of service center operations consist of wear and spare part services and is carried out through more than 200 service points of which some 50 are Ponsse's own and some 150 are resellers' and licensed repair shops' service points.

Ponsse sells around 65% of new machines through its own sales companies in which case the customer very often offers their used machine as a trade-in. Ponsse sells the used machine and typically again receives a trade in machine (older and cheaper) in this trade. This process can be repeated 2-4 times until the customer no longer has a relevant trade-in machine to offer. The sales gains from the machines are naturally recorded in Ponsse's net sales.

Net sales distribution by business area, 2020



Net sales distribution by area, 2020



Source: Ponsse

Business model for new forest machines 1/2

Majority of manufacturing in own hands

All harvesters, forwarders, and harvester heads manufactured by Ponsse are produced in one factory in Vieremä. Thanks to the expansion investment in 2016-2018 the factory floor area grew from 27,000 m² to some 40,000 m².

Ponsse manufactures the bodywork of the machines (forebody and rearbody, booms, harvester head frame, cab frame) and several other key components itself. At the same time, Ponsse has ensured sufficient flexibility in manufacturing under normal circumstances, as well as quality control and core expertise remaining in the company's own hands.

Tight subcontractor cooperation

The main parts purchased from outside are machine engines, as well as hydraulic and cast components. Ponsse emphasizes the tightness of its subcontractor cooperation and the transparency of the entire delivery chain to the subcontractor, which is the best way to ensure supplier relations. Ponsse has a constant rolling estimate of its own manufacturing volumes and related component needs that stretches beyond 12 months.

The situation has become more challenging in components as the subcontracting chain gradually recovers from the COVID pandemic and as global component demand has grown rapidly. According to Ponsse it has to compete tightly in certain components with other agricultural, forest, and mining machine manufacturers. Currently

hydraulics manufacturers are announcing longer delivery times to Ponsse and a strong demand spike has been seen in semiconductors, which, e.g., Volvo Trucks has recently indicated.

Component availability as a whole is not a currently a bottleneck according to Ponsse but the company is unable to create a reserve supply and when the market is active switching suppliers is not usually an option due to scheduling.

Objective of expansion investment approaching

In 2016-18 Ponsse invested a total of EUR 38 million in a factory expansion where the floor area of the Vieremä factory grew by 1.3 hectares. The investment included a new assembly line, an increase in the degree of automation and a more efficient warehouse. In the new warehouse system component and accessory packages are collected in cooperation with the customer based on a predetermined specification. The factory's internal logistics delivers the machine-specific subsets to the accessory assembly lines from where the assembled parts (e.g. harvester's forebody, rearbody, and pre-equipped subsets) end up at the main assembly line.

Ponsse's manufacturing philosophy where everything happens based on an order and where part manufacturing happens based on the main order did not change after the investment. The investment aimed primarily at shortening delivery times clearly. We estimate that the previous annual capacity of 1,100-1,200 machines grew as a result of the investment to 1,500-1,600 machines (some +30-

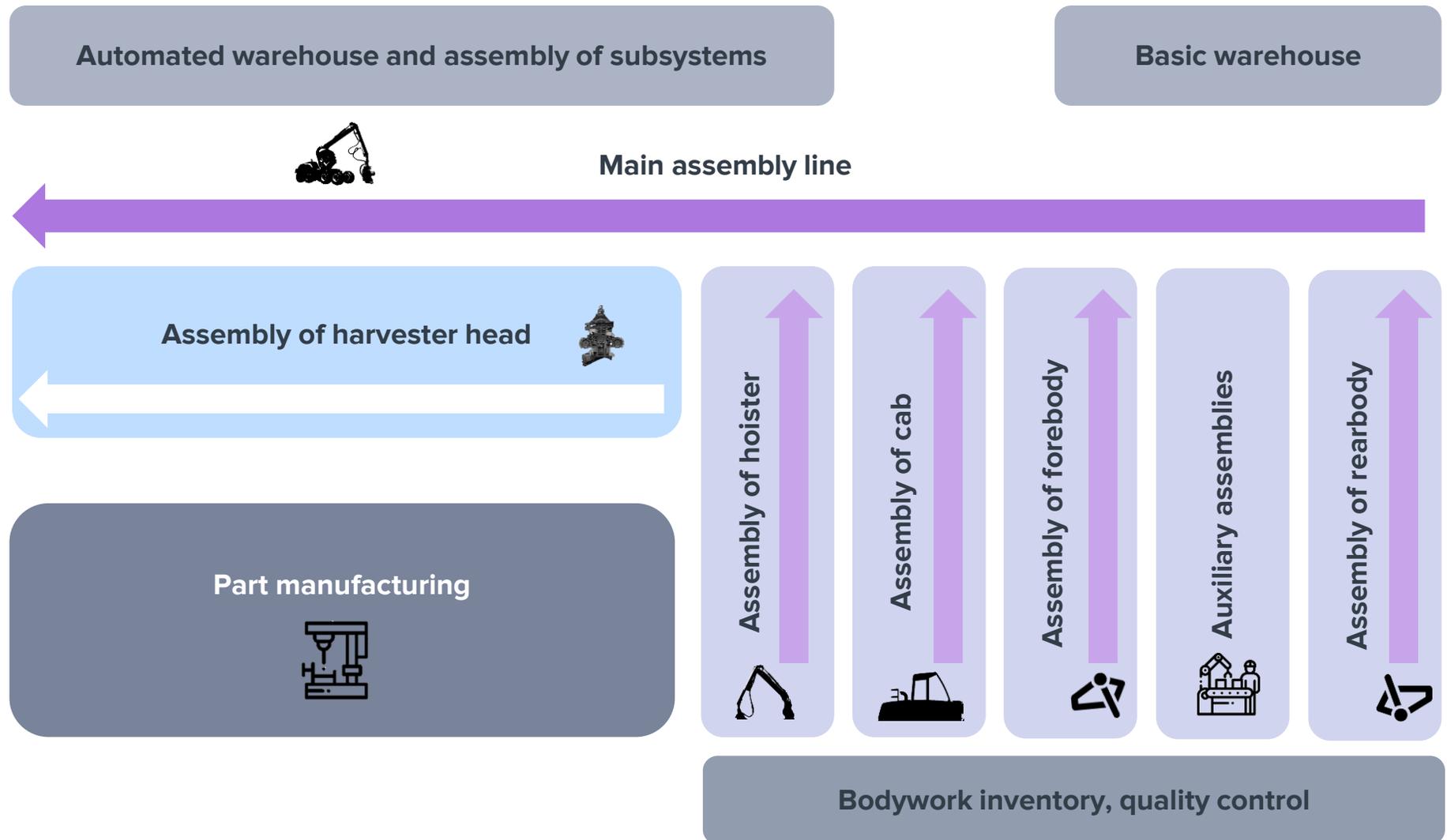
35%) and Ponsse's own capacity will not become a limitation for delivery speed or volumes in the foreseeable future.

According to Ponsse, the targets set for the investment, i.e., improved quality and increased flexibility, as well as increased productivity as a result of these has been reached. The development has been supported by both a new production system and quality measuring system, as well as the implementation of new work spaces and working methods. Ponsse's target has been 5% productivity increase in a year (measured by paid working hours/completed machine) and the company says it has reached this target.

Products technically top of the line

Ponsse's products have always been considered among the most technically advanced in the industry. Examples include using aluminum structures in the machines already in the early 1980s and introducing a PC to the harvester cab already in 1992. Ponsse was also the first to introduce an 8-wheeler harvester to the market in 2009 and now their share of production is nearly 100%. In recent years, the focus of product development has moved from the performance to environment friendliness and the driver's ergonomics. The latest example of this product development is the renewed Scorpion harvester that is Ponsse's flagship product (product discussed in more detail in the Competition section). In all, Ponsse's forest machines utilize around 70 patent families.

Manufacturing model at Vieremä factory 2018-



Business model for new forest machines 2/2

For Ponsse, feedback from customers is always key in product development. The company also emphasizes that it has the willingness and ability to take even larger risks in product development and offer original solutions to problems highlighted by customers.

Offering adjusted to different customer segments

The average size of forest machine customers is growing. Next to forest machine contractors that own and operate individual machines, so-called fleet loggers that need different service packages than the first mentioned have entered and are entering the field. Fleet loggers typically have 20-70 machines in their machine portfolio. Fleet loggers are often covered by Ponsse's service agreement and are also price-conscious, that is they focus on whether the service provides actual added value and do not pay for trifles. Large customers are also represented by so-called industrial loggers that often are large forest companies. These companies can have large forest resources and logging is only part of the chain at the end of which the company usually sells pulp. Typical examples are the Brazilian Fibria and Suzano. Industrial loggers also have high expectations concerning information systems. In terms of the product portfolio, the key question is whether Ponsse has the right offering for different customer segments.

As the customer base is changing structurally, Ponsse adds new maintenance, training, financing, and other service solutions to its offering. Ponsse will also in future launch new services with which it can, e.g., improve visibility into the machine's condition. New services involve a lot of

experimenting and Ponsse wants to ensure what the customer is willing and prepared to pay for in the early stages. Ponsse does not, however, prioritize customer groups, all are equal, e.g., in terms of service speed and quality.

Ponsse has not reported data on the share of common components and subsystems of different machine models but we estimate this to be 40-50%. A large number of interchangeable parts enables, not only considerable synergy gains in wear and spare part activities, but also efficient mass tailoring of an extensive model selection and machines.

Role of logistical costs low

Ready, customer-equipped, and tested forest machines are transported on flatbed trucks to Finnish customers or Iisalmi railroad station and from there via ports to distributors. In 2020, freight and forwarding represented only 1.5% of Ponsse's net sales so the location of the factory far from freight traffic hubs is not a problem. The factories of the main competitors are also located in Finland or Sweden.

Distribution covers all key markets

Ponsse's distribution covers all main markets of machine logging and it takes place through 11 own sales companies and some 40 reseller companies. In 2020, some 35% of the machines Ponsse sold were sold through resellers and 65% were sold by the company itself or through its subsidiaries. Ponsse is constantly seeking a balance between more capital efficient reseller sales and own sales that offers a better customer contact.

Role of digitalization continues growing

Logging technology and related services will continue digitalizing heavily. Megatrends are 1) increasing digital services in, e.g., forest resource management, equipment management and maintenance and reporting of productivity; 2) quest for sustainability or detecting and minimizing environmental effects; 3) connectivity solutions or optimal way to transfer information from/to forest machines. 5G technology will open a lot of new opportunities here, and 4) automation (like in the Scorpion crane described later) and remote controlling.

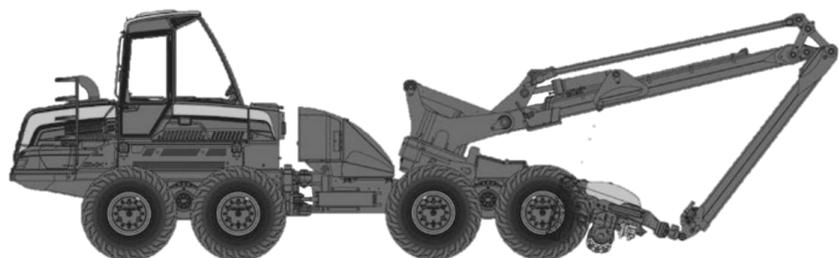
Ponsse has actively recruited programmers to its subsidiary EPEC and to Vieremä (20 persons in 2020-2021e) and moved digital services from product development to corporate IT. The operating method is to build digital services on top of collected data, opening the application programming interface (API) to the customers, and testing the feasibility of the services and how they can be monetized with customers (proof of concept).

Assessment of business model

Based on the track record, the business model is working well. The combination of one factory and low degree of outsourcing can, however, be risky in case of various disruptions (break-down of an important machine, fire, disruption in energy supply, strike in the factory or, e.g., in railroad traffic) and narrows the company's adjustment possibilities. It is still too early to assess the success of the "digital leap".

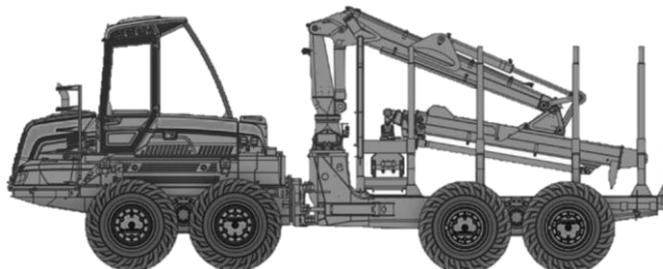
Ponsse's main products

Harvesters (harvesting machines)



Weight, tn	17.5-24.5
Length x width, m	7.3-9.0 x 2.8-3.1
Engine power, kW	150-260
Tractive force, kN	130-230
Crane reach, m	10-11
Price, 1,000 EUR	350-550

Forwarders (carrying vehicles)



Weight, tn	17.3-23.7
Length x width, m	9.1-11.1 x 2.7-3.2
Engine power, kW	150-205
Lifting moment, kN	106-160
Crane reach, m	10
Price, 1,000 EUR	300-400

Business model for services 1/2

Business based on extensive maintenance service network

Ponsse's services business represented 20% of the Group's net sales in 2020 and amounted to some EUR 126 million. The company has 211 service points in 26 countries. Of the service points, 45 are Ponsse's own and 166 are resellers' or licensed repair shops' service points. Measured in absolute numbers, there are most service points in Finland (24), Sweden (27), Russia (36) and the US (18). The service points employ a total of 990 repair men. The number and location of the service points is determined based on local customer needs, logistical solutions, and developing service concepts. The service network also includes 590 service vehicles that circulate to customers' working places, of which a majority are specialized in Ponsse machine maintenance.

Of the good 16,000 machines Ponsse has delivered, an estimated 12,500 are still in use (good 75%). The machine stock has grown by an estimated 9% over the past year. In practice nearly all the above-mentioned 12,500 forest machines are covered by maintenance as at minimum spare parts for the machine are purchased from Ponsse or its representative. Ponsse's long-term target is to have over 50% of the annually used machine stock covered by its own service agreements. Ponsse has not reported the current share but we believe it to be around 20% even though over one-half of the machine stock is serviced by Ponsse annually. According to Ponsse, choosing service agreement coverage is largely a generational issue among forest machine entrepreneurs as younger generations are less willing to service the machines themselves than their predecessors. Ponsse's

interest increases because a larger share of customers that are covered by service agreements also buys wear parts (like saw chains and blades) through Ponsse which increases Ponsse's share of the money the customer uses on machine maintenance (share of wallet).

Warranty costs covered with a EUR 5 million guarantee provision

Ponsse gives new forest machines a 12 month or 2,000 operating hour warranty during which possible faults are repaired at the company's expense. At the end of 2020, Ponsse's balance sheet included a EUR 5.0 million guarantee provision based on the failure history recorded in the previous years. The trend of the guarantee provision has been decreasing in recent years which indicates good quality development.

Service agreements aim at predictability

In addition to wear and spare parts, Ponsse offers, for example, three-year or 7,200 operating hour service agreements (Ponsse Active Care) that includes a fixed-price scheduled maintenance with genuine spare parts defined by the factory. Active Care+ is an extended warranty for certain components from the normal 2,000 operating hours to as much as 6,000 operating hours. Service agreements also include technical assistance, i.e., maintenance advice as well as service center appointments and field maintenance (service vehicle drives to customer's site). Customer service also includes user training when the forest machine is delivered.

Service net sales grows as a function of operating hours

The net sales from service operations varies heavily by market. Because 90% of service net sales consists of wear and spare parts the operating hours of the machines have a crucial effect on demand. The operating hours of harvesting machines is usually good 2,000 hours per year in the Nordic countries but only some 1,500 hours per year in North America, while in Russia and Brazil the operating hours are often over 5,000 hours per year. Because the technical lifespan of the machine usually ends after 25,000-30,000 operating hours it is clear that the need for wear and spare parts and other maintenance is clearly higher during the last 10,000 operating hours than during the first 10,000 operating hours. We estimate that the share of service operations in Ponsse's net sales in Russia and Latin America can be 30-40% while it is 20% at Group level.

Plenty of preconditions for service growth and good profitability

The following factors support growth and profitability in service operations: 1) expected growth in the delivered stock of forest machines by over 1,000 machines per year translating to close on 10% increase in the machine stock in use; 2) forest machine entrepreneurs increasingly keen to outsource maintenance and no longer try to service the machines themselves; 3) cross maintenance of forest machines between different machine brands is low so Ponsse is practically the only maintainer of the machines it has delivered; and 4) the role of cheap pirate parts of questionable quality on the important wear and spare parts market is low.

Business model for services 2/2

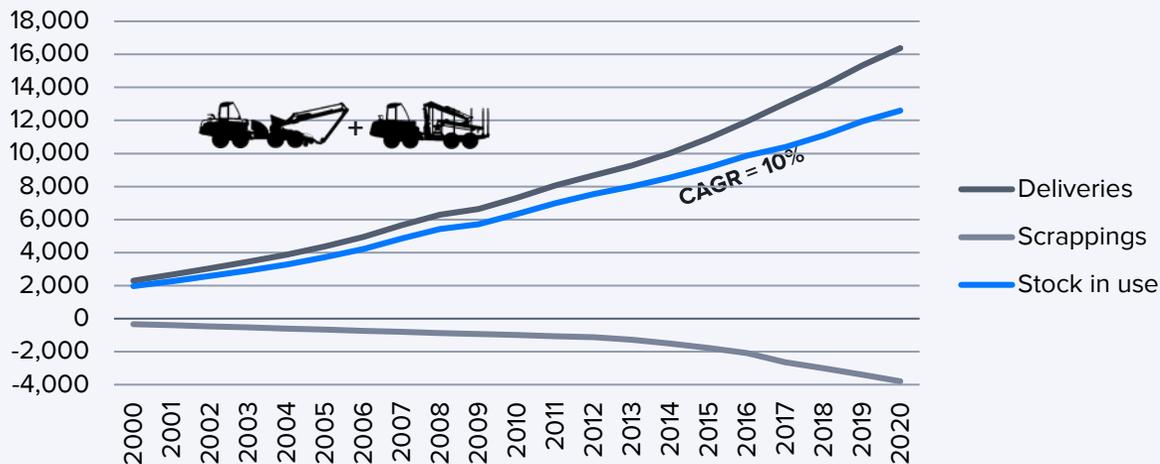
Ponsse has commented on the profitability of its service operations only by saying that the wear and spare part business is more profitable than new machine sales. Ponsse does not differ from other engineering companies in this respect. Ponsse considers maintenance services as part of machine sales and related services. Thus, the aim is not to separately maximize the profitability of service operations but Ponsse's aim is to optimize the life cycle costs of the customer's machine. Life cycle costs determine customer satisfaction and have a crucial effect on brand loyalty when making repeat purchases.

keeping Ponsse's own fixed costs under control. The lack of competition is also positive, especially in the profitable wear and spare parts business. Lack of information on the actual number of service agreements and conversion rate in new machine sales makes it difficult to make an overall assessment. We do, however, believe there is room for growth in preventive services enabled by digitalization.

Assessment of business model

The strengths of the business model are an extensive service point network that, however, focuses on resellers and licensed repair shops thus

Ponsse's cumulative number of machines 2000-2020



Source: Ponsse, Inderes' estimates

Business model for used machines

On a mature market, customers nearly always have a trade-in machine

On a mature market like in Europe and North America, selling of a new forest machine practically always means receiving a trade-in machine. On rapidly growing markets like in Russia and Brazil, the role of trade-in machines is somewhat smaller.

Resellers handles their trade-in machines

Ponsse sells some 65% of the forest machines it manufactures through its own distribution channel, i.e., its own sales companies while the rest are delivered to customers through resellers. The latter handle their own trade-in machine business independently.

Used machine business is iterative

It is typical for used machine business that it is iterative. When selling new machine, Ponsse typically receives a trade-in machine, and the same situation is often repeated when selling a “trade in machine of a trade in machine”. So, in the end, Ponsse may generate 2-4 trade-in machine deals when selling a new machine. However, round-by-round 1) the average price of the trade-in machine to be sold decreases, and 2) the share of customers offering a trade-in machine falls.

We estimate that when Ponsse sells a new machine itself it receives a trade-in machine in its balance sheet in 90% of cases. When selling a trade-in machine, we estimate the share drops to 65% and when selling a trade in machine of a trade in machine further to 40%. In practice, the machines

are often at the end stages of the technical life cycle at this point.

A machine is typically sold locally

According to Ponsse, the used machine market is quite active, and all forest machine customers are not looking for new machines. The company does not spontaneously restore trade-in machines it puts up for sale but Ponsse offers the buyer the opportunity to have desired machine parts restored. Used machines are primarily sold on the same market as where they were received.

Focus on inventory turnover and cash flow

Ponsse’s focus in the used machine business is primarily on inventory management and cash flow. The average selling time for a used machine is 3-6 months. Ponsse regularly arranges sales campaigns for used machines and auctions if necessary.

Ponsse tries to negotiate the trade-in prices to such that the company is not forced to sell used machines at a loss. The margins from used machine sales are, however, low compared to other operations, which means the company’s sales mix weakens as the role of used machine sales grows.

Net sales from used machines good EUR 100 million

We assume that “other inventories” in Ponsse’s balance sheet under inventories (2020: EUR 34.2 million; 2019: EUR 26.9 million) is in practice all used machines inventory. This corresponds with 12-

13% of equity in the years in question, so the risks related to valuation are moderate. If the average selling time of used machines is assumed to be around 4 months and the sales margin to be 4% the net sales from used machines is around EUR 105 million. This corresponds with 16% of the Group’s net sales in 2020.

Assessment of business model

The dynamics are healthy in the respect that a trade-in machine entering the balance sheet is always preceded by selling a new machine and the size of the used machine inventory is reasonable considering Ponsse’s size. Focusing on cash flow is justified and the fact that the business is apparently profitable is a positive feature. If the inventory turnover is assumed to be 3x and the average EBIT margin to be 4%, Ponsse generates moderate return on investment of some 12% from the used machine business.

Investment profile

Growth company with good track record

After a successful internationalization in the 1990s, Ponsse has grown at an annual level of 9% in the past 10 years while main competitors have grown by 6-7%. At the same time the company has become the second largest in the world in cut-to-length forest machines.

Even though Ponsse has been listed since 1995, the holding of the founding family and their involvement in company business is still considerable. Currently the Vidgren family owns around 63% of the company. Strong ownership brings perseverance to company operations and the willingness and ability to take risks when necessary. On the other hand, strong family ownership means that the possibility of an outside buyer making an offer is largely eliminated. All in all, we feel the ownership structure lowers the acceptable valuation level of the share a bit.

Positive value drivers and strengths

Strong market position. Ponsse's market share in rubber-tire cut-to-length forest machines is around 30%, which makes it the second largest player on the market and offers benefits of scale from product development to aftermarket. The threshold for entering the market is high due to required investments and the relatively small size of the whole market.

Market for new machines growing. Ponsse's operating environment includes both existing and potential growth drivers. The first-mentioned are growth in global logging volumes, driven by

general economic growth and growing pulp market as well as ongoing/future investments there, increasing share of wood construction and increased use of wood, for example, to replace plastic in the packing industry. Other drivers are increased mechanization in logging and continued growth in the cut-to-length method which Ponsse represents. Potential growth drivers are related to progressing digitalization and automation in logging.

There is growth potential in services. Ponsse's delivered machine stock still in use is around 12,500 machines. Service business that consists primarily of high-margin wear and spare parts sales generated 20% of Ponsse's net sales in 2020 and 40% of operating profit according to our estimate. Even if the market for new machines would face difficulties, the large and still growing delivered machine stock that is constantly aging offers new growth opportunities for the service business.

Earnings development quite predictable. In 2011-2020, Ponsse's EBIT margin varied between 7.2% and 12.1% while the median was 10.1%. At the same time, the variability index of the EBIT margin was low at 16.5% which indicates the good predictability of the result and thus a rather low risk profile in a cyclical industry.

Strong cash flow offers opportunities. Ponsse's operational cash flow has been positive since 2009 and the cash flow after investments has also been clearly positive since 2013. When considering the company's low gearing (net debt/EBITDA = -0.1x) Ponsse has good opportunities to invest in

developing digital products, strengthening its presence in, for example, the Americas and Asia, and higher dividend.

Negative value drivers and risks

Cyclical industry. The market for new rubber-tire cut-to-length forest machines crashed by 65% in the financial crisis year 2009 and the market has fallen by over 20% also in 2012 and 2020. Even though we do not consider significant negative development likely in the near term, faltering growth in Chinese wood imports or even turning to a downward trend could have considerable negative effects on forest machine demand especially on the important Russian market but also elsewhere in Europe.

Unfavorable timing of expansion investments in the industry. Ponsse's main competitors have invested or are investing in increasing capacity, in Komatsu Forest's case even significantly. If a negative market scenario materializes and the subdued economic trend is prolonged, the capacity utilization rate of companies in the industry would fall below expectations and price competition would tighten, which would cause margin pressure.

One factory and low degree of outsourcing in manufacturing can be a risk in case of various disruptions, like a fire or strikes.

Centralized ownership. The already mentioned centralized share ownership in Ponsse decreases the liquidity of the share, as well as the possibility of an offer for the company by an outside buyer or other industry restructuring.

Investment profile

1.

Track record of faster than market growth, world's #2 in the segment

2.

Predictable profitability and strong balance sheet

3.

Family company that is unlikely to be sold

4.

Market for new machines is cyclical

5.

Over-investment in the industry

Potential



- Mechanization of logging continues
- Increasing share of cut-to-length method
- New digital services
- Service potential generated by growing machine stock in use
- Investments enabled by strong cash flow either in new products or dividends

Risks



- Faltering growth in Chinese wood imports grinding market for new machines to a halt
- Over-investment in the industry resulting in underutilization of capacity and tight price competition
- One factory and low degree of outsourcing in manufacturing can be a risk in case of disruptions

Strategy and financial objectives 1/3

No published strategy

Ponsse has no actual published strategy. The company speaks of continuous strategy work where the operating plans are updated annually, and they are “implemented through the budget”. In the ongoing 2020-2023 strategy period, the framework for planning is the 2021-2022 operating plan. Ponsse’s idea is that the company does not want to become captive by a particular strategy in a quickly evolving operating landscape and technology revolution. We find the lack of a published strategy to be negative for investors but still find the overall picture to be quite clear and the fact that the company has clear financial targets makes estimating easier.

Our assumptions of key strategic factors

Based on discussions with Ponsse’s management and other materials we find the following factors to be the company’s strategic cornerstones:

- 1. Tight focus.** Unlike the main competitors that act as part of international conglomerates, Ponsse’s entire operations only involve around developing, manufacturing, and selling rubber-tire cut-to-length forest machines.
- 2. Considering customer needs in all operations.** For Ponsse this means extensive and continuous collection of customer feedback, that is user experience, critique and development ideas, and highlighting this in the

entire chain from product development via manufacturing and distribution to aftermarket business. Part of this procedure is personally knowing the customers and even considering their families in operations is important which we believe sets the company apart from its competitors.

- 3. Innovativeness.** Ponsse gives its designers free hands to develop new types of solutions. Related to this, the company is prepared to take considerable risks in product development. One example of such an innovation is placing the crane behind the cab in the Scorpion harvester which proved to be an excellent solution.
- 4. Expertise in the company's own hands.** Ponsse has focused product manufacturing on one unit and feels it benefits considerably from having all key expertise in its own hands and from close integration between product development, procurement, and manufacturing. According to the company, this is visible in efficiency, quality, and reaction speed.
- 5. Sustainable development and responsibility.** Ponsse’s vision is to be the most desired cooperation partner in sustainable forestry and carbon neutral in the long term. Ponsse’s responsibility model is divided into a) social responsibility (products and services,

personnel, operations), b) environmental responsibility (sustainable forestry, product life-cycle management, operating method that saves natural resources), and c) financial responsibility (balanced and sustainable finances, proactive and risk perceiving financial management, supporting the continuity of stakeholders).

Need for competition strategy may arise

The success of a strategy is measured by its functionality in practice and Ponsse’s strategy seems efficient. It is not easy to replicate, and the company’s growth, profitability and cash flow have all been at a good level. The situation is also affected by the oligopolistic structure of the cut-to-length forest machine market and the fact that the forest machine market is not the core business of the Groups that own Ponsse’s main competitors. We feel the competitive situation is still quite calm.

The situation could, however, change if, for example, a capital investor would buy one of Ponsse’s two main competitors and would start to aggressively seek market shares. In this case, Ponsse would probably have to reassess its product, market and pricing strategies and possibly consider a partnership with the other “remaining” forest machine manufacturer.

Strategy and financial objectives 2/3

Assessment of the strategy

Of the above presented strategic cornerstones we particularly like the first two. Strong focus on the company's core competence area is in the interests of investors and the company's objective to keep customer needs as the leading operating principle helps generate new orders and stand out from the competition. In contrast, we find the one factory manufacturing concept is a risk despite its good sides and the fact that the situation among the main competitors is largely similar does not change our view.

Financial objectives

Ponsse's reported financial targets are:

- **Growth:** Net sales grows faster than the market
- **Profitability:** EBIT margin $\geq 12\%$
- **Cash flow:** Operational cash flow \geq EBITDA
- **Capital efficiency:** Asset turnover ratio $\geq 2x$

We interpret the above-mentioned targets to mean reaching them during 2021-2022 and not, for example, on average in these years or over the cycle.

Our comments on the targets relative to actual figures in recent years are:

- **Growth:** Ponsse's net sales grew by an average of 7% per year in 2016-2020, which exceeds our estimate of 3% market growth. The growth rate of the main competitor Deere Forestry has, according to our estimates, been 5% on average during the period in question.

- **Profitability:** The EBIT margin in 2016-2020 was 9.0-11.7% so close to the target level at its best. The COVID pandemic had a negative effect on profitability in 2020 (9.0%).
- **Cash flow:** Operational cash flow in 2016-2020 was 64-109% of EBITDA (92% on average) so the target is realistic.
- **Capital efficiency:** Ponsse calculates this as a net sales/average balance sheet ratio. In 2017-2019, the company was slightly below target (1.7x-1.8x) and in 2020 clearly below (1.4x) but the latter is the effect of the COVID pandemic.

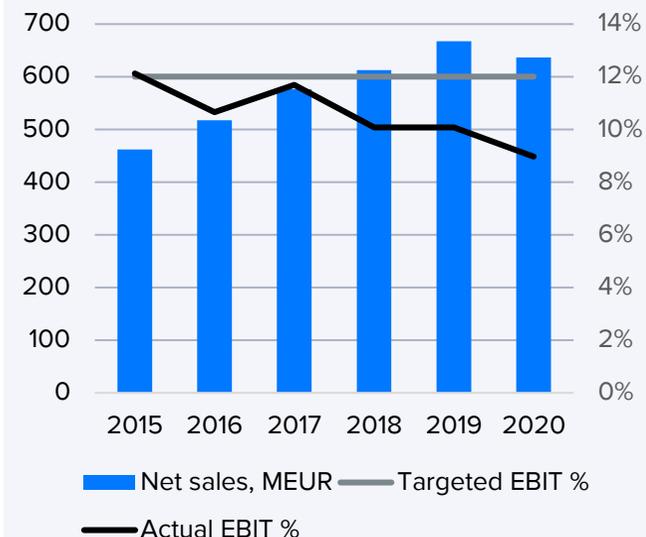
Modest net sales growth target

The target has been reached in recent years and it can be reached also in future. Growth is supported by the expansion investments made at the Vieremä factory and continuing investments in expanding the distribution network. Scarce information on market growth, however, makes it difficult to estimate whether the target can be reached.

Profitability target is challenging

Ponsse has previously reached the profitability target only in highly favorable conditions. According to the company, the target requires successful volume growth, good productivity at the Vieremä factory, and tight cost control. We do not find the target unrealistic but raising the EBIT margin with the current business concept and mix sustainably above 12% is very challenging.

Actual profitability vs. targeted level



Strategy and financial objectives 3/3

Cash flow target is realistic

Because the operational cash flow is already mathematically close to the EBITDA, the target depicts Ponsse's willingness to keep net working capital under control. The company has succeeded well in reaching the target in recent years.

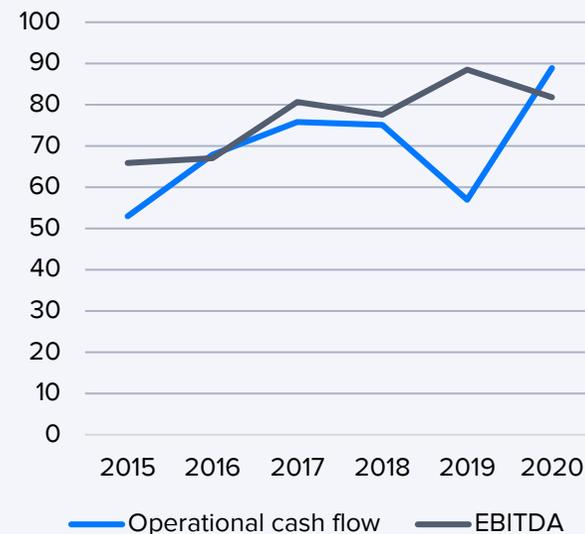
Higher dividends would raise capital efficiency

Decreasing capital efficiency in the way Ponsse measures it is not worrying as it has been based on balance sheet growth because of increasing equity (i.e. good profitability) and growth investments in 2018-2019, as well as raising the liquidity reserve during the COVID year 2020. For investors, the sensible way to reduce the balance sheet and improving the ratio in future would naturally be a generous dividend distribution.

No precise dividend policy, but the dividend sum is likely to continue growing

According to Ponsse's dividend policy "dividend is distributed based on the company's long-term earnings development and equity requirements". The trend of earnings per share has been rising in the long-term and the payout ratio has been 46-52% in 2018-2020. We expect the payout ratio to remain at 41-47% in 2021-2024. At the same time, the dividend sum is constantly above historical figures.

Operational cash flow and EBITDA, EUR million



Forest machine market 1/5

Global industrial roundwood market 2.0 billion cubes

The global market size for forest machines is affected primarily by the logging volumes of industrial roundwood that is good 2.0 billion cubes per year and the mechanization rate logging. In addition to industrial roundwood, roughly the same volume of wood is used as firewood. A majority of this is felled/harvested by hand for heating dwellings and cooking purposes mainly in Asia, Africa and Latin America. Therefore, it is hard to get exact data. The use of actual industrial fuelwood is still rather low globally. The share of fuelwood in Finnish logging was 13% in 2019.

Growth in logging volumes slow but stable

The largest end demand markets for industrial roundwood (pulpwood, timber tree) are found in construction (sawn timber), packaging, furniture, interior decoration, and other wood industry (e.g. plywood and other wood panel and wood product industry), and chemical pulp and pulp industry. The two first mentioned industries are responsible for some 65% of roundwood demand and the share of pulpwood is around 35%.

This is a globally mature market where the growth of some end products (e.g. paperboard and other packaging material industry) is compensated by the gradual decrease in the demand for some other products (printing paper). However, for example

according to UPM the decrease in the consumption of printing paper does not translate to an equal decrease in pulp consumption as the recycled fiber disappearing from the market must be replaced with pulp.

Global logging volumes have grown in the 2010-2019 review period by an average of 2.7% per year. Growth has been fastest in Russia (3.3%) and North America (2.7%), while in Latin America growth in logging has surprisingly been slower than this (2.1%) but still positive.

We believe the trend growth in global logging volumes will remain at 1.5-2.0% annually while growth is fastest in Latin America as, e.g., plantation wood continues increasing. Growth is supported by the estimated 2.8% annual growth in market pulp demand in 2021-2024 (source: Hawkins Wright). Pulp demand in turn is driven especially by China, whose share of global pulp consumption has risen to 36%.

Degree of mechanization in logging continues increasing

The key driver for forest machine markets has from the start been the benefits gained from the mechanization of logging. Mechanical felling, delimiting, cutting, and transporting either with a feller, skidder and delimber or, on the other hand, harvester and forwarder has increased the efficiency of logging considerably and clearly

improved logging quality and safety compared to the traditional chainsaw and horse/farm tractor combination. The mechanization of logging progressed quickly in Finland rising from around 20% in 1985 to nearly 100% in 2005. Globally the degree of mechanization is rising stably and according to an estimate from Komatsu Forest it rose from 54% in 2010 to 58-59% in 2017, so by an annual rate of 0.6-0.7 percentage points. We expect the growth in the degree of mechanization to accelerate a bit going forward as a) semiautomatic logging chains (logger felling + cable skidding + roadside processing) on developed markets can efficiently be replaced with a harvester, and b) on developing markets an excavator + harvester head combination will increasingly replace the work of loggers.

Cut-to-length method brings considerable competitive advantages

Because actual logging volumes will grow slowly on a global level, the progress of mechanization and especially the technology used in forest machines are crucial for Ponsse.

The forest machine market is in practice fully divided between two technologies, that is, the full-tree method and the cut-to-length method, CTL. In the full-tree method the tree is felled with a feller-buncher, transported from the forest with a skidder, delimited with a delimber and if necessary, cut into suitable lengths for transport with a slasher.

Forest machine market 2/5

In the cut-to-length method the harvester, fells, delimits, measures and cuts the wood in the forest to the customer's (e.g. sawmill or paper mill) desired measurements. The wood is piled by timber grades next to the logging road from where they are transported with a forwarder to assorted piles next to the forest truck road.

In this report we only focus on the market for rubber-tire cut-to-length, RTCTL machines. The benefits of RTCTL compared to the full-tree method are:

- **Lower environmental burden** (trimmed crowns and limbs act as a working surface so the machine does not burden the soil and smaller damage to remaining trees in improvement felling)
- **Higher yield from logging**
- **Better suitability for soft soil** (e.g. swamplands) and on steep hills
- **Savings in transportation costs** (capacity of a forwarder clearly higher than a skidder)
- **Better quality and cleaner outcome**, due to fewer handling rounds and "softer" handling (wood is carried not dragged)

The disadvantages of the cut-to-length method are:

- **Higher investment cost**
- **Higher skill requirements of the machine operator**

- **Functionality risks** due to more complicated technology and
- **Weaker functionality of the harvester head** with some trees (e.g. large aspens)

Increasing market share of cut-to-length method

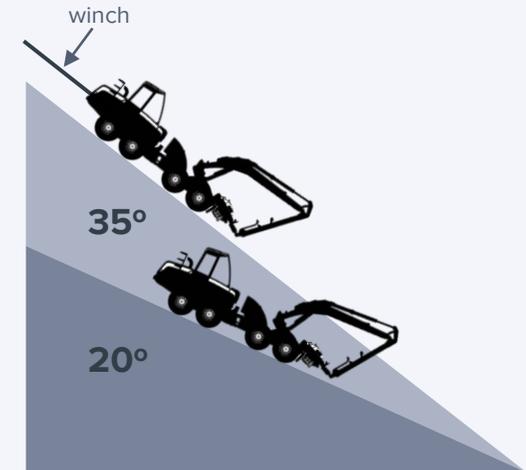
In mechanical logging the cut-to-length method has constantly increased its popularity at the expense of the full-tree method and is currently estimated to be 60% having been only around 20% in the early 1990s. The increasing share is based on the cut-to-length method becoming more common especially on the European Continent, in Russia and Latin America. According to Ponsse's estimate, the growth in the market share of the cut-to-length method has accelerated and now nearly all large forest industry investments lean on logging/wood procurement based on the cut-to-length method.

Geographical differences still large

In Northern Europe, the share of the cut-to-length method of all mechanical logging is full 100% and elsewhere in Europe over 80%. Thus, the market growth potential from increasing the share of cut-to-length method is small in these areas.

In Russia, the popularity of the cut-to-length method has grown quickly and its share of mechanical logging in Russia rose from some 40% in 2005 to 80-90% in 2018 and is regionally close to 100%. In Russia, the cut-to-length method is popular everywhere where there

Cut-to-length method on steep hills



Winch-assisted Ponsse Bear in a logging area in Oregon (US)



Source: Ponsse

Forest machine market 3/5

is western forest industry. Main arguments for the method are load capacity of machines on soft soil, suitability for logging during the season of frost-damaged roads, and logging moving to plantation woods and man-made forests.

The share of the cut-to-length method is low in North America (around 25%). Reasons for this are: 1) a culture where timber is seen as a raw material whose use does not need to be optimized; 2) customers whose storing, other logistics and timber processing is tuned into timber handling as a bulk product; and 3) the workforce in the forest industry consisting primarily of immigrants who do not have the high-level expertise and language skills required for the cut-to-length method. The share of the cut-to-length method has, however, been rising in North America in recent years and it is likely to have exceeded 30% in the US having been only half of this on the early 2010s. Strengthening the market position of the cut-to-length method has progressed regionally from east to west and to the Southern states. In the Southern states, investments in the sawmill industry have focused on processes favoring the cut-to-length method, i.e., receiving logs that are already cut to size. The cut-to-length method is also better suited for the steep hills in the Western states and for improvement felling.

In Latin America, mechanical logging focuses primarily on tree plantations and all logging methods are used. In terms of the cut-to-length method, forwarders work well on plantations but the trees are instead of regular harvesters usually felled with crawler fellers, which Ponsse does not manufacture. In total, the share of

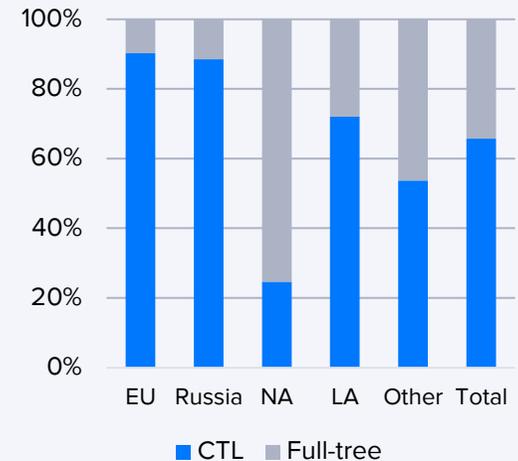
the cut-to-length method is estimated to be close on 70% in all mechanical logging in Brazil. The share has grown in recent years. The other important market, Uruguay is nearly fully dominated by the cut-to-length method.

Asian markets have been less attractive for Ponsse. In China, the logging restrictions of natural forests are tight, and the quality and productivity of plantation woods are poor even though logging has increased in them. Mechanization of logging in China with a combination of crawler machines and detachable grapples can, however, open new opportunities for Ponsse at least in harvester heads. In other Asian countries, lack of skilled workers alone slows down market development. Ponsse has not researched the Indian markets much and the size of the Indonesian market is estimated to be a few dozen machines per year.

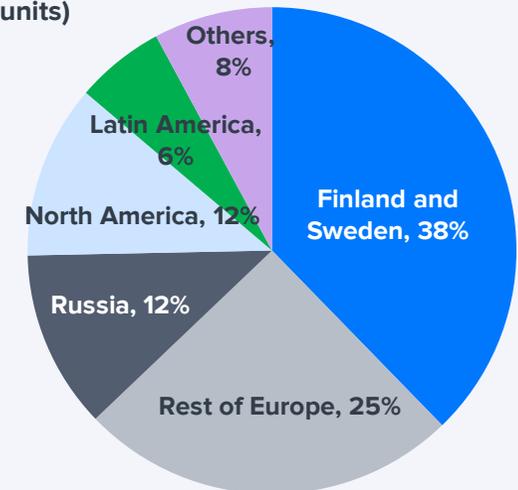
Market focus in Europe

In 2020, the RTCTL forest machine market decreased clearly due to the COVID pandemic and the effects of the pandemic varied by geographical region. According to our estimates, the market was still quite Europe-centric and Europe as a whole represented 63% of the entire market, divided into a 38% share for Finland and Sweden and 25% share for the rest of Europe. The share of the Russian forest machine market dropped to 12% from 18% in the year before and in 2020 Sweden was the world's largest RTCTL machine market. North America stood for 12% and Latin America for 6% of the market.

Relative share of cut-to-length and full-tree method of mechanical logging, 2018



RTCTL machine market geographically, 2020 (units)



Source: Traficom; the Swedish Transport Agency; Ponsse; Inderes' estimates 22

Forest machine market 4/5

New machine market size of the cut-to-length method EUR 1.4 billion in 2020

There is very little research material available covering the entire forest machine market. The market that is relevant for Ponsse is easiest to estimate based on the volumes of sold machines and the net sales of the key players. Manufacturers do not, however, report delivery volumes for individual years nor net sales purely from new machine sales. Ponsse has estimated that in 2020 a total of 3,600 RTCTL forest machines were sold in the world. If we assume the figure is divided evenly between harvesters and forwarders and that the average selling price for harvesters is EUR 440,000 and EUR 330,000 for forwarders the global market size for cut-to-length method new machine sales was around EUR 1,400 million in 2020.

Forest machine demand is cyclical

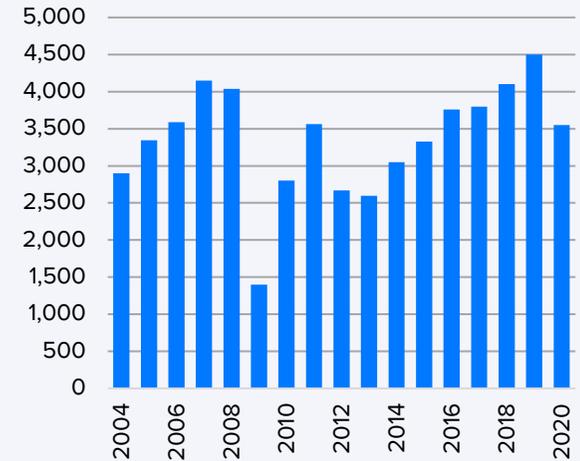
Even though the overall market for rubber-tire cut-to-length forest machines has grown strongly over the past 25 years the industry is cyclical. In 2009, the global market plummeted to 1,400 machines from 4,000 machines in 2008, so by -65%. The market did not exceed the 2008 level until 2018. A considerable drop was also seen in the market in 2012 (around -25%) and due to COVID in 2020 (around -20%). Different sized market shocks are naturally also possible in future.

New customs duties in Russian wood exports create a risk

Russia's future logging volumes and thus the development of the forest machine market in the country is still a huge question mark as the Putin administration is planning to introduce at most 80% export duties on the export of unprocessed wood or sawn timber already from the beginning of 2022. The biggest risk is directed at small and medium-sized forest owners and contractors in far east Russia where an estimated 20-30% of loggings are exported to China as sawn timber. Considerable wood processing industry investments are needed in the region, which are not visible in near future. The other option that has been discussed is to establish a state-run timber trading company for whom export of unprocessed wood would be allowed and the proceeds of which would be used to develop wood processing industry in the region.

Even though only good 20% of all felled wood in Russia is exported, export that is usually carried out as dollar-denominated trade has a huge impact on the preconditions of local forest entrepreneurs to buy western forest machines. The need for forest machines in Russia will remain big and the market trend is likely to be rising after a weak 2020, but strong volatility on the market is also likely before the customs duties enter into force and their effect start to materialize.

RTCTL forest machine market 2004-2020



Source: Traficom; the Swedish Transport Agency; Ponsse; Inderes' estimates

Forest machine market 5/5

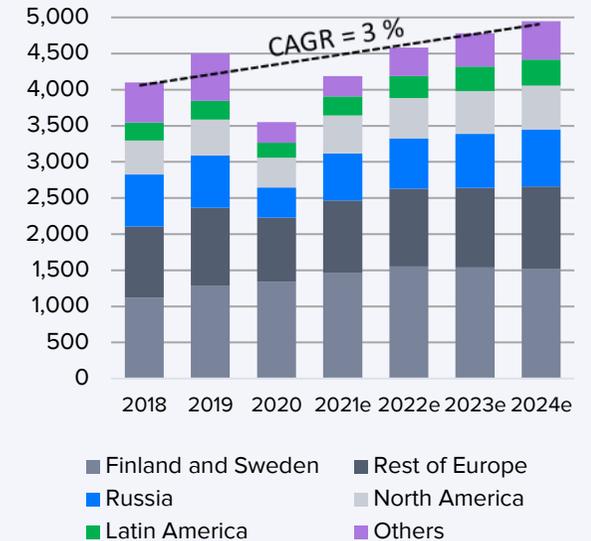
Forest machine market estimates 2021-2024

Of the key demand drivers for industrial timber, the growth estimates of construction for 2021-2022 are generally high after a weak comparison year in 2020. For example, Eurofer expects in its newest report (2/2021) that EU's construction volumes will grow by over 4% y-o-y in 2021-2022 while the drop in 2020 was -6%. In China, construction is expected to grow on average by nearly 5% per year in 2021-2024 (source: GlobalData). By contrast, the development of construction volumes in the US is subdued in coming years (2021e ±0%; 2022e -2%...-4%) based on various estimates (AIA, FMI, Dodge Data). A positive opportunity in the US is connected to the USD 2,300 billion infrastructure construction plan introduced by Biden's administration but it is too early to say how big an impact this would have on the demand of wood and logging volumes.

In terms of pulp, the demand outlook is still good and the growth expectation for 2021-2024 is close on 3% y-o-y as stated previously. The growth outlook for pulp is supported by considerable expansions in pulp capacity, the main ones in the next few years being Metsä Fibre's bioproduct mill in Kemi (2023: 1.5 million tons) and UPM's project in Uruguay (2022; 2.1 million tons). Another potential project is Euca Energy (2022-2023; 2.0 million tons) in Brazil. Ponsse has estimated that the 5.0-5.5 million m³ wood supply for Kemi's bioproduct mill alone will translate to a need of at least 100 harvesting chains or 200 forest machines. This amount would, however, be divided over several years.

After the COVID year 2020 the growth on the forest machine market should be quite lively at least in 2021-2022. In our estimates the average annual growth (CAGR) in 2021-2024 is 9% where the rate is naturally due to the weak comparison period in 2020. In the longer term, 2019-2024, the growth rate (CAGR) is quite modest at 3%. This is not too cautious of a scenario in our opinion when bearing in mind that average annual growth on the RTCTL machine market was 3% p.a. in 2005-2019.

RTCTL forest machine market 2018- 2024e



Source: Ponsse; Inderes' estimates

Competition 1/4

Market largely divided between three players

The global market for rubber-tire cut-to-length forest machines (RTCTL) of some 3,600 units (2020) was primarily or an estimated 85% divided between three players. These are Deere Forestry from the US, Ponsse and the Japanese Komatsu Forest. Of these, only Ponsse focuses purely on the cut-to-length method, while Deere Forestry and Komatsu Forest also manufacture full-tree method machines in the US. All of Deere's cut-to-length method machines are manufactured in Joensuu and Komatsu's cut-to-length forest machines are manufactured in Umeå in Sweden.

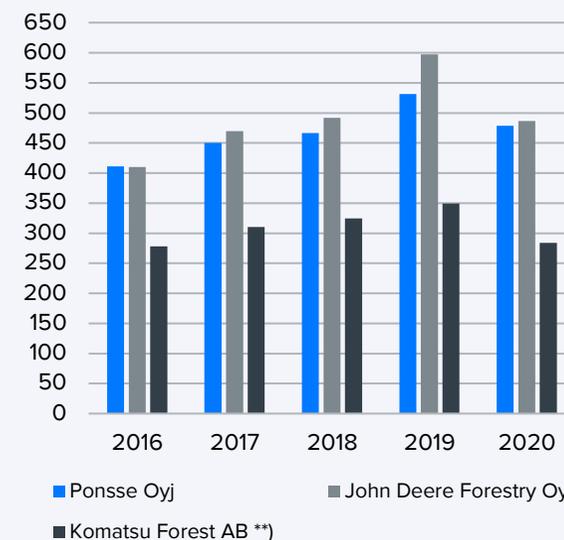
Comparable competitive information scarcely available

Assessing the market shares of three large manufacturers is made difficult by the scarcity of information. We have worked around the lack of information by only comparing the figures of the cut-to-length forest machine businesses' parent companies. Both Deere's and Komatsu's financial period deviate from the calendar year. John Deere Forestry Oy's net sales plus the net sales of the subsidiary Waratah OM Oy that manufactures harvest heads was EUR 487 million in the period November 1, 2019 to October 20, 2020. Komatsu Forest Ab's previous reported financial period ended already on March 31, 2020 but we have used, e.g., market share data from the Finnish and Swedish markets and estimated Komatsu Forest Ab's krona-denominated net sales to have decreased by some 2% y-o-y in the financial period that ended on March 31, 2021. Thus,

the estimated euro-denominated net sales for Komatsu Forest AB was EUR 284 million. Ponsse Groups' parent company's Ponsse Oyj's net sales was EUR 479 million in 2020.

The graph shows Ponsse Oyj's, John Deere Forestry Oy's and Komatsu Forest Ab's closest comparable net sales data for 2016-2020. Based on the figures, Ponsse has in the depicted period grown at the same rate as Deere Forestry (CAGR = 5%) while Komatsu Forest AB has lagged behind (CAGR = 2%). One should, however, have some reservation when interpreting the order of size of the companies on the forest machine markets based on the graph as in addition to differing fiscal periods differences may also arise from 1) deviations in intra-Group transfer prices and margins, and 2) different sales mixes, that is the share of used machine business and aftermarket business of net sales. Based on collected volume data and our estimates Deere Forestry's market share in cut-to-length method machines was slightly larger than Ponsse's in 2020 and correspondingly Komatsu Forest's market share was clearly smaller. The table shows our rough estimates of volumes and market shares in 2020.

Net sales of forest machine businesses' parent companies, EUR million *)



*) companies' fiscal periods differ from one another
 **) 2020 net sales is Inderes' estimate
 Source: companies, Inderes' estimates

Cut-to-length method (RTCTL) forest machine market 2020, indicative

	Units	Share
Ponsse	1,060	30%
Deere	1,100	31%
Komatsu	800	23%
Others	590	17%
Total	3,550	100%

Source: companies, Inderes' estimates

Competition 2/4

Big differences in country-specific market shares

The adjacent table shows our partly indicative estimate of different manufacturers' shares of rubber-tire cut-to-length machines on the three key markets in 2020. Ponsse's leading position on the Finnish market is no surprise but on the even bigger Swedish forest machine market the share has traditionally been quite modest. In recent years, the share in Sweden has been growing as Ponsse has invested more in its own service centers. Ponsse now has seven such centers in Sweden.

On the Russian forest machine market, Deere Forestry and Ponsse hold the two top slots and their combined market share is nearly 80%. In recent years, especially Komatsu Forest has lost market shares.

Ponsse more active in renewing its model selection than its competitors

The rise in Ponsse's global market share from 26% in 2018 to 30% in 2020 was in our opinion caused by the successful ramp-up of the expansion investment in Vieremä and a modern model selection. In recent years, the biggest new products in Ponsse's product selection have been the Cobra harvesters launched in the mid-segment in fall 2018, the Bison forwarder models in the heavier end, and especially the renewed Scorpion harvester launched at the beginning of 2021.

Just like the previous model, the new Scorpion is Ponsse's flagship product. The key features of the new model are clearly improved visibility, next generation (marketed as 5G) information system and

user interface, and implementing the Active Crane. Active Crane is a control system for the crane grapple introduced in 2018 with the driver can use to directly control the grapple movement instead of individual functions. This allows the driver to concentrate on wood loading instead of crane work. According to Ponsse, reception of the new Scorpion has been excellent, and sales has kicked off well.

According to Ponsse, the focus areas of product development will in future be introducing the 5G information system and Active Crane to the entire product selection. The main themes of product development will continue to be digitalization and autonomic equipment, as well as sustainable forestry. Ponsse does not, however, believe in rapid changes in the driving power and expects that diesel engines will be the backbone of the offering for years to come.

Ponsse's competitors' product launches have not been as visible as the new Scorpion. Deere's launched new products have been new harvester heads and introducing intelligent boom control IBC (corresponds with Ponsse's Active Crane) to smaller and larger machine models. In 2020, Komatsu launched three lighter end forwarder models (825TX, 835TX and 845), but otherwise it has mainly made product updates in recent years.

Indicative shares on the main RTCTL machine markets 2020

	Finland	Sweden	Russia
Units	520	820	420
<i>Ponsse</i>	46%	19%	36%
<i>Deere</i>	31%	42%	40%
<i>Komatsu</i>	18%	22%	10%
<i>Others</i>	5%	17%	14%

Source: Traficom, the Swedish Transport Agency; companies; Inderes' estimates

Competition 3/4

Profiles of main competitors and their differences

In addition to differences in geographical focus, the key differences between Ponsse, Deere Forestry and Komatsu Forest in terms of strategies and operating models are the following based on our assessment:

- **Independence.** Deere Forestry and Komatsu Forest are cost centers of larger Groups while Ponsse is an independent player. This may for the first two lead to a shorter review period when assessing the success of the forest machine business and if problems become prolonged to the divestment of the business, heavy restructuring or even shutdown.
- **Group support.** Deere Forestry as part of Deere that manufactures agricultural and other outdoor working machinery is strategically natural. Ponsse has estimated that Deere Forestry's product development investments are 30-50% larger than Ponsse's even though Deere Forestry Oy's R&D costs in the fiscal year that ended in 10/2020 were 23% lower than Ponsse's. Deere Forestry is, however, able to utilize Deere Group's large (EUR 1.5 billion in 2020) product development investments. According to Ponsse, the bigger investments are visible, e.g., as digitalization and automation expertise where Deere may be a bit ahead of Ponsse.

Komatsu Group's fragmented product and customer base does not in our opinion support investments in forest machine operations that is

classified as a niche area. In addition to forest machines, Komatsu manufactures earth-moving machinery, machine tools, equipment, and tools for the metal industry, as well as machines and equipment for the mining industry. Komatsu's new forest machine factory that will start in Umeå in August 2021 indicates commitment to the business.

- **Product portfolio.** The selection of the largest forest machine manufacturers includes 4-6 basic models in both harvesters and forwarders. The differences between the different models of an individual manufacturer are usually linked to power/capacity but sometimes the basic concept also differs from other models (like in Ponsse's Scorpion). As a whole, Ponsse's product portfolio is a bit wider than its competitors'. The company has a comparable machine selection of 15 machines (7 harvesters, 7 forwarders and one combination model), while Deere Forestry has a selection of 12 machines (5 harvesters and 7 forwarders) and Komatsu Forest likewise a selection of 12 machines (6 harvesters and 6 forwarders). Calling an individual machine, a separate model is largely a question of definition. Measured by key power/capacity indicators Ponsse's, Komatsu's and Deere's model selections are quite close to one another.
- **Pricing** Ponsse's and Deere Forestry's comparable machines are roughly priced at the same levels. Ponsse does, however, emphasize that it wants to keep the life cycle costs of its

machines below Deere's. On average, Komatsu Forest's machines are 5-15% cheaper and the company is also known as an aggressive pricer. Deere has also adopted a more active pricing method in some geographical areas.

- **Digitalization.** Digitalization plays a crucial role in supporting the information needs in the customer's business and in machine maintenance. Fleet management software play a key role; they help collect, deliver, and analyze data on operation and performance both at the level of stands marked for cutting and at the level of an individual body, machine, and driver. All large manufacturers have their own fleet management solutions (Ponsse Manager, Komatsu MaxiFleet, Deere TimberManager), for which new functionalities are constantly developed and to which it is technically easy to add new functionalities. We estimate that in the current situation differences in how technically advanced the software is are small and it comes down to the priorities of the buyer/user of the forest machine. We believe the differences will grow in future depending on how well forest machine companies are able to implement new technological opportunities.

Competition 4/4

Competitors' capacity growing

Like Ponsse's completed factory investment, its main competitors have invested or are investing in their factories. Komatsu Forest is completing a new forest machine factory in Umeå. All of Komatsu's cut-to-length forest machine production will focus on this factory. Only little details have been published concerning the investment, but the size is said to be SEK 1 billion or some EUR 100 million and the production area to be 28,000 m². The reference point is Ponsse's Vieremä factory whose production area is now 40,000 m². The size of the investment is explained by the fact that Komatsu is now in addition to its previous final assembly of forest machines also investing in its own part manufacturing so expanding backwards in the value chain while reducing the share of subcontracting in manufacturing. The new factory should be ramped up in August 2021.

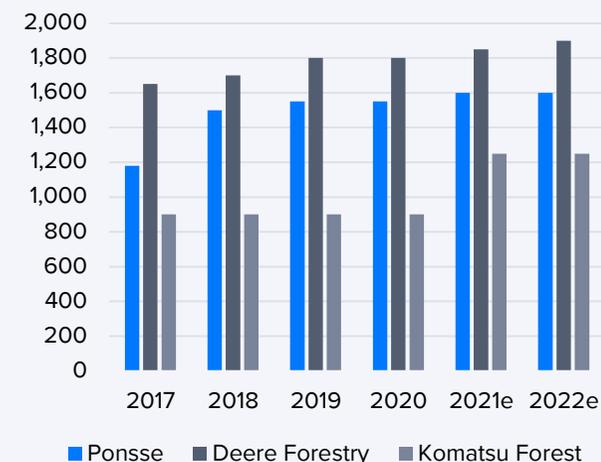
Deere Forestry is also expanding its factory in Joensuu with a EUR 15 million investment with which it improves and expands the assembly and test drive areas and increases the capacity of component manufacturing. The production area grows by 7,000 m² to 32,000 m². According to Deere Forestry, the investment does not at this time aim at increasing capacity and the number of personnel does not grow from some 500 people. According to the company, the investment does, however, help to better respond to booming demand and enables capacity increases later. The investment will be completed during 2021.

Simply comparing the floor areas or number of personnel of different manufacturers' factories does not paint the full picture of the capacity as manufacturing concepts (factory layout, own part manufacturing vs. share of outsourcing) vary considerably. We estimate that with the new factory investment, Komatsu Forest's capacity grows from some 900 to some 1,200-1,300 machines and Deere Forestry's correspondingly quite marginally from some 1,800 to some 1,900 machines, while Ponsse's current capacity is around 1,500-1,600 forest machines. As the demand outlook for forest machines is good, we do not feel overcapacity is forming in the industry that could lead to considerably tighter price competition.

Small manufacturers likely to remain small also in future

On the forest machine market, small manufacturers like the Swedish Rottne and Eco Log and the Finnish Logset together hold a global market share of around 11% (2019). These manufacturers can have a reasonable local market share, like Rottne (8%) and Eco Log (5%) have in Sweden. We do not, however, believe that their market share will grow elsewhere, and it might even decrease. We believe the small companies lack the critical mass for competitive product development and above all to build an extensive service point network.

Indicative capacity of the manufacturer's main factories, units/year



Source: companies, Inderes' estimates

Financial position 1/2

Strong track record of net sales growth

Even though the basic nature of Ponsse's industry is cyclical, the company's growth story is stable. In the past 20 years net sales has only decreased in five years (2008, 2009, 2012, 2013 and 2020). Of these, the drop in 2008 (-50%) can be seen as exceptional, in the other above-mentioned years the drop has been modest (-1%...-5%). In 2011-2020 net sales growth has been brisk, 9.3% on average. Due to COVID, the average growth in 2016-2020 has been slower at 6.6% p.a. Growth in services business has been more stable at 8.6% on average p.a. in 2011-2020 and 8.3% p.a. in 2016-2020.

Ponsse's strong long-term growth story is, in addition to a strong market, based on a modern model selection. Growth has been organic and mainly taken place through expanding the service network.

Relatively small share of fixed costs

Materials and services (some 65% of net sales) are emphasized in Ponsse's cost structure as are personnel costs (some 14%). The share of other operating costs (e.g. operating and maintenance, freight, rents, marketing, and administration) is around 9% and depreciation good 2%. With this cost structure, Posse should in our opinion in normal market conditions be able to consistently deliver an EBIT margin of 9-10%.

What stands out in Ponsse's cost structure is the low share of fixed costs of net sales (23-24% in

2018-2020) for an engineering company. We have included personnel costs, depreciation and other operating expenses adjusted by freight and forwarding expenses as fixed costs. For other engineering companies, the share often exceeds 40%. The difference is primarily explained by the personnel and other maintenance costs of the comparison companies' own maintenance and service organizations. For Ponsse, the share of service business of net sales is small (20%) compared to the peers and 90% of this net sales consists of wear and spare part services that are not very staff intensive.

Fixed costs are also flexible if necessary

Division into variable and fixed costs is simplified and it is always a depends on the review period. When Ponsse's net sales decreased by 5% due to COVID in 2020, the personnel costs dropped by 8% and other operating expenses by as much as 17%. Ponsse utilized temporary layoffs in cutting personnel costs and in other operating expenses the 37% cut in marketing costs and 60% drop in travel expenses was visible. Due to these cuts, Ponsse was able to keep its EBIT margin at a reasonable 9% level (2019: 10.1%) even though, due to logistics and other challenges caused by COVID, the net sales share of raw material costs grew by two percentage points.

Flexible cost structure supports satisfactory profitability

In the 2001-2020 review period, the median of Ponsse's result page (ratio of change in operating result to change in net sales) has been 1.9x and the leverage from regression to the current net sales level calculated for the same period is 1.1x. Based on these figures, the cost structure is very flexible. It should be noted that the flexibility of the cost structure becomes properly tested in the next forest industry recession, but we are not particularly worried about this. Since 2009, the company's annual EBIT margin has varied between 7.2% (2013) and 12.1% (2015) with the median being 10.1%.

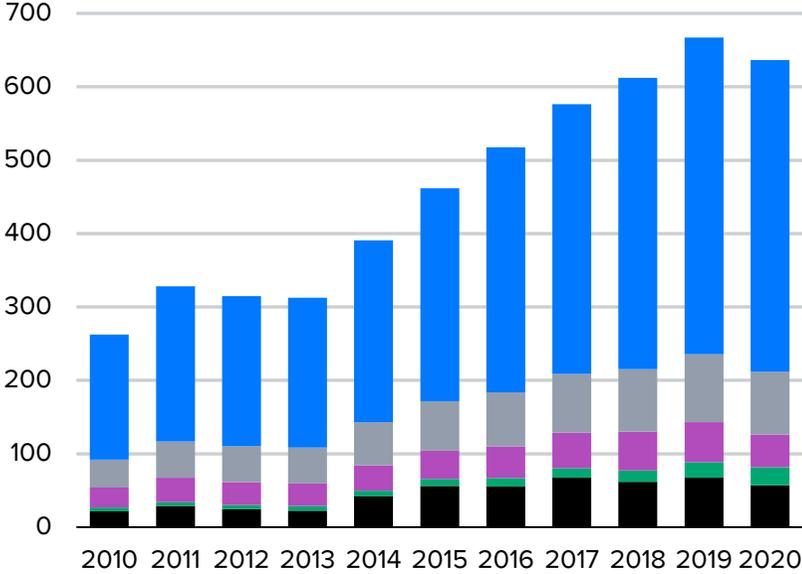
Good working capital control supports cash flow

Since 2008, Ponsse has reported positive operational cash flow every year that has fluctuated between EUR 11.2 million (2009) and EUR 74.8 million (2020). Strong cash flow has been the result of both good profitability and successful working capital control. Used machine business raises Ponsse's inventories reasonably but their turnover has decreased from 150 days in 2013 to the current some 90 days.

Because Ponsse sells most of its machines in cash the turnover of the entire sales receivable stock is fast, around 25 days in a normal market. At the same time the turnover of Ponsse's accounts payable is around 60 days.

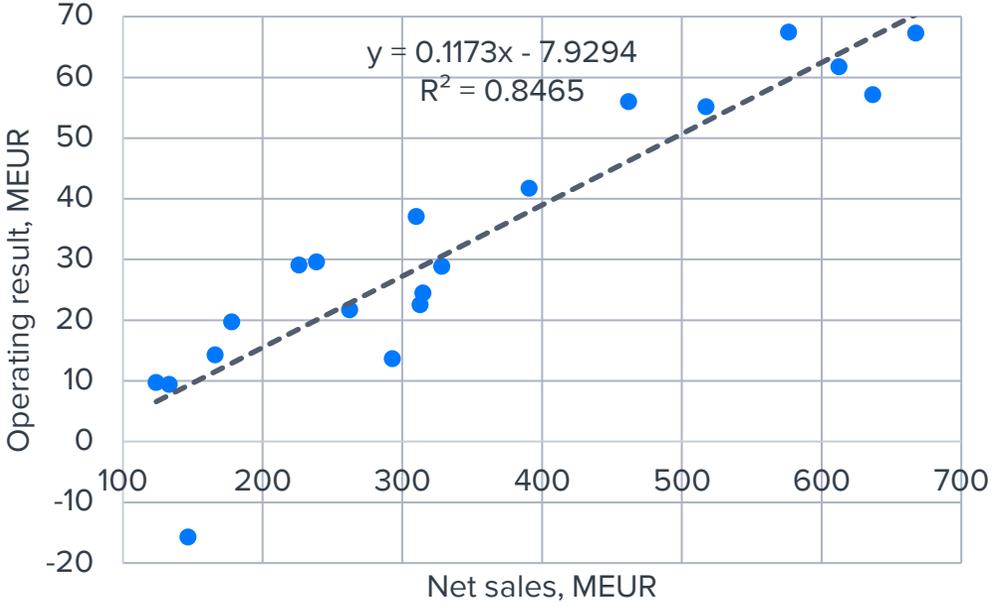
Small earnings leverage indicates flexibility in costs

Net sales distribution between costs and result, MEUR



- Operating result
- Depreciation
- Other operating expenses
- Personnel costs
- Material and service costs

Regression of net sales and operating result 2001-2020



Stable margin development as share of fixed costs is low

During the fast net sales growth in 2016-2020 (on average 6.6% p.a.) the EBIT margin has been quite stable between 9.0% and 11.7% despite the COVID pandemic in 2020. Operational earnings leverage (change in operating result/change in net sales) is low, in regression only 1.1x as net sales grows from EUR 600 million to EUR 700 million. The main explanatory factor is the low share of fixed costs of net sales for an engineering company, 22-24%. A share of over 40% for fixed costs is typical for the industry.

Financial position 2/2

The difference in the turnover explains why during the 2016-2020 net sales growth (on average 6.6% p.a.) the change in the company's working capital has been very modest, apart from in 2019, varying from a EUR 12.9 million increase (2015) to a EUR 5.4 million decrease (2020). In 2019, working capital increased by EUR 31.6 million due to the suboptimal situation between Ponsse's workload, capacity, and material management.

Investment financed fully with cash in hand

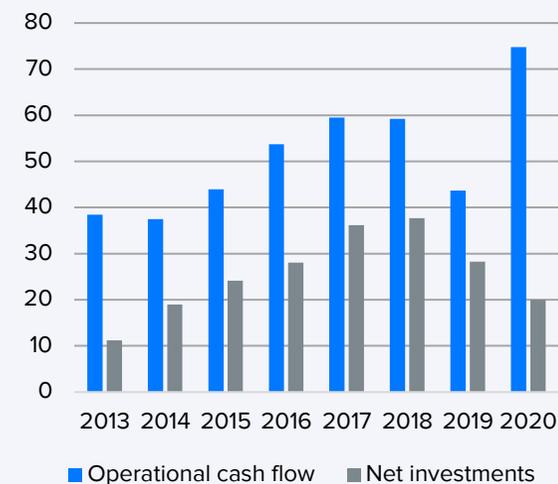
Funding investments with operational cash flow is part of Ponsse's cautious financing strategy. Over the past 20 years, the Group's investments have only twice (2008 and 2012) exceeded operational cash flow. Over the past five years (2016-2020), Ponsse's operational cash flow has been 94% higher than net investments (EUR 291 million vs. EUR 150 million) and this period also covers the EUR 36 million expansion investment in Vieremä. From a cash flow viewpoint, Ponsse thus has a lot of operational leeway.

Excellent financial indicators

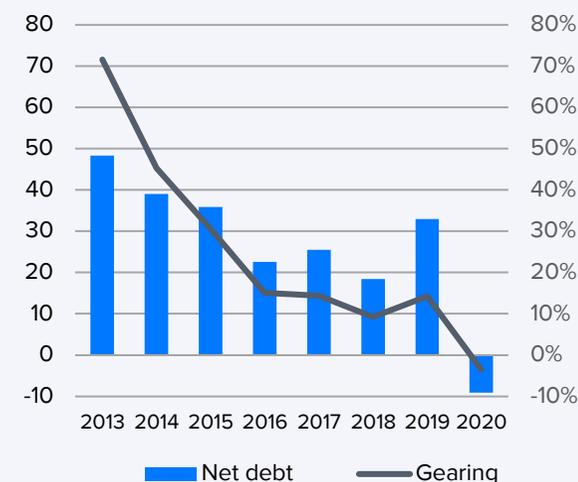
The strong cash flow has also resulted in clearly strengthened financial indicators. Ponsse's net gearing was -4% at the end of 2020. The net debt/adjusted EBITDA ratio that depicts the company's debt sustainability was also excellent at -0.1x having been 0.4x one year earlier.

All in all, Ponsse's financial risk can be described as extremely low. In 2020, the average interest paid by the company on its promissory notes is 1%. There is no real collateral in financing nor are there any financial covenants.

Operational cash flow and net investments, MEUR



Net debt (EUR million) and gearing



Source: Ponsse

Estimates 1/3

Background assumptions of net sales estimate

We estimate Ponsse's net sales development as a combination of the expected sales volume of new forest machines and related used machine business, as well as growth in service business based on the delivered machine stock. Our estimate is based on the previously presented estimate of average annual 9% growth on the cut-to-length forest machine market in 2021-2024.

The table shows our estimates of both market volume development and the development of Ponsse's volumes and market share in 2019-2023. The quick rise in the market share from 2019 to 2021 is due to the successful ramp-up of the Vieremä investment, modern selection with new products (e.g. new Scorpion), and the fact that we believe the investments of the main competitors will still burden their delivery ability. The rise in the market share evens out a bit in our estimate in 2022-2023 as the effects of the above-mentioned factors decrease. We do, however, expect Ponsse to be able to further increase its deliveries, which is possible with the help of constant process optimization and a third work shift if necessary. Our expectation for earnings growth (CAGR) from Ponsse's new machine sales in 2021-2024 is 13% as the baseline is quite low. Next to forest machines Ponsse sells harvester heads (grapples) whose 2020 net sales we estimate to be EUR 18

million and growth rate (CAGR) in the estimate period around 6%.

The strong market for new machines automatically also increases Ponsse's used machine business, where we expect 6% average annual growth in 2021-2024. The more modest growth percentage than in new machine sales is caused by the strong comparison figure as Ponsse actively sold its used machine inventory towards the end of 2020. Our corresponding growth expectation (CAGR) for the service business in 2021-2024 is 9% due to the further growing machine stock that operates with high utilization rates. As a combination of the above-mentioned segments, we expect Ponsse Group's net sales growth (CAGR) to be 11% in 2021-2024.

Background assumptions of profitability estimate

Our estimate for the profitability development in 2021-2024 is based on the following assumptions:

- COVID caused a temporary change in the 2020 sales mix as the net sales share of new machines decreased but in all the net sales shares of the different segments in 2024 (new machines 68%, used machines 14% and service 18%) are close to 2019 levels.

Volume development of the RTCTL forest machine market and Ponsse 2019-2023e

	2019	2020	2021e	2022e	2023e
Forest machinesl	4,500	3,550	4,90	4,585	4,782
- change	10%	-21%	18%	9%	4%
Ponsse	1,220	1,060	1,390	1,510	1,565
- change	14%	-13%	31%	9%	4%
Market share	27.1%	29.9%	33.2%	32.9%	32.7%

Estimates 2/3

- Small changes in cost structure. Instead of the COVID year 2020, year 2019 is a better comparison period. However, 2019 profitability was also depressed by a long overtime ban in the industry, which made material and production control difficult at the Vieremä factory and depressed profitability. In the 2021-2024 income statement we expect the share of material and service costs of net sales to be 64.2-64.7% (2019 actual: 64.7%), the share of personnel costs to be 13.5-13.6% (13.9%), share of other operating expenses 7.8-8.1% (8.6%), and share of depreciation 2.5-3.0% (3.2%). The stability of the cost structure depicts 1) the company's relatively low operational leverage, 2) Ponsse's good track record in transferring increases in material costs to its product prices, and 3) some of the cost savings from the COVID years, and especially marketing and travel expense savings becoming permanent.
- The interest Ponsse paid on its loans rises from 1.1% (2020) to 1.3% (2024).
- The Group tax rate in 2021-2024 is 21.0%.

Return to normal in investments

After the expansion investment in Vieremä, Ponsse's investments will focus on developing own part manufacturing (machining center, robotic welding) and expanding the service point network over the next few years. The company's indication

for 2921 investments is EUR 25-30 million. The figure includes some investments transferred from 2020. Our estimate for 2021-2024 investments are EUR 25-28 million per year when the outcome in 2020 was EUR 20 million.

Estimates for 2021

Ponsse's Q1'21 report was strong in particular in terms of the EUR 299 million order intake (+180% y-o-y). Global sales was good but the strong domestic and Russian markets were emphasized. Based on won bids, Ponsse believes it has increased its market share. In addition, the order intake accelerated towards the end of the quarter, which provides a strong basis for Q2 and onwards. We estimate that the EUR 308 million order book at the end of Q1 means that the delivery time for new ordered machines is close to year end of possibly even later. Q1'21 net sales (+13% y-o-y) and EBIT margin (10.3%) were in line with expectations. However, the non-recurring tax expense of Ponsse Latin America depressed the EPS as it raised the group's effective tax rate in Q1 to 42% from the typical level of around 21%.

Ponsse's guidance for 2021 is still slightly higher net sales than in 2020 measured in euros even though Q1 net sales grew by 25% y-o-y. The cautious guidance is still due to the COVID pandemic and a possible considerable price increase in components or an actual shortage of components. We find the 2021 guidance to be conservative.

Based on the previously described market outlook and strong Q1 figures there are good preconditions for brisk net sales growth in 2021. Our net sales expectation is EUR 796 million (+25% y-o-y). Growth is divided as follows: new machines +34%, used machines +10%, and services +10%.

Our 2021 operating profit estimate is EUR 91.3 million (margin 11.5%), where euro-denominated operating profit improves by 60% and the EBIT margin by 2.5% points from 2020. The margin improvement is supported by the marketing and travel expenses remaining very low in H1'21 due to COVID while the load and deliveries of the Vieremä factory are on a high level.

We estimate the 2021 reported EPS to be EUR 2.48, and improvement of 115% from the corresponding result in 2020 (EUR 1.15). Our adjusted EPS estimate for 2021 is EUR 2.52, which is 60% higher than the 2020 EPS adjusted for non-recurring exchange rate losses (EUR 1.58). Our dividend estimate is EUR 1.05 (2020: 0.60) translating to a 42% (2020: 52%) payout ratio.

Estimates 3/3

Estimates for 2022–2024

Based on Ponsse's forest machine sales volume estimates presented above and 1-2% annual increases in average prices we expect the net sales from new machine sales to grow by 11% in 2022, by 5% in 2023, and by 4% in 2024. As comparison figures drop, we expect used machine sales to grow by 3-6% annually in 2022-2024.

We expect that the machine stock (aged under 15 years) covered by services to grow from some 12,800 machines (2021e) to some 15,800 machines (2024e) and service net sales / machine to be around EUR 10,800-11,200. Our growth estimates for net sales from services are 8% (2022e), 9% (2023e) and 9% (2024e). Our net sales growth estimates on group level are 10% (2022e), 6% (2023e) and 5% (2024e).

Our result estimates for 2022-2024 are based on above-presented assumptions of the cost structure. The good market situation in the estimate period helps Ponsse maintain the EBIT margin of new machines above 11%, the margin for used machine business at 3-4%, and the margin for services at around 20%. On Group level we expect a modestly rising EBIT margin trend. In 2022 (11.6%) the rise is slowed down by the net sales share of the company's marketing and travel costs rising from the exceptionally low figures in 2020 and 2021. As

said before, we do, however, expect that some of the changes in operating methods and cost savings seen in these functions will become permanent. Our EBIT margin estimate for 2023 is 12.0% and the margin estimate for 2024 is 12.1%.

Our EPS estimates are EUR 2.82 (2022e), EUR 3.08 (2023e), and EUR 3.25 (2024e) The 2021-2024 expected average earnings growth (CAGR) is very strong at 20%. Around 60% of earnings growth is generated from net sales growth and some 40% from margin improvements.

Good profitability and strong balance sheet and cash flow create good preconditions for growing dividend for Ponsse. Our dividend estimates are EUR 1.30 (2022e), EUR 1.45 (2023e) and EUR 1.55 (2024e) indicating a payout ratio of 46-48%.

Our estimates for Ponsse's operational cash flow in 2021-2024 are high (EUR 74-110 million) and with these cash flows the above-mentioned investments can be covered easily. In our estimates, net debt turns even more negative and by the end of the estimate period in 2024 net debt would stand at EUR -154 million and gearing at -34%. Thus, it seems that Ponsse will face "over capitalization" of its balance sheet. If the company wishes to avoid this it must carry out significant investments or raise the payout ratio clearly above our estimates.

Long term estimates

After the actual estimate period we expect on average 3-4% growth from Ponsse with terminal growth at 2.5%. We believe the EBIT margin will remain at 10.5-11.8%. Our terminal margin assumption 10.5% is not much higher than the 2011-2020 median (10.3%) especially considering the increase in efficiency and benefits of scale from the Vieremä expansion investments.

Income statement

Income statement	2019	Q1'20	Q2'20	Q3'20	Q4'20	2020	Q1'21	Q2'21e	Q3'21e	Q4'21e	2021e	2022e	2023e	2024e
Revenue	667	145	132	155	205	637	163	191	198	245	796	872	923	966
Ponsse	667	145	132	155	205	637	163	191	198	245	796	872	923	966
EBITDA	88.5	19.5	14.4	28.3	19.6	81.8	22.7	27.3	27.6	37.3	115	126	135	141
Depreciation	-21.2	-6.0	-6.0	-6.7	-5.9	-24.6	-5.9	-5.9	-5.9	-5.9	-23.6	-24.1	-24.1	-24.3
EBIT (excl. NRI)	67.3	13.4	8.4	21.6	13.7	57.1	16.8	21.4	21.7	31.4	91.3	102	111	117
EBIT	67.3	13.4	8.4	21.6	13.7	57.1	16.8	21.4	21.7	31.4	91.3	102	111	117
Ponsse	67.3	13.4	8.4	21.6	13.7	57.1	16.8	21.4	21.7	31.4	91.3	102	111	117
Net financial items	-1.0	-15.0	0.2	-5.9	3.0	-17.7	-1.6	-0.6	-0.6	-0.6	-3.4	-1.7	-1.6	-1.3
PTP	66.6	-1.6	8.6	15.7	16.8	39.6	15.3	20.8	21.1	30.8	88.0	99.9	109	115
Taxes	-14.6	-1.6	-2.4	-4.0	0.8	-7.3	-3.2	-4.4	-4.4	-6.5	-18.5	-21.0	-22.9	-24.2
Net earnings	52.0	-3.2	6.1	11.7	17.6	32.3	12.1	16.4	16.7	24.3	69.5	78.9	86.2	91.0
EPS (adj.)	1.85	0.28	0.20	0.56	0.53	1.58	0.47	0.59	0.60	0.87	2.52	2.82	3.08	3.25
EPS (rep.)	1.86	-0.11	0.22	0.42	0.63	1.15	0.43	0.59	0.60	0.87	2.48	2.82	3.08	3.25
Key figures	2019	Q1'20	Q2'20	Q3'20	Q4'20	2020	Q1'21	Q2'21e	Q3'21e	Q4'21e	2021e	2022e	2023e	2024e
Revenue growth-%	9.0 %	1.0 %	-23.6 %	4.6 %	0.9 %	-4.6 %	13.1 %	44.5 %	27.6 %	19.2 %	25.1 %	9.5 %	5.8 %	4.7 %
Adjusted EBIT growth-%	9.0 %	4.5 %	-52.1 %	33.5 %	-33.9 %	-15.1 %	24.8 %	154.5 %	0.6 %	128.8 %	59.7 %	11.3 %	8.9 %	5.3 %
EBITDA-%	13.3 %	13.5 %	10.9 %	18.3 %	9.6 %	12.8 %	13.9 %	14.3 %	14.0 %	15.2 %	14.4 %	14.4 %	14.6 %	14.6 %
Adjusted EBIT-%	10.1 %	9.3 %	6.4 %	13.9 %	6.7 %	9.0 %	10.3 %	11.2 %	11.0 %	12.8 %	11.5 %	11.6 %	12.0 %	12.1 %
Net earnings-%	7.8 %	-2.2 %	4.7 %	7.5 %	8.6 %	5.1 %	7.4 %	8.6 %	8.4 %	9.9 %	8.7 %	9.0 %	9.3 %	9.4 %

Source: Inderes

Balance sheet

Assets	2019	2020	2021e	2022e	2023e
Non-current assets	161	158	162	163	165
Goodwill	3.8	3.8	3.8	3.8	3.8
Intangible assets	32.2	36.7	39.4	41.7	44.0
Tangible assets	119	112	113	112	112
Associated companies	0.8	0.8	0.9	0.9	0.9
Other investments	0.4	0.4	0.4	0.4	0.4
Other non-current assets	1.2	0.8	0.8	0.8	0.8
Deferred tax assets	3.8	3.1	3.7	3.7	3.7
Current assets	266	316	336	397	453
Inventories	153	142	178	195	206
Other current assets	0.0	0.0	0.0	0.0	0.0
Receivables	64.2	50.4	63.7	69.8	73.8
Cash and equivalents	48.7	124	94.6	132	173
Balance sheet total	427	474	499	560	618

Source: Inderes

Liabilities & equity	2019	2020	2021e	2022e	2023e
Equity	232	255	307	356	406
Share capital	7.0	7.0	7.0	7.0	7.0
Retained earnings	216	240	290	339	389
Hybrid bonds	0.0	0.0	0.0	0.0	0.0
Revaluation reserve	5.4	4.4	6.5	6.5	6.5
Other equity	3.5	3.5	3.5	3.5	3.5
Minorities	0.0	0.0	0.0	0.0	0.0
Non-current liabilities	52.9	56.6	46.2	46.2	46.2
Deferred tax liabilities	1.4	1.1	1.1	1.1	1.1
Provisions	3.5	5.0	5.0	5.0	5.0
Long term debt	48.0	50.5	40.0	40.0	40.0
Convertibles	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	0.0	0.0	0.0	0.0	0.0
Current liabilities	142	162	146	158	166
Short term debt	33.7	64.1	20.0	20.0	20.0
Payables	108	98.2	126	138	146
Other current liabilities	0.0	0.0	0.0	0.0	0.0
Balance sheet total	427	474	499	560	618

Valuation and recommendation 1/3

Basis of the valuation

We examine the valuation of Ponsse's share from three viewpoints, i.e., 1) with earnings-based multiples (P/E and EV/EBIT) and comparing them to the peer group; 2) through the DCF model; and 3) total return model of the share, where we consider earnings growth, relative valuation level and dividend yield. Based on the results these generate we try to form an overall picture of the share's fair value on which we base our investment view.

Positive and negative value drivers

According to our view, factors that support Ponsse's share value are:

- **Tight focus** on the growing market of cut-to-length machines
- **Strong market position** as the world's second largest player in the chosen segment and track record of long-term market share growth
- **Flexible cost structure** for an engineering company which helps in economic fluctuations
- **Excellent earnings history**, where the stability and predictability of the result is emphasized
- **Very strong balance sheet** that both protects from market shocks and offers opportunities for new growth investments.

According to our view, the following factors depress Ponsse's share value:

- **Smaller size than the average peer.** The share valuation of medium-sized companies like Ponsse (that the market does not interpret to be growth companies) suffers a bit from the lack of visibility and recognition relative to peers that are often 3-5 times bigger measured by market value.
- **Relatively small share of continuous business.** The small share of continuous business (typically service work) in net sales raises the risk profile and thus lowers the valuation level. For example, 52% of Metso Outotec's net sales, 49% of Wärtsilä's net sales and 40% of Konecranes' net sales was service in 2020, while the corresponding share for Ponsse was 20%.
- **Relatively thin liquidity of the share.** In all, 63% of Ponsse's share capital is held by the founding family so the free float is quite small. The liquidity of this pot is relatively thin: over the past year the traded share was 22% while the corresponding share for large engineering companies was over 100% and even in smaller companies (e.g. Glaston, Kesla and Raute) over 30%. The liquidity of Ponsse's share has, however, improved from one year ago by 15%. In any case, the weakish liquidity of the share drives some institutional investors away and is reflected in the valuation level.

Valuation	2021e	2022e	2023e
Share price	43.0	43.0	43.0
Number of shares, millions	28.0	28.0	28.0
Market cap	1204	1204	1204
EV	1170	1132	1092
P/E (adj.)	17.0	15.3	14.0
P/E	17.3	15.3	14.0
P/FCF	28.1	17.6	15.4
P/B	3.9	3.4	3.0
P/S	1.5	1.4	1.3
EV/Sales	1.5	1.3	1.2
EV/EBITDA	10.2	9.0	8.1
EV/EBIT (adj.)	12.8	11.1	9.9
Payout ratio (%)	42.3 %	46.2 %	47.1 %
Dividend yield-%	2.4 %	3.0 %	3.4 %

Source: Inderes

Valuation and recommendation 2/3

- **Absence of acquisition target option.** Ponsse's ownership structure and largely also the basis of operations makes it an unlikely acquisition target and thus eliminates any possible speculation upside from the pricing of the share.

Peer group valuation

Due to the lack of direct peers Ponsse's peer group is quite mixed and is largely formed of clearly larger companies than Ponsse, like the Finnish Cargotec and Valmet, and international conglomerates like Deere & Company and AGCO. When compiling the peer group, we have focused on companies that operate in the forest industry, lifting devices and construction machinery in a broader sense. We believe these sectors have similar end demand and profitability drivers as Ponsse. Because the COVID pandemic has significant effects on various companies' earnings development in 2021 and because on median level the peers' earnings growth in 2022 is expected to be faster than what we expect from Ponsse we focus on 2022 in our peer group valuation.

The peer group's median P/E for 2022 is 16x. Ponsse's corresponding ratio with our estimates is 15x. The 2022 EV/EBIT ratio is 11x for both the peer group and Ponsse. The valuation discount for Ponsse's share in 2022 is 8% with the P/E ratio and only 1% with the EV/EBIT ratio. Ponsse's discount with other multiples (EV/EBITDA and P/S) is some 2-3% so the valuation image relative to the peers is quite unanimous.

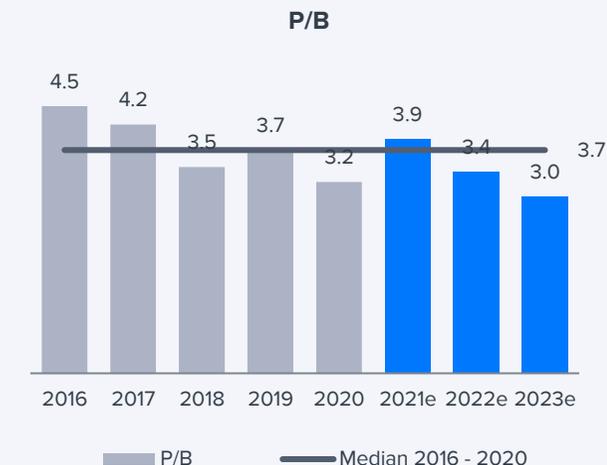
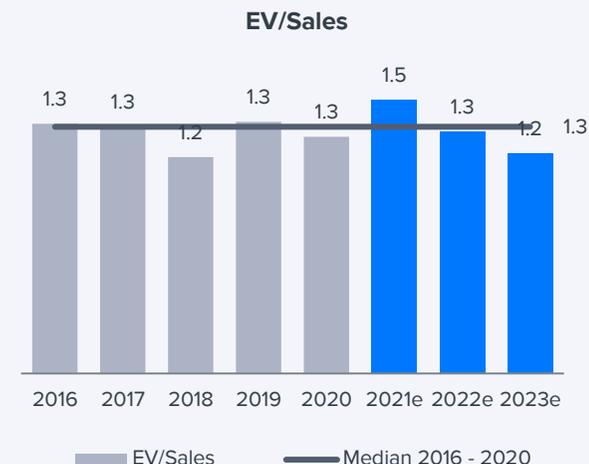
Ponsse's acceptable valuation multiples

Due to the above-mentioned factors that lower Ponsse's valuation level, a reasonable multiple-based discount of, e.g., 5-10% compared to the peer group median would be justified. However, considering Ponsse long growth story that has been faster than market growth, stable result history and predictability of earnings performance and the company's strong balance sheet, the justified discount in our opinion is either non-existent or very low, 0-5%. For 2022 this would mean a P/E multiple of around 16x and an EV/EBIT multiple of 11x. Ponssetta. This multiples are also in line with Ponsse's own historic multiples.

DCF model indicates upside potential

The DCF model discounts estimated future free cash flows (including the terminal assumption) to the present moment and current net debt is subtracted from this value. The weakness of the model is its sensitivity to the terminal growth and profitability estimates so the result should be interpreted with caution.

As we said in the Estimates section, our terminal net sales growth rate expectation is 2.5%. Our terminal EBIT margin estimate is 10.5%, which does not differ much from the median of 2011-2020 (10.3%). Used in the DCF model



Valuation and recommendation 3/3

The discount rate (weighted average cost of capital, WACC) used in our DCF model is 7.7% and it is raised by 0.40% liquidity premium of the share. Cost of equity is 8.3%. Both figures are based on a 2.0% risk-free interest and a 4.75% market risk premium.

The DCF model indicates a EUR 48 value for Ponsse's share to which there is an upside of some 12%. Considering the risks related to the parameters of the DCF model, the upside is quite modest. The more detailed calculation can be found in the appendices.

Result of total return model is unfavorable

The total return expectation (share price potential based on earnings growth and expected change in valuation multiple in 2022 plus dividend yield) of Ponsse's share is 7-8% p.a. according to our calculations. The return comprises a 4- 5 % share price potential p.a. and a dividend yield of some 3%. The figure is raised by the rapid growth in the adjusted EPS from EUR 1.58 in 2020 to EUR 2.82 in 2022. We have estimated the acceptable P/E ratio for 2022 to be 16x, which is in line with the peer group median and the company's own historic median multiple. The share's total return expectation undercuts the good 8% equity return requirement, which is why the risk adjusted return expectation is weak.

Investment view

We lower Ponsse's recommendation to Reduce (previously Accumulate) as the share has risen by 14% after we gave the positive recommendation (April 16). Our new target price is EUR 45.50 (EUR 46.50) with

which the 2022 P/E and EV/EBIT ratios are in line with the peer group median and the company's own historic multiples.

Main arguments for lowering the recommendation are: 1) the share's risk-adjusted total return expectation is no longer attractive; 2) the share's undervaluation compared to its peers has disappeared and the valuation multiples are also in line with the share's own historic multiples; 3) upside to DCF value quite narrow; and 4) our estimates are quite challenging both in terms of the entire forest machine market and the development of Ponsse's market share and margins. Even though we do not think the share is overvalued, the current valuation level cannot take any disappointments either in the entire forest machine market nor in Ponsse's performance.

A potential positive share price driver in the short term is growth in order intake that would continue exceeding estimates which could be based on a stronger than expected market and/or a quick rise in Ponsse's market share. Our expectation for order intake growth in Q2-Q4'21 is, however, already challenging at 26% y-o-y. Our expectations for Ponsse's margin development are also quite challenging when we consider historic levels and the cost pressure currently arising from the subcontracting chain.

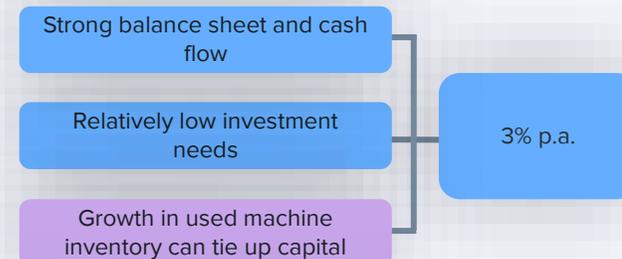
EPS drivers 2021e to 2023e

■ Positive ■ Neutral ■ Negative

Earnings return drivers



Dividend yield drivers



Valuation multiple drivers

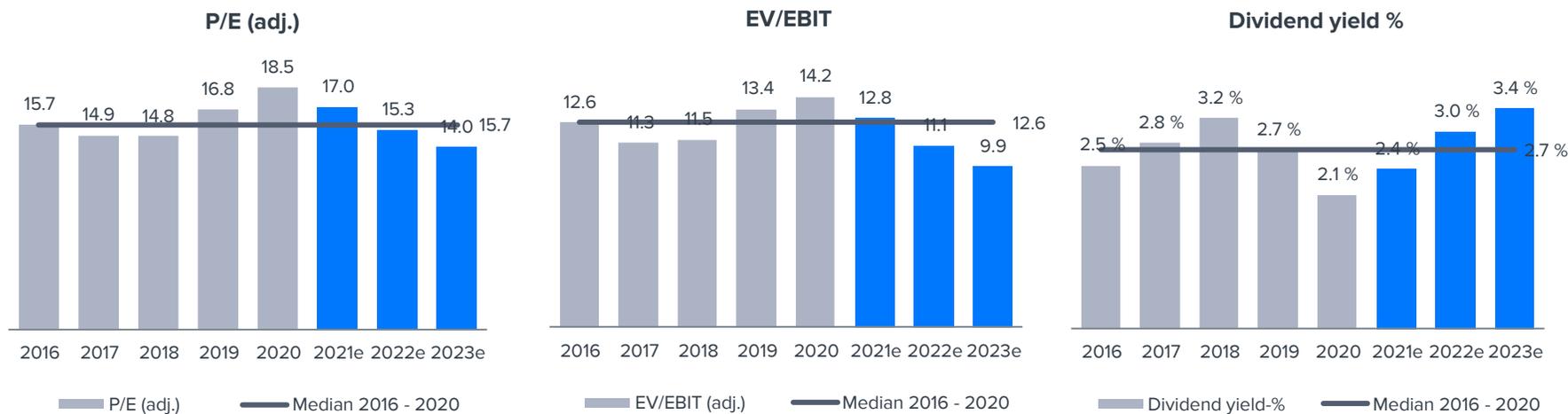


Share's expected total return around 7-8% p.a.

Valuation table

Valuation	2016	2017	2018	2019	2020	2021e	2022e	2023e	2024e
Share price	24.0	26.4	24.8	31.0	29.2	43.0	43.0	43.0	43.0
Number of shares, millions	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0
Market cap	671	738	692	868	818	1204	1204	1204	1204
EV	693	763	711	901	809	1170	1132	1092	1050
P/E (adj.)	15.7	14.9	14.8	16.8	18.5	17.0	15.3	14.0	13.2
P/E	14.7	16.5	15.8	16.7	25.3	17.3	15.3	14.0	13.2
P/FCF	27.4	33.2	21.9	>100	12.4	28.1	17.6	15.4	14.5
P/B	4.5	4.2	3.5	3.7	3.2	3.9	3.4	3.0	2.6
P/S	1.3	1.3	1.1	1.3	1.3	1.5	1.4	1.3	1.2
EV/Sales	1.3	1.3	1.2	1.3	1.3	1.5	1.3	1.2	1.1
EV/EBITDA	10.3	9.5	9.2	10.2	9.9	10.2	9.0	8.1	7.5
EV/EBIT (adj.)	12.6	11.3	11.5	13.4	14.2	12.8	11.1	9.9	9.0
Payout ratio (%)	36.7 %	46.9 %	51.2 %	45.8 %	52.1 %	42.3 %	46.2 %	47.1 %	47.7 %
Dividend yield-%	2.5 %	2.8 %	3.2 %	2.7 %	2.1 %	2.4 %	3.0 %	3.4 %	3.6 %

Source: Inderes



Peer group valuation

Peer group valuation Company	Share price	Market cap MEUR	EV MEUR	EV/EBIT		EV/EBITDA		EV/S		P/E		Dividend yield-%		P/B 2021e
				2021e	2022e	2021e	2022e	2021e	2022e	2021e	2022e	2021e	2022e	
Cargotec Corp	46.62	2559	3317	13.0	10.5	8.4	7.8	1.1	1.0	16.8	12.9	2.7	2.6	2.1
Neles Oyj	12.14	1815	1888	20.3	17.4	16.3	14.2	3.0	2.6	28.7	24.5	1.7	1.9	6.2
Valmet Oyj	34.50	5170	5173	12.1	11.3	9.8	9.1	1.3	1.2	17.7	16.8	3.1	3.3	4.1
Metso Outotec Corp	9.39	7744	8471	17.2	12.7	13.4	10.5	2.0	1.8	20.2	16.2	2.4	3.4	3.5
Palfinger AG	38.75	1449	1913	12.4	10.6	8.4	7.4	1.1	1.0	15.9	13.5	1.9	2.4	2.2
Deere & Co	384.00	99143	131273	19.6	16.4	15.9	12.8	3.1	2.7	23.7	19.5	0.9	1.0	8.7
AGCO Corp	145.90	9056	9785	12.7	11.0	9.7	8.6	1.1	1.0	16.9	15.2	0.5	0.5	3.4
Terex Corp	54.59	3139	3473	13.5	10.1	11.6	8.9	1.0	0.9	21.4	14.5	0.6	0.7	3.5
Caterpillar Inc	242.23	109300	131443	19.7	16.6	14.2	13.0	2.8	2.6	24.6	20.3	1.8	2.0	8.9
Komatsu Ltd	3271.00	23950	29749			13.0	9.4	1.7	1.5	30.5	18.8	1.5	2.0	1.7
Ponsse (Inderes)	43.00	1204	1170	12.8	11.1	10.2	9.0	1.5	1.3	17.0	15.3	2.4	3.0	3.9
Average				15.6	13.0	12.1	10.2	1.8	1.6	21.6	17.2	1.7	2.0	4.4
Median				13.5	11.3	12.3	9.2	1.5	1.3	20.8	16.5	1.7	2.0	3.5
Diff-% to median				-5%	-1%	-17%	-3%	-2%	-2%	-18%	-8%	40%	49%	12%

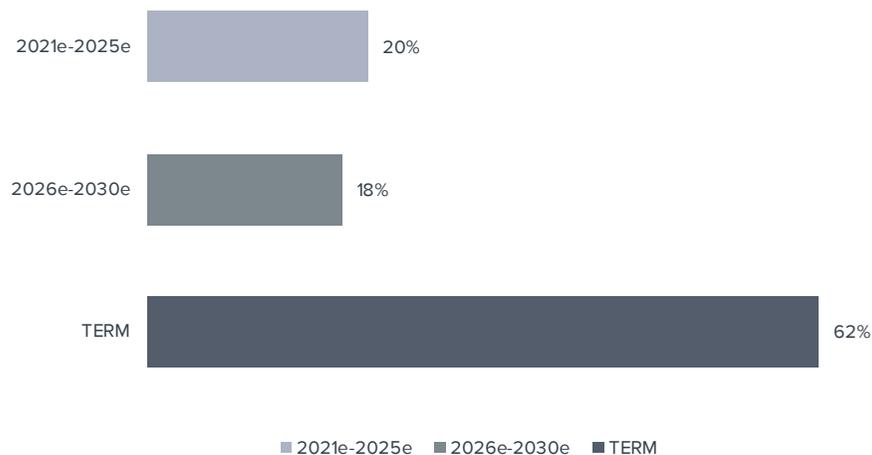
Source: Thomson Reuters / Inderes

NB: The market cap Inderes uses does not consider own shares held by the company

DCF calculation

DCF model	2020	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	TERM
EBIT (operating profit)	57.1	91.3	102	111	117	118	120	120	120	120	123	
+ Depreciation	24.6	23.6	24.1	24.1	24.3	24.7	28.5	29.4	30.2	30.9	31.5	
- Paid taxes	-6.8	-19.1	-21.0	-22.9	-24.2	-24.6	-24.9	-25.1	-25.2	-25.1	-25.8	
- Tax, financial expenses	-3.3	-0.8	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	
+ Tax, financial income	0.1	0.1	0.1	0.2	0.3	0.4	0.5	0.5	0.6	0.7	0.8	
- Change in working capital	14.9	-21.4	-11.0	-7.4	-6.3	-6.0	-5.6	-5.1	-4.6	-4.0	-4.1	
Operating cash flow	86.7	73.6	93.3	104	110	112	117	119	120.6	121.4	124.3	
+ Change in other long-term liabilities	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
- Gross CAPEX	-22.5	-27.5	-25.0	-26.0	-27.0	-47.8	-34.4	-34.8	-35.0	-35.0	-36.5	
Free operating cash flow	65.7	46.1	68.3	78.2	83.2	64.5	83.0	84.4	85.6	86.4	87.7	
+/- Other	0.0	-3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCFF	65.7	42.9	68.3	78.2	83.2	64.5	83.0	84.4	85.6	86.4	87.7	1716
Discounted FCFF		40.9	60.6	64.3	63.5	45.7	54.6	51.6	48.5	45.4	42.8	838
Sum of FCFF present value		1356	1315	1254	1190	1126	1081	1026	974	926	881	838
Enterprise value DCF		1356										
- Interesting bearing debt		-114.5										
+ Cash and cash equivalents		124										
-Minorities		0.0										
-Dividend/capital return		-16.8										
Equity value DCF		1348										
Equity value DCF per share		48.1										
Wacc												
Tax-% (WACC)		21.0 %										
Target debt ratio (D/(D+E))		10.0 %										
Cost of debt		3.0 %										
Equity Beta		1.25										
Market risk premium		4.75%										
Liquidity premium		0.40%										
Risk free interest rate		2.0 %										
Cost of equity		8.3 %										
Weighted average cost of capital (WACC)		7.7 %										

Cash flow distribution



Summary

Income statement	2018	2019	2020	2021e	2022e	Per share data	2018	2019	2020	2021e	2022e
Revenue	612.4	667.4	636.6	796.4	872.2	EPS (reported)	1.56	1.86	1.15	2.48	2.82
EBITDA	77.6	88.5	81.8	114.8	125.7	EPS (adj.)	1.67	1.85	1.58	2.52	2.82
EBIT	61.7	67.3	57.1	91.3	101.6	OCF / share	2.36	1.58	3.09	2.63	3.33
PTP	56.3	66.6	39.6	88.0	99.9	FCF / share	1.13	0.23	2.35	1.53	2.44
Net Income	43.7	52.0	32.3	66.2	78.9	Book value / share	7.16	8.29	9.11	10.94	12.71
Extraordinary items	0.0	0.0	0.0	0.0	0.0	Dividend / share	0.80	0.85	0.60	1.05	1.30
Balance sheet	2018	2019	2020	2021e	2022e	Growth and profitability	2018	2019	2020	2021e	2022e
Balance sheet total	379.1	426.8	474.0	498.5	560.0	Revenue growth-%	6%	9%	-5%	25%	10%
Equity capital	200.2	232.1	255.0	306.5	356.0	EBITDA growth-%	-4%	14%	-8%	40%	9%
Goodwill	3.8	3.8	3.8	3.8	3.8	EBIT (adj.) growth-%	-8%	9%	-15%	60%	11%
Net debt	18.5	33.0	-9.1	-34.6	-72.2	EPS (adj.) growth-%	-6%	10%	-15%	60%	12%
Cash flow	2018	2019	2020	2021e	2022e	EBITDA-%	12.7 %	13.3 %	12.8 %	14.4 %	14.4 %
EBITDA	77.6	88.5	81.8	114.8	125.7	EBIT (adj.)-%	10.1 %	10.1 %	9.0 %	11.5 %	11.6 %
Change in working capital	1.5	-29.1	14.9	-21.4	-11.0	EBIT-%	10.1 %	10.1 %	9.0 %	11.5 %	11.6 %
Operating cash flow	66.0	44.2	86.7	73.6	93.3	ROE-%	23.2 %	24.1 %	13.3 %	24.8 %	23.8 %
CAPEX	-34.0	-35.8	-22.5	-27.5	-25.0	ROI-%	24.7 %	23.5 %	12.4 %	24.6 %	26.1 %
Free cash flow	31.6	6.3	65.7	42.9	68.3	Equity ratio	53.5 %	55.0 %	54.4 %	62.1 %	64.3 %
						Gearing	9.2 %	14.2 %	-3.6 %	-11.3 %	-20.3 %
Largest shareholders						Valuation multiples	2018	2019	2020	2021e	2022e
Vidgren Juha			22.2 %			EV/S	1.2	1.3	1.3	1.5	1.3
Vidgren Jukka			13.4 %			EV/EBITDA (adj.)	9.2	10.2	9.9	10.2	9.0
Vidgren Janne			13.2 %			EV/EBIT (adj.)	11.5	13.4	14.2	12.8	11.1
Vidgren Jarmo			13.2 %			P/E (adj.)	14.8	16.8	18.5	17.0	15.3
Sijotusrahasto Nordea Nordic Small Cap			5.3 %			P/E	3.5	3.7	3.2	3.9	3.4
Skandinaviska Enskilda Banken, Helsingin sivukonttori			1.9 %			Dividend-%	3.2 %	2.7 %	2.1 %	2.4 %	3.0 %

Source: Inderes

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Sell	The 12-month risk-adjusted expected shareholder return of the share is very weak

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Recommendation history (>12 mo)

Date	Recommendation	Target price	Share price
15-02-17	Accumulate	23.00 €	22.30 €
26-04-17	Accumulate	25.00 €	23.08 €
21-06-17	Accumulate	27.00 €	23.89 €
09-08-17	Accumulate	26.50 €	24.06 €
18-10-17	Reduce	27.50 €	27.40 €
14-02-18	Reduce	26.50 €	26.55 €
18-04-18	Reduce	28.00 €	27.45 €
22-05-18	Reduce	29.00 €	31.50 €
08-08-18	Reduce	30.50 €	32.30 €
24-09-18	Reduce	30.00 €	29.70 €
24-10-18	Reduce	28.50 €	27.20 €
20-02-19	Reduce	28.50 €	28.25 €
17-04-19	Reduce	28.50 €	29.45 €
14-08-19	Reduce	27.00 €	28.30 €
23-10-19	Reduce	27.00 €	29.30 €
04-12-19	Accumulate	29.50 €	28.10 €
17-02-20	Reduce	31.00 €	32.90 €
19-02-20	Reduce	29.50 €	29.85 €
18-03-20	Reduce	20.00 €	21.00 €
22-04-20	Reduce	20.00 €	22.95 €
12-08-20	Reduce	25.00 €	25.50 €
21-10-20	Accumulate	29.00 €	26.05 €
26-11-20	Reduce	31.00 €	29.85 €
17-02-21	Reduce	33.00 €	33.20 €
16-04-21	Accumulate	42.00 €	37.70 €
21-04-21	Accumulate	46.50 €	42.85 €
17-05-21	Reduce	45.50 €	43.00 €



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