Martela

Company report

11/2017

inderes.

Back on track

We set our target price of Martela to 8.0 EUR (prev. 9.0 EUR) and reiterate our Accumulate-recommendation. We find the risk/return -profile of the share attractive, as we think it is unlikely that the problems experienced in 2017 would continue. Moreover, we expect the cost reduction and efficiency programs conducted in 2013-2017 to be fully reflected on the company's profitability from 2018 onwards. The valuation level is not high, dividend yield is at a decent level, and in the positive scenario the share has significant upside potential. We however highlight that it will take time for investors confidence to return after the disappointments in 2017.

Provider of work and learning environments

Martela was established in 1945. It is Finland's largest and also one of the Scandinavia's largest work and and learning environment solution provider. The company has gone through a significant transformation from a loss making furniture manufacturer to a profitable service company. Martela's current focus is in the Nordic countries and its key product is the Lifecycle® - service model. The model offers a comprehensive solution for a workspace for its entire lifecycle. Currently about 15% of Martela's net sales are generated from services.

We think the worst problems of 2017 are now behind

We still see Martela as a turnaround company. We expect the company's business to be now back on track after the disastrous IT-system problems experienced in 2017. We expect significant improvement in the earnings in the coming years, as the cost and efficiency programs undertaken in 2013-2017 should be fully reflected on the profitability for the first time. We also expect the company's sales to recover from the weak 2017 performance. We expect EBIT-margins to increase to about 3.5% in the next few years from the weak 1.9% forecasted in 2017. We note that the company has potential to achieve significantly higher profitability levels if it succeeds in its strategic expansion in Norway and Sweden.

Valuation level is low, but it will take time for investor confidence to return

With our conservative estimates, Martela's P/E-figure for years 2018-2019 are about 10-11x and expected dividend yield is in the range of 5-6%. We think there is clear upside potential in the share due to earnings growth and normalization of valuation multiples. Our target price reflects a 2018 P/E-figure of 12x. We do however emphasize that after the disappointments in 2017, it will take time for investors confidence to return. Moreover, Martela's first half of the year is typically weak due to the normal seasonal fluctuations. The normalization of the valuation level will thus take time and the investors need to remain patient.

Analyst

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Recommendation and target price

Accumulate
Previous: Accumulate

8.0 EUR
previous: 9.0 EUR

Share price : 7.44 EUR (23.11.2017)
Potential: +7.5%

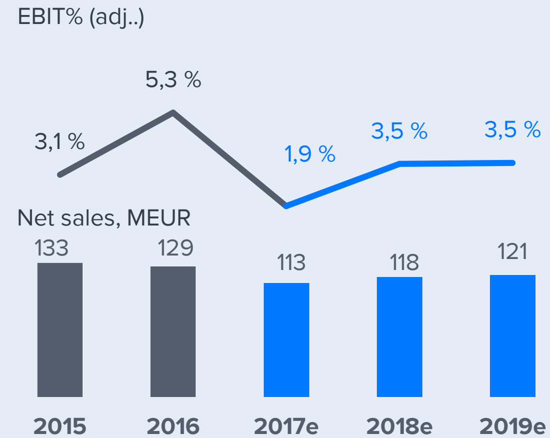
Key figures

	2016	2017e	2018e
Net sales	129	113	118
Growth -%	*-2.8%*	*-12.7%*	*5%*
EBIT	6.2	2.2	4.1
EBIT-%	*4.8%*	*1.9%*	*3.5%*
Pre-tax profit	5.6	1.7	3.6
EPS (adj.)	0.97	0.25	0.68
Dividend	0.37	0.37	0.47
EV/Sales	0.4x	0.3x	0.2x
EV/EBITDA	4.9x	5.6x	4.0x
EV/EBIT	7.0x	13.0x	6.7x
P/E (adj.)	13.2x	30.1x	10.9x
P/B	2.1x	1.3x	1.2x
Dividend-%	2.9%	5.0%	6.3%

Share price development

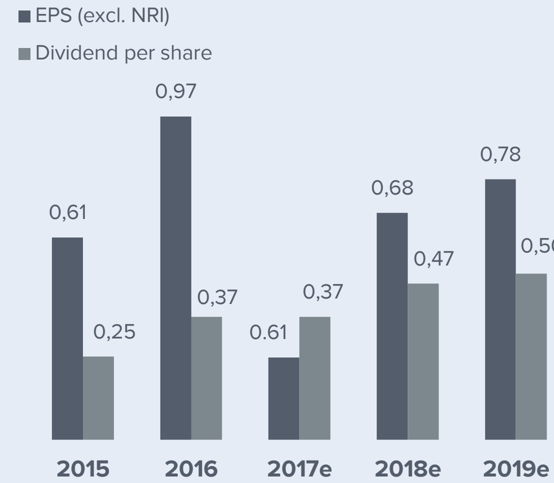
Source: Reuters

Net sales (MEUR) and EBIT-%



Source: Inderes

EPS and dividend per share



P/E (adj.)
11x
2018e

EV/EBITDA
4.0x
2018e

EV/S
0.2x
2018e

dividend-%
5.0
2017e

Value drivers

- The cost and and efficiency programms conducted in 2013-2017 will be fully reflected on the profitability from 2018 onwards
- Implementation of the Lifecycle-strategy in the Nordics
- Increasing dividend

Risk factors

- Industry is sensitive to business cycles
- Gross margin deterioration in the long term
- Potential failure of the Nordic Lifecycle-strategy
- Continuation of the IT-problems

Valuation

- Valuation low in both relative and absolute terms
- High dividend yield supports the valuation level
- Upside potential through earnings growth and multiple expansion

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Company description

Provider of work and learning environments

Martela is a 1945 established provider and designer of interior design for work and public environments. In Finland, Martela is the market leader and also one of the largest in the Nordic countries. Group net sales totaled 129 MEUR in 2016 and the company employed 504 people at the end of Q3'17. The company has been listed in Helsinki since 1986. With its broad product and service portfolio, the company is able to produce user centric solutions to work and learning environments for the entire lifespan duration. In addition to furniture, the company's offering includes numerous maintenance, recycling, designing, moving, and specification solutions. In 2016, we estimate that about 15% of net sales were derived from different services.

Vision and Mission

Vision: "People Centric Workplaces"

Mission: "Better working"

Leadership

Martela has been led by CEO MBA Matti Rantaniemi since 2015. The CFO since 2016 has been M.Sc Riitta Järnstedt.

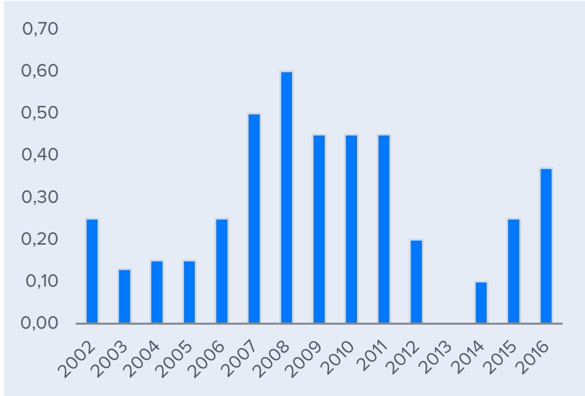
Ownership structure

Martela's ownership is quite centralized. The Martela family owns over 20% of outstanding shares and has over 70% of votes. The company has two series of shares, of which the K-series has 20 votes per share compared to the A-series which has one.

Earnings distribution policy

Martela does not currently have an official earnings' distribution policy. Historically however the company has been quite generous in dividend payouts. The annual dividend has been between 0-0.45 EUR during the last six years, and has often exceeded the EPS. The exception is 2013, marking the first time in twenty years that no dividends were paid.

Martela's dividend history 2002-2016

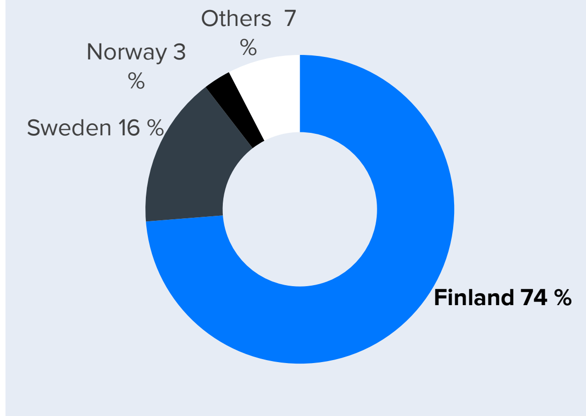


Source: Martela

Organizational structure has been reformed

After the 2016 organizational restructuring, the three different business segments were replaced by a single Customers and Workplace Service unit, which is accountable for clients, sales, and workspace related services as well as the global sales network.

Martela 2016 net sales distribution



Source: Martela

Production mostly outsourced

The Martela group operates mostly on demand and has outsourced most of its production. Assembly is generally done at the Nummela logistics center. The center relies on its broad subcontracting network in procurement, but a part of the semi-finished goods are manufactured in Martela's own factories in Kitee and Varsova. In Kitee, melamine and laminate based components are manufactured, and in Varsova fabric coated semi products are manufactured and are then transported to Nummela for final assembly. The in-house production is relatively small, with the Nummela logistics center mostly focused on final assembly of outsourced products.

We estimate that the inhouse production accounts for under 20% of total procurement. Production management is based on customers orders, so there is no need for large inventories of finished products.

Martela in brief

Martela is Finland's largest and one of the Nordic leaders specializing in user centric working and learning environments

1945
Established

1986
Listed on stock exchange

#1 market share
Finnish office furniture market (Inderes estimate)

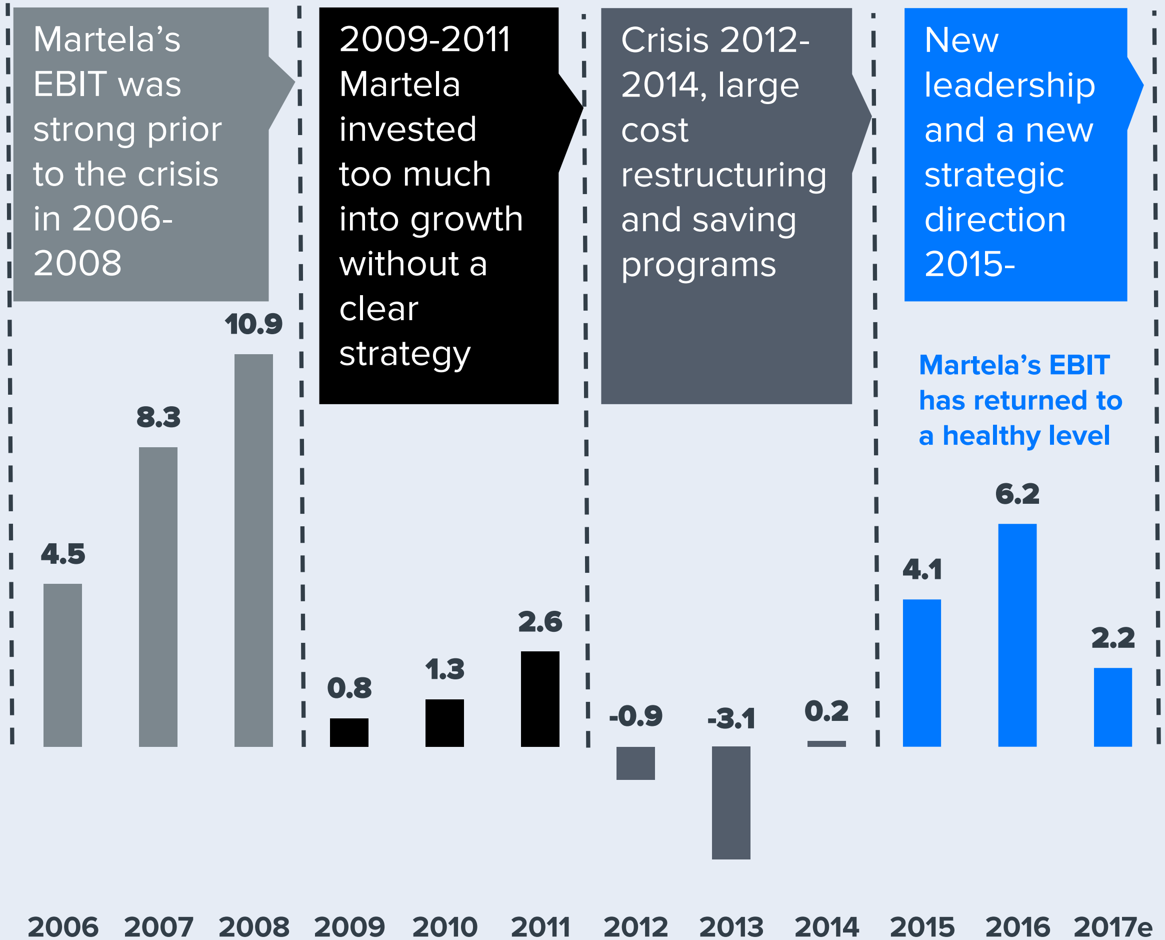
129 MEUR (-2.8% vs. 2015)
Net sales 2016

6.9 MEUR (5.3% of sales)
Adjusted EBIT 2016

550
Average number of employees 2016

1 Logistic center

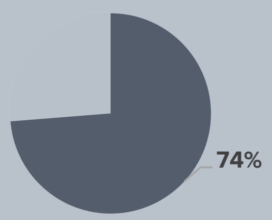
2 Component factory



Martela group structure

Finland

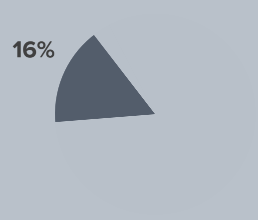
Net sales



- Nationwide sales and service organisation
- Grundell Oy and Kidex Oy
- 2016 net sales 95.2 MEUR

Sweden

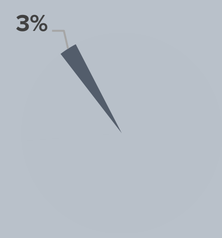
Net sales



- Own sales team and showroom premises in Stockholm
- 2016 net sales about 20.4 MEUR

Norway

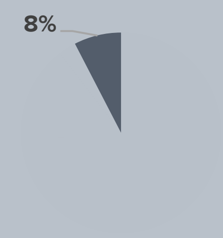
Net sales



- Own sales team and showroom premises in Oslo and Bergen
- 2016 net sales about 3.7 MEUR

Other

Net sales



- Sales through local licensed retailers
- 2016 net sales about 9.8 MEUR

Customer Supply Management

- R&D and quality
- Production, procurement, assembly, logistics, and installation
- Logistics center in Nummela and component factories in Kitee and Varsova

Investment profile

Dividend and a turnaround company

We see Martela as a dividend company and despite the setbacks of 2017, also as a turnaround company with growth options in Sweden and Norway. The cost reduction and efficiency improvements conducted between 2013 and 2017 are not yet fully reflected in the profitability, and thus we expect the EBIT margin to improve to about 3.5% in the coming years. Should the company prove successful in its strategic expansion in Norway and Sweden, it has potential to further improve its profitability.

Positive scenario provides ample upside

In the positive scenario Martela has significant upside potential. The company is still aiming to achieve 8% profitability excluding non-recurring items in 2018. We estimate that achieving this would result in about 1.7 EUR EPS, and with our multiples of 10-12x P/E, this should be reflected to a share price of about 17-20 EUR. We find the 8% EBIT margin target to be quite ambitious, requiring success in the Nordic Lifecycle strategy.

Potential

The positive drivers in the share in our view are:

- **2013-2017 cost and efficiency program's reflection in the result:** Martela has undergone significant cost reduction and efficiency programs since 2013, thanks to which the company's efficiency has improved and fixed costs have been reduced. The year 2017 was a major setback due to the IT-systems' problems, but as they are solved, profitability will rise well beyond the 2017 level.
- **Lifecycle-strategy implementation in the Nordic countries:** Martela's current strategy aims to implement the lifecycle strategy, which has performed strong in Finland, to the rest of the Nordic countries. Should this succeed, the company should be able to achieve clearly higher profitability than we have forecasted.
- **Dividend growth:** Martela does not have an official dividend policy, but historically the company has paid out most of its profits. We do not see any significant investment needs in the coming years and the company could raise the dividend substantially from the 0.37 EUR paid out last year. Dividend growth could be, in our view, a positive driver for the share.
- **Increasing the gross margin:** We estimate that Martela's gross margin has decreased from about 51% in 2005 to about 44% in 2016. Should the company improve its sales mix and/or improve its pricing power (e.g. through successful design), the margins could have some room for improvement. The company's net result is extremely sensitive to changes in gross margins. For instance, we estimate that a single percentage point increase in gross margin would increase net profits by one million euros.

Risks

From the investors' point of view, the main risks are:

- **Sensitivity to economic cycles:** Martela's business is by nature relatively sensitive to the economic cycles. Especially in Finland this sensitivity has been historically notable. The 1990 recession, the IT bubble burst of 2000, and recession of 2008-2009 all impacted Martela negatively. During these times Martela has experienced 20-30% sales drops in single years, with the result deep in red. A new recession or economic downturn would most likely have a negative impact on the company.
- **Margins deterioration:** Martela's sales mix weakening, increased competition and negative development in pricing power could all have a negative impact on Martela's margins in the long term, and thus weaken overall profitability. We find this scenario to be possible if Martela fails for instance in R&D. We don't find this risk to be especially pronounced when considering the sales mix and current market position held in Finland.
- **Failure in the implementation of Lifecycle-strategy in the Nordics** would naturally be disappointment to investors, but the effect on the company's result would most probably be relatively minor. According to our estimates the company could withdraw from Sweden and Norway completely without a significant effect on the net result.

Investment profile

1. Market leader in Finland
2. Turnaround company
3. Strong cash flow
4. High dividend yield
5. Growth option in the Nordics

Potential

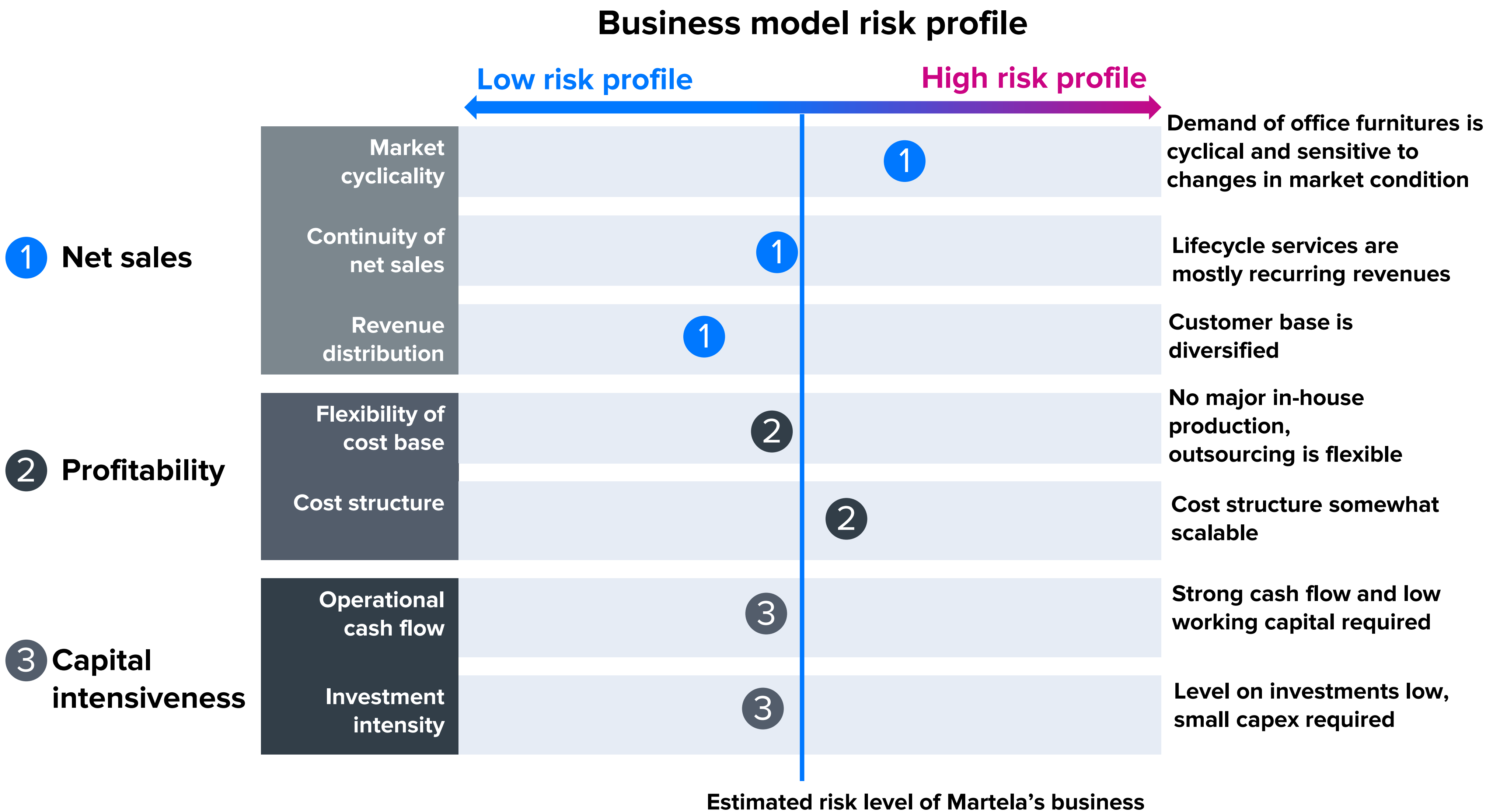
- Improving profitability
- Current valuation level has clear upside potential
- Nordic expansion
- Potential to increase dividend

Risks

- Sensitivity to economic cycles
- Gross margin deterioration
- Lifecycle-strategy failure in other countries
- IT-system problems could continue

Source: Inderes

Business model



Source: Inderes

Products and services 1/2

Comprehensive provider of workspace solutions

Martela's product and service offering spans from comprehensive solutions for offices, public spaces and learning environments for the entire life spans of these environments. The key product is a modern and intelligent activity based working environment with furniture and services. Services offered include e.g. specification of the working space, planning, designing, implementation, maintenance, evaluation of the utilization levels and recycling.

Offering

Functional working environment

The Activity based working concept was born during the turn of the millennium. It is strongly integrated to the development of mobile technologies and telecommuting. Companies realized that working methods had changed, and the actual utilization rate of many offices was less than 40%. The way in which people work had changed permanently, and the change has been compared to the spreading of open offices in the 1960's. in Finland, activity based offices have become more and more common since the 2010's and nowadays the majority of new knowledge based offices are designed using the activity based working concept.

Activity based working is often described as a working environment where the whole working space has been designed and tailored to suit specific working requirements. The activity based working environment offers spaces for different kind of working activities e.g. for private working, co-operation, interaction and leisure. The working space design depends on the company's needs, size and industry.

Martela has been developing its own activity based working office concept since the 2000's. The current Lifecycle strategy introduced in 2014 is strongly based on activity based working implementation and data based optimization. A new activity based working office needs only about 10 sq.m. of space per employee, while in Finland the current average office size is about 15-25 sq.m. per person.

A user based environment aims to improve working efficiency and output as well as comfort, in addition to optimizing the space.

Intelligent office

Martela's working environment solutions utilize intelligent technology. With the Martela Dynamic solutions the space and resources dynamically adapt to the needs of the present day employees. Analytics enables the users to utilize different kind of spaces and allow to monitor employees user experience and to optimize their working environment.

The Martela Dynamic product family includes smart card- and smart phone operated solutions such as storage, work station, and meeting room reservation. The real time information is then used to help the employee find the best solution for the working needs at the time.

With these technologic solution, the employees can choose the best available working space and change the working place numerous times during the day, if required. Well planned activity based working environments support many kind of activities e.g. peaceful working, confidential conversations, working in groups and spontaneous encounters.

Work space utilization information is an important part of user centric working environment design, as is the continuous optimization of the working space. Analysis of the utilization of desks, meeting rooms and other spaces is an integral part of understanding how the space is actually used. The analysis eases the identification of the actual demands for space and uncovers saving potential. The Martela Dynamic service produces analytics to support continuous optimization of the work space.

Design furniture

Martela has, throughout its history, invested heavily in design. The company has co-operated with numerous Finnish and global designers, such as Eero Aarnio, Yrjö Kukkapuro, and Karim Rashid. The products made by Martela have won numerous rewards over the years, such as the IF Design Award, the Red Dot Award and the ADEX Design Award. Well known furnitures include the Kilta chair which has been in production since the 1950's and the Kari chair which has been in production since the 1960's.

The competitive advantage that Martela's design and brand have brought is difficult to assess. In our opinion they have at least partially been reflected in the relatively high gross margins. Martela's gross margin has been between 44% and 51% in the last decade which is relatively high level. In comparison, large global competitors have had average gross margin of about 35% during the same period.

Products and services 2/2

Martela's services

Lifecycle-services in the cornerstone of the strategy

Martela has in the last few years gone trough a drastic change from a product company to a company that provides solutions and services. Services account for about 15% of the current net sales and their meaning in the strategic direction of the company will only grow in importance going forward. The cornerstone of Martela's new updated strategy is the comprehensive Lifecycle service model, which enables employees to be more efficient and employee satisfaction to increase, while simultaneously bringing down total lifecycle costs of the working environment.

In the future, Martela's service offering in the whole Nordic region will include nearly everything that the transformation of working environment requires. Martela's Lifecycle service model can be divided into four stages:

Specification

The first stage in the model is specification of the working environment. It starts with defining the client's business targets and work space requirements. Martela analyzes the work space requirements by measuring the utilization rate of the current space with intelligent wireless sensors, which are attached to desks for 4-8 weeks. The result is a utilization report which is used as a foundation for planning the new environment. According to Martela's research, the current average utilization is very inefficient at about 30-40%.

Planning the working environment

The next stage is planning and designing an efficient working environment based on the data from stage one. It includes evaluating premises and furniture needs as well as designing the interior and space. The customer can use their own existing furniture. If the old furniture are not feasible in the new environment, Martela offers recycling services, and can also refurbish the furniture and sell them. It is also possible to lease the furniture with financing solutions offered by Martela.

Working environment implementation

The third stage is the actual implementation. Martela does this with a comprehensive turnkey approach. If needed, Martela will take charge of the entire process, from renovating surfaces, storage, moving, delivery, installation, and recycling and selling old and obsolete furniture.

Working environment maintenance

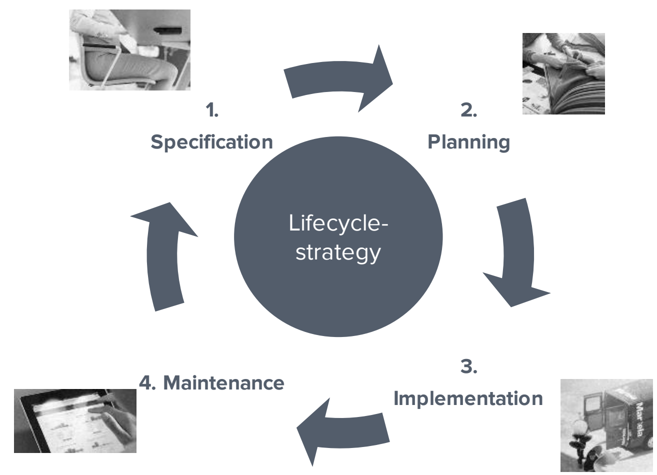
The last stage is maintaining the new working environment. This includes instructing employees on usage of the new furniture as well as the finishing touches and optimization of the space. Martela is able to monitor and measure, and thus optimize, the new environment with the help of wireless real time sensors to find out the actual utilization rate. Martela also maps out the acceptance and user experience with regularly conducted surveys.

The working environment as a service

The client sees the potential impact of the environment on their key results. With the constant optimization the working environment remains as efficient as possible, meeting the dynamic needs of the employees, as well as emphasizing satisfaction and commitment.

The working environment as a service facilitates strategic development of the environment, where functionality and optimized working is based on knowledge based leadership, anonymous usage information, and user experience.

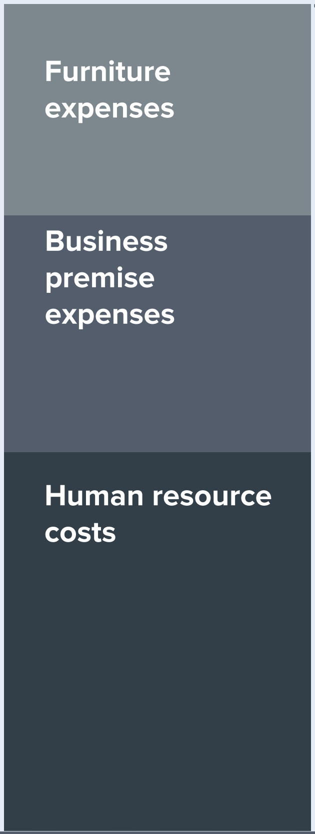
Martela Lifecycle® - service model



Source: Martela

Martela Lifecycle® -service model

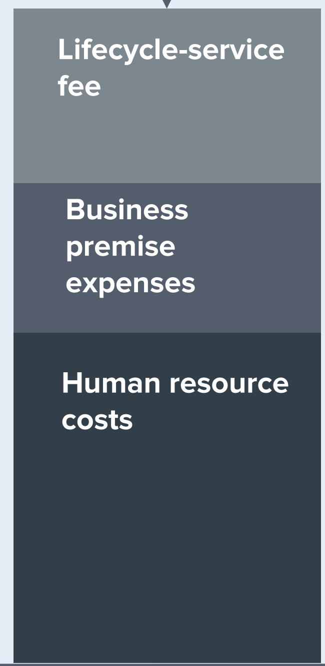
Cost savings as high as 35%



- Annual recurring fee to replace furniture costs
- No longer need to tie capital in furniture
- Clients no longer need to maintain their furniture
- Martela offers continuous maintence of the premises

- Working space requirements typically drop 20-40%
- Lease decreases
- Cleaning costs decrease
- Energy costs decrease

- Sick leaves typically decrease
- Effective working time increases
- Output per employee increases
- Workplace satisfaction increases



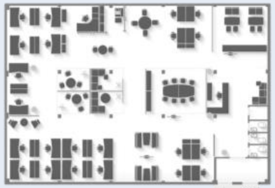
Cost structure of a typical office

Cost structure of Martela Lifecycle model

Source: Inderes and Martela

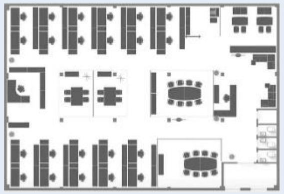
Activity based office and most common office solutions

Activity based office



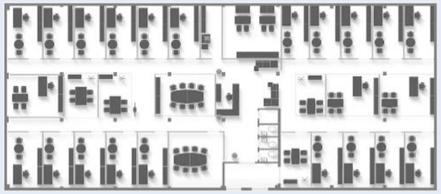
Activity based office is a user driven space that is tailored specifically to the needs of the customer and space requirements. Required space usually dramatically decreases, efficiency is boosted and work satisfaction increases. The average space required is 10 sq.m. per employee.

Open office



Open office mitigates the space requirments of the company and thus decreases direct rental costs. The downside is noise, elevated stress level of employees, increased turnover rate of workforce and increased sick leaves. Usually the space requirement is between 10-20 sq.m per employee.

Traditional room office



Traditional room offices provide the employees with privacy and a peaceful working environment where they are able to concentrate on their work. The negative side is less co-operation compared to the activity based office or open office and a relatively large space requirement of 20-25 sq.m. per employee.

Source : Inderes and Martela

Strategy and competitive advantages 1/2

Significant strategic change

Martela has undergone a significant strategic change from a product based company to a service provider. The new updated strategy which was released in June 2016 states that Martela will focus in the Nordic countries. The updated strategy is based on the Lifecycle model implementation to other Nordic countries as well as increasing sales, profitability and cash flow. According to our estimate the success of the strategy and the company's ability to achieve its target profitability level relies mostly on succeeding in Sweden.

Improving profitability

Martela's management has set a goal to achieve EBIT-margin of 8% (excluding non-recurring items) in 2018. The company has conducted numerous cost reduction programs and has succeeded in cutting fixed costs in recent years. Due to these procedures, Martela reached a healthy 3.1% operational profitability in 2015 (FY14: 0.1%). In 2016 profitability continued to increase and the adjusted operating margin was 5.3%. Due to the IT-system problems in 2017, profitability was however poor.

In addition to its cost reduction programs, Martela has reorganized its business and changed many executives. We estimate that the cost structure still has some room for improvement. For instance, out of the 550 employees in 2016, 266 were white-collar workers, which is relatively high of a number in our opinion.

Martela Lifecycle® -model

The cornerstone of Martela's strategy is the Martela Lifecycle® model. This service model is based on the idea of offering a continuous and comprehensive service that decreases the total cost of a working environment during its lifecycle. With a recurring lifecycle management fee, which costs less than direct furniture expenses, the client is able to decrease both direct office space expenses and employee costs.

The client starts to use the Inspiring Office® by Martela activity based working- office where the office space requirement decrease by about 35%. Additionally, employee work satisfaction increases and sick leaves decrease, with efficiency improving simultaneously. The Lifecycle service outsources all of the work to Martela, meaning that the client no longer needs to tie working capital in furniture and does not need to take care maintenance and repair of furniture.

Expansion in the Nordic countries

With the new updated strategy, Martela's market focus is in the Nordic countries as they share a common cultural background and are pioneers in the activity based working solutions. Previously sales in Sweden and Norway have been centered on product sales, relying heavily on retailers, but now the company aims to increase service sales, streamline sales as a whole, and keep customer contact in its own hands.

With the new organizational structure a single business unit is responsible of all of Martela's sales, and the Customer Supply Management unit is responsible of production, procurement, logistics, installation, relocation, quality, and R&D.

The Lifecycle- strategy which has been successful in Finland, will now be implemented to the rest of the Nordic countries with the same working principles as in Finland. The services offered in Finland (e.g. relocation and recycling services) will be offered through Martela or another company, but in such a fashion that the customer contact and customer experience are solely in Martela's hands.

Martela has emphasized that the expansion in the Nordic countries will be performed in an orderly fashion and in such a way that it does not create risk for the company. At first, Martela will focus on the Stockholm region, from where the sales will be gradually expanded to other parts of Sweden. The investments required will be cost-based at first and relatively small. Martela aims to focus on companies that it has defined to be in its main target group, and who have a need to change their working environments.

Strategy and competitive advantages 2/2

Competitive advantages in the Nordic countries

In the Nordic countries Martela's main markets in addition to Finland are Sweden and Norway. We estimate that the relevant market size in Sweden for Martela is more than twice compared to Finland. In Norway we estimate that the market size is close to the level in Finland. Martela has operated in Sweden and Norway for a long time, but historically it has not been able to grow its market share, at least not in a notable fashion. The brand recognition of Martela in Norway and Sweden are also not as good as in Finland. The possible competitive advantages in these markets rely heavily on the Martela Lifecycle® -service model. The Lifecycle strategy has proved to be successful in Finland, and we estimate it has all the potential to achieve the same in Sweden and Norway.

Competitive advantages in Europe

The European office furniture market is extremely fragmented, with about 100 large to medium sized players, each with sales of less than 500 MEUR. Martela is the 12. largest in Europe by net sales in this segment.

Martela's differentiating factors in the international market are in our view Scandinavian design, environmentalism, quality, and fast deliveries. According to Martela the logistics center in Finland and the component factory in Poland enable fast deliveries to central Europe and Russia. In Europe and in the global markets Martela has to compete against large well-known brands such as Steelcase and Herman Miller, but also against strong local brands. Therefore we draw the conclusion that Martela does not have a clear differentiating competitive advantage outside the Nordic countries.

Competitive advantages in Finland

The domestic office furniture market is very centralized and over half of the market is under Isku and Martela's control. We think Martela has a clear competitive advantage in Finland which is based on being well known among customers and having a strong market share. Martela is the market leader in Finland, and we estimate its market share to be about 43%. The company is very well known in Finland and its name is often associated with high quality, ergonomics and design. The retail network is also quite broad, and the company has over 20 retail locations in Finland.

In Finland the service offering comprehensively covers everything that changing a working environment requires. The company is able to offer its furniture and services with a turnkey approach, which we consider to be an advantage especially in large office projects. The intelligent activity based working environment is also competitive, as we have not been able to identify any local competitor that is able to offer such comprehensive solutions as Martela.

Competitive field in Finland

In Finland international cheap bulk providers such as IKEA and domestic counterparts such as Asko and Sotka compete with Martela. These manufacturers however mostly operate in the consumer market, and seldom sell large comprehensive packages to companies or the public sector, at least not on the same Nordic scale as Martela. Due to the aforementioned reasons, we find the threat posed by these players in relation to the current strategy to be small.

In addition to Isku on the Finnish market, comparable competitors for Martela are for instance European Furniture group and Kinnarps. These are however quite small players in Finland, and have not been able to notably grow market shares in their history.

There are also some smaller project oriented design based companies, such as Modeo and Workspace. For the time being, they remain relatively small and do not have brand recognition as strong as Martela.

The most notable domestic competitor Isku offers similar lifecycle services to companies, and has a comparably wide product and service offering. Isku hasn't however brought out its activity based working solution as strongly as Martela. In our view, Isku has not invested in the intelligent office concept in such a way as Martela. Isku's profitability development has also been poor, despite strong growth in recent years. As a whole, we do not consider the threat posed by Isku to be substantial at this point.

Martela's strategy

Strategic drivers	Strategic actions	Financial targets
One of the largest in its field in Scandinavia Pioneer in the activity based working Working environment importance is growing	• Implementing the Martela Lifecycle strategy in the Nordic countries • Fine-tuning procedures	• Sales volumes, cash flow, and profitability improvements • 8% EBIT margin without non-recurring items in 2018
➢ Martela has a strong position in the Nordic countries and resources to invest in its Lifecycle strategy ➢ The company has developed its own activity based office concept since 2000's ➢ Job satisfaction needs and relevance of working environments are growing in knowledge based workplaces	➢ Martela Lifecycle® -service model has excellent track record in Finland and the company has all the requirements to be successful in other Nordic countries	➢ Ambitious, but achievable goal. In 2016 Finland & Sweden-segment reached EBIT-margin of 7.5%. ➢ Achieving the target would require a clear success in the Nordic lifecycle strategy.

Source: Inderes

Markets 1/3

Martela's operating environment

Relevant market size about one billion euros

A notable part, about 74%, of Martela's 2016 revenue came from Finland. With the new updated strategy, Nordic countries and Sweden especially, will be more important in the future (Sweden 16% and Norway 3% of FY16 revenues). We estimate the relevant Nordic office furniture market to be roughly one billion euros in size, of which Sweden accounts for more than half. In current light we see the outlook and general business environment as positive and expect them to offer some support to Martela in the coming few years.

The most important demand driver is economic growth

Martela's demand is mainly driven by economic development as a whole, as well as construction activity in the public and office sectors. When financial activity increases, construction usually increases, thus increasing demand of office furniture and furniture for public sector.

Finnish economy showing positive signs

The long recession in Finland is finally behind us, and the outlook for the upcoming years is in our opinion positive. The economy is forecasted to grow moderately and this should give support to Martela's business. Overall the positive outlook gives confidence for Martela's earnings growth that we are expecting in 2018 and 2019.

Finanssialan Keskusliitto has gathered a report on the most recent estimates of Finnish GDP growth from financial institutions. According to this report the Finnish economy is expected to grow by 2.5-3% this year. The institutions expect moderate growth to continue also in 2018 and the current median growth estimate is 2.0%.

GDP growth-%	2017e	2018e
Danske Bank	2,8	1,8
Nordea	3,0	2,0
S-Pankki	3,0	2,3
Aktia	2,8	2,0
OP Ryhmä	2,5	2,5
Hypo	3,0	2,0
Handelsbanken	2,7	1,5
LähiTapiola-ryhmä	2,6	1,6

Source: Finanssialan keskusliitto

Swedish and Norwegian economies growing

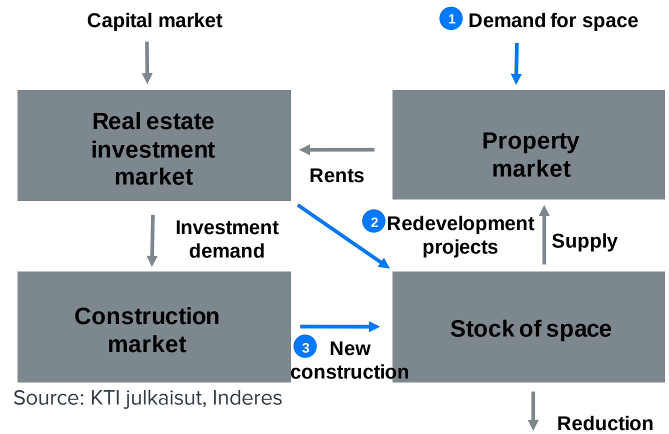
Economic growth in Sweden has been strong in the last few years, but GDP growth is expected to slow slightly to 2.3-2.7% (2016: 3.2%) according to OECD. The Norwegian economy is expected to grow by 1.3-1.5% in the next few years. Especially the strong economic growth in Sweden will likely support Martela's business, easing the implementation of the Lifecycle model in this market.

Working environment market

Office market

Demand for office furniture is strongly driven by office construction and redevelopment, in addition of the end-user demand for office space. The market dynamics and factors affecting the demand for Martela's products are shown in the picture below:

Office market dynamics:



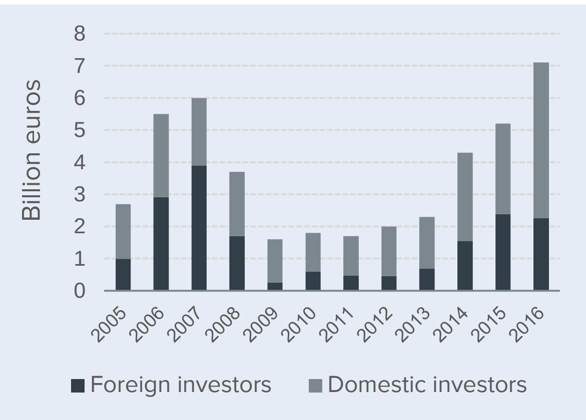
Source: KTI julkaisut, Inderes

The office furniture market demand is driven by the overall business cycle and the end-users demand 1 for office space, but also the real estate investment market. The decline in interest rates during the last few years has increased the attractiveness of the real estate investment, thus increasing the investment demand. This has resulted in increased transaction volumes in the real estate market.

Markets 2/3

According to Catella, Real estate transaction volume in Finland in 2017 is going to rise to above 2016 level (7.1 BEUR) to an all-time high level. According to the current barometers and estimates, demand for real estate investments will remain high in short term, which will most likely keep the transaction volumes high, in turn supporting 3 office space construction and redevelopment projects 2

Real estate investment transaction volumes in Finland, 2005-2016

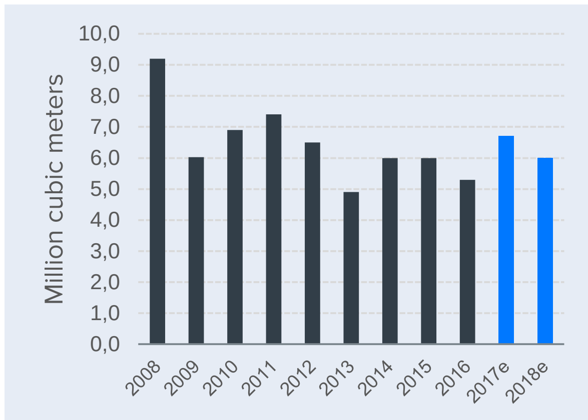


Source: Catella

Office space construction

The high investor demand for real estate investment has in our view been reflected in new construction of office and retail space in Finland. Office and retail space cubic volumes that went under construction were up by 20% in H1'17 form the previous year. We expect to see the rise in new construction to be reflected on the office furniture market with a small delay. We emphasize however that despite the high percentages in growth figures, the forecasted absolute cubic meters of new retail and office space to be started in 2017-2018 are still well below the 10 year average of 7.3 million cubic meters.

Office and retail space construction starts, 2008-2018



Source: Tilastokeskus, forecasts by Rakennusteollisuus RT

Office space demand

Office space demand is driven by employment rates, business cycles, changing trends in offices, as well as business's needs to enhance and improve the utilization rate of their work space. In Finland, the most important office market is in the Helsinki Metropolitan Area (HMA), where about 44% of the total national office space is located. The office space market in Finland, and especially in the HMA, is currently negatively impacted by the supply exceeding demand, illustrated by the 1.2 million sq.m. of vacant office space available in the Helsinki metropolitan area. This corresponds to a vacancy of about 14%, out of the total office space available. A large portion of the vacant space is however older space which does not satisfy the current demand for offices. There is still demand for modern, dynamic and flexible office space and therefore the large vacancy is in our opinion not a threat to growth in new construction.

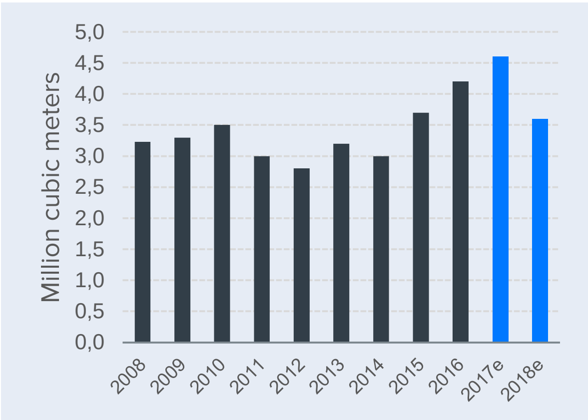
Furniture market for public spaces

The Finnish public sector is an important customer for Martela. The company sells both furniture and services to schools and other learning environments, but also to healthcare facilities. New learning environments such as schools constructed in Finland are for the most part more flexible, utilizing similar solutions and furniture used in modern offices. Municipalities in Finland continue to struggle financially, limiting public construction commencements to some extent.

Markets 3/3

Public construction commencements were up by 12% last year, measured by cubic meters, and are expected to continue to grow from the 2016 level, driven by the 2017 starts in hospital and educational spaces. Rakennusteollisuus RT estimates that in 2018 construction of public spaces will decline. We expect the public space construction to offer a small support to Martela in the upcoming few years.

Construction starts for public spaces, 2008-2018e



Source: Tilastokeskus, ennusteet Rakennusteollisuus RT

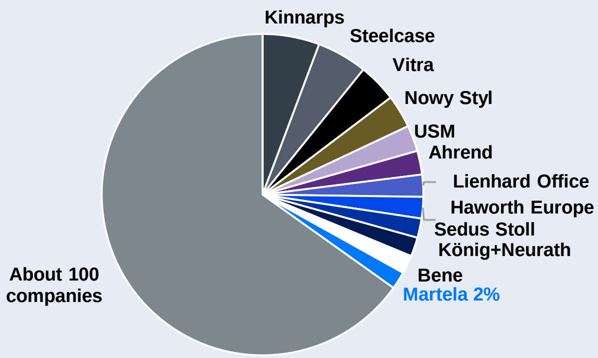
Demand drivers for Martela

Pressure to cut costs in both the public and private sectors is a factor that affects Martela's demand negatively. At the same time however this trend also provides some growth opportunities for the company. The most important growth drivers for Martela are:

- The pressure to cut costs in both the public and private sectors weaken demand on short term, but simultaneously offer opportunities for the company. Martela's Inspiring Office® by Martela -activity based working office and the Martela Lifecycle® -service model offers clear cost reduction potential and other advantages compared to traditional offices.
- Office efficiency requirements. According to barometers by KTI and Skanska, office space efficiency requirements are growing rapidly. Martela's products help to increase efficiency and offer solutions that satisfy this demand.
- Activity based office is gaining popularity and this provides a growth opportunity for Martela. Over half of the Skanska and KTI working environment barometer participants expect activity based working to become more widespread. Martela's key product, activity based working environment, is a relatively competitive and comprehensive solution at the moment.
- Value added services and outsourcing offer growth opportunities for Martela's services. Companies are more and more focused in their core competences and seek to outsource other business functions. The Martela Lifecycle -service model outsources the entire work space maintenance to Martela, freeing the clients capital from furniture to a more efficient use.
- The importance of the working environment is bound to grow according to the KTI-Skanska barometer. The working methods and workplace satisfaction can be improved by improvements in the workplace environment. Modern premise also support the company business image and can improve competitiveness in e.g. employee recruiting and customer relations.

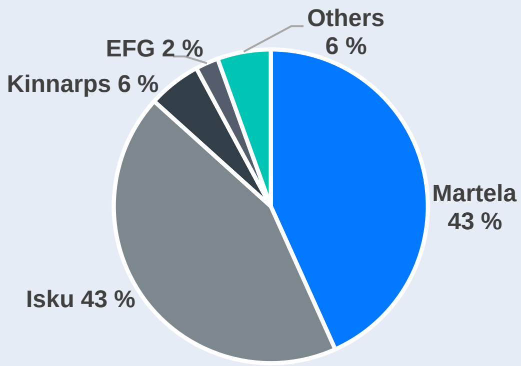
Markets and the competitive field

European office furniture market



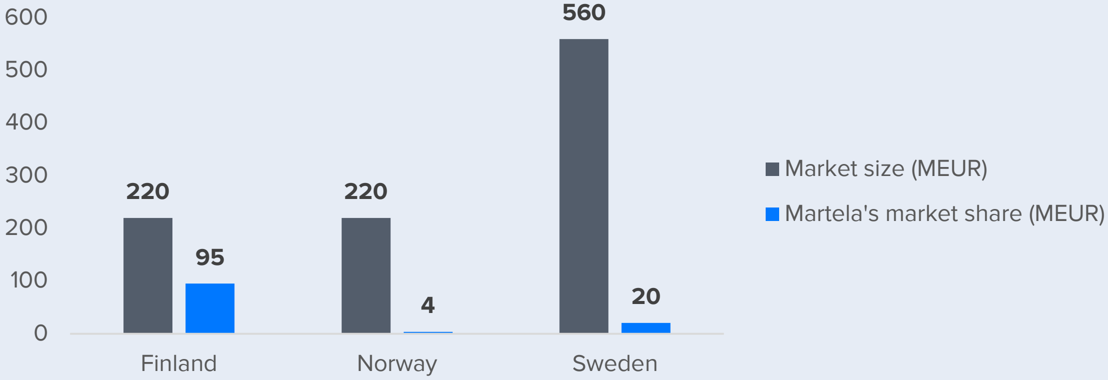
Source: JSA Consultance Services

Finnish office furniture market



Source: Inderes

Nordic office furniture market (Inderes estimate)



Source: Inderes

Financial situation 1/3

Cost structure has decreased over last few years

Martela's fixed cost structure has decreased in both absolute and relative terms due to the cost reduction and efficiency programs implemented in 2013-2017. We expect the fixed costs to remain close to 2017 level during the next few years. Martela's cost structure can be divided into 3 categories: materials and services, personnel costs, and other expenses.

Materials and services are the most significant costs to Martela. These essentially include procurement and outsourcing expenses. The development of these expenses in relation to revenue is largely dependent on economies of scale, pricing power, and the competitiveness of Martela's products. We will further analyze materials and services through gross margin in the next chapter.

Personnel expenses are the company's second largest expenses. During Q1-Q3'17 the enterprise employed 509 people on average with the average expense being 54 TEUR annually. The personnel expenses have historically been about 22-29% of total sales. Due to the efficiency improvements and cost cutting measures, the aforementioned have gone down significantly. In light of the current strategy and number of employees, we expect personnel costs to be in the region of 29 MEUR annually, or about 24% of revenue. We find this relative figure to be realistic in the long term as well.

The third largest costs are **other expenses.** These include real estate costs, vehicle costs, marketing expenses, and IT-expenses. These other expenses have been about 14-22% of the annual net sales during the last decade. In addition to personnel expenses, these costs have also decreased substantially in the last few years due to the efficiency and cost saving measures. In light of cost reductions we find about 17-18 MEUR or 14% of revenues as an achievable figure for the next few years. This is quite close to the 2015 actual level.

Balance sheet structure

Intangible assets account for 7.4 MEUR of the Q3'17 balance sheet, including activated R&D expenses, software licenses, activated IT expenses, patents, licenses, and other comparable rights. These are depreciated in 3-10 years depending on the expected economic life of those assets, in accordance to the IFRS accounting standards. The intangible assets also include 883 TEUR worth of goodwill from the 2011 Grundell acquisition. We don't find it very likely for the company to write-down the goodwill, as the sensitivity analysis in the 2016 financial statements indicate a buffer between the goodwill and actual monetary value. The relation of the intangible assets compared to equity was about 32% at the end of 2016, which in our view isn't notably high.

Tangible assets at the end of Q3'17 were 6.25 MEUR. According to the 2016 financial statements, land and buildings account for about half of this and equipment for the other half. These balance sheet items are valued at acquisition cost that has been depreciating according to the depreciation plan. The tangible assets and their value seems to be solid taking account the production facilities and logistics center.

Working capital management

Martela's working capital percentage has decreased in recent years, and was 5.6% in 2016. The more efficient working capital management is due to lower inventory levels and decrease in receivables. Due to the IT-problems working capital management weakened in 2017 and working capital increased. We will further go into the IT problems on the next page.

Capital structure

Martela had 7,1 MEUR of net debt at the end of Q3'17. The average interest rate was 2.6% in the end of 2016, which we consider to be relatively low level. We consider the low interest rate to reflect creditors confidence in the company.

The company's equity ratio was 41% at the end of Q3'17, and net gearing 30.2%. Cash and cash equivalents were 9.1 MEUR. The company's solvency has improved substantially in the last few years, as in 2013 the company had 11 MEUR in net debt and its gearing was 51%. The financial risk of Martela as a whole is currently relatively small in our opinion.

Financial situation 2/3

2017 was a major setback for Martela

The first three quarters of 2017 were challenging and a clear setback considering the turnaround in 2014-2016. Net sales, earnings, and cash flow all decreased significantly from the comparison period. At the center of the problems has been the new IT system implemented in the beginning of 2017, but also the strategy change in the sales channel in Sweden.

IT system reform

Behind Martela's 2017 main problems was the New Business Platform - (NBP) IT system implemented in February, which caused significant problems. In 2014 Martela came to realize that the old IT system tailored for Martela would not be able to support the new strategy. The company began planning an all new system, which was a huge investment. The new IT-system replaced the whole quote-to-cash chain with all of its subsystems. 2.2 MEUR was invested into the new system in 2016 and out of the accrued investments this year (2.1 MEUR), the majority were to do with the system.

The company mentioned for the first time in its Q1'17-report that the implementation of the new IT-system had caused operative challenges and invoicing mistakes. In June Martela released a negative profits warning and reported a negative Q2-quarter. The new IT system had caused operative delays and delays in invoicing, which resulted into a -11.2 MEUR operative cash flow in H1'17. later in October the company released its second negative profits warning, stating that during Q3 the company had focused on stabilizing deliveries, which had a negative effect on revenue and earnings. In the Q3-report there were signs that the IT problems would have been solved, as earnings and cash flow were both positive. Profitability was however still below the reference period, and we estimate that the gross margin was also relatively weak. According to Martela, the company managed to regain the 2016 level of reliability in deliveries, operations had normalized, and the largest challenges relating to the new IT- system had been overcome. Martela states that the IT-system would fully support the new strategy at the end of Q1'18 at the latest, but the system would need small additional non-recurring costs.

According to the management, Martela had especially lost "fast sales" in 2017 due to the IT problems, and the company's resources have been wasted on IT problems which has led to decrease in sales. In light of current information, we don't think it is very likely for the problems to continue into 2018, and we don't believe that they have caused any irreversible damage to the company.

Strategy change in the Swedish sales channel

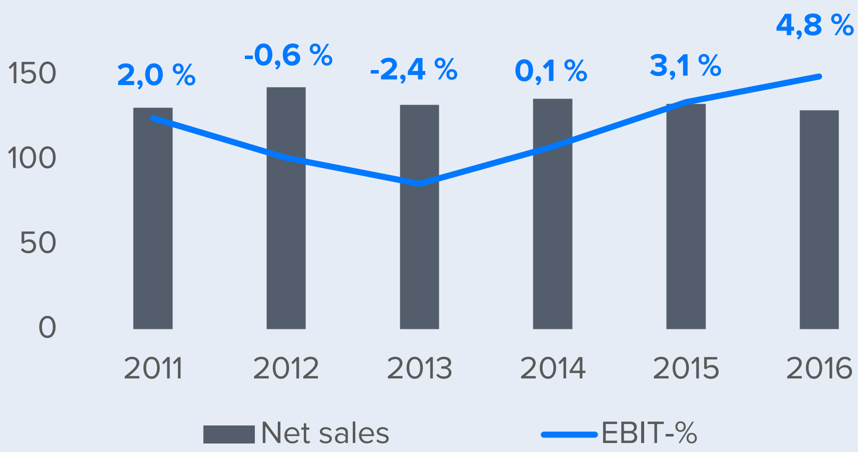
Before 2017 Martela's sales in Sweden and Norway was very product centered, mostly relying on the resellers. With the updated 2016 strategy, the company aims to grow service sales, streamline overall sales, and keep Nordic customer contact solely in its own hands. The Lifecycle strategy that has proven successful in Finland will be implemented into other Nordic countries with the same working principles as in Finland.

In Norway the strategy change has been successful in light of the numbers, with the first three quarters of 2017 showing 27% growth in net sales. The change has however not been as successful in Sweden. According to Martela, the sales channel change had a negative effect on the net sales during Jan-Sep. In addition to this there were no large projects during the period. Due to these issues and IT problems, sales in Sweden decreased by 45% in Jan-Sep compared to the previous year. According to Martela the comparison period in 2016 was exceptionally good in Sweden, but Swedish revenues were also down 25% from 2015.

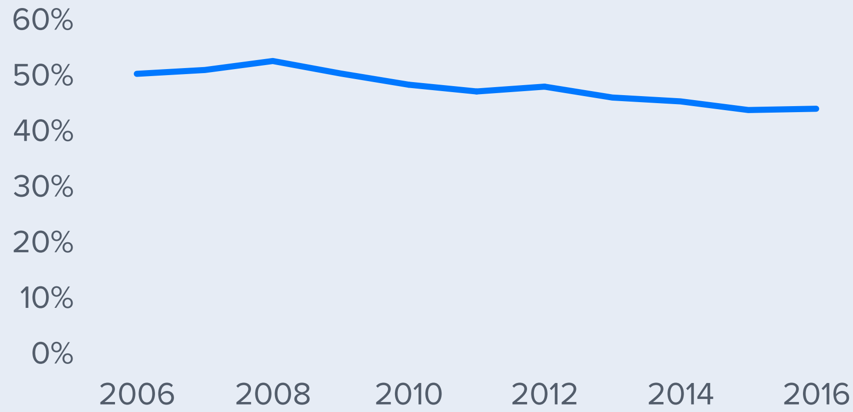
During Q3'17 Martela's Swedish unit did however succeed in closing a major deal with NCC. The contract is for all of NCC's offices in the Nordic countries, and we see this as a good indication of Martela's competitiveness in Sweden. In the Q3'17 report the company also told that it had recruited additional employees to its sales team in Sweden. We expect these sales investments together with slightly improving economic environment to be reflected into higher net sales in the upcoming years.

Financial situation 3/3

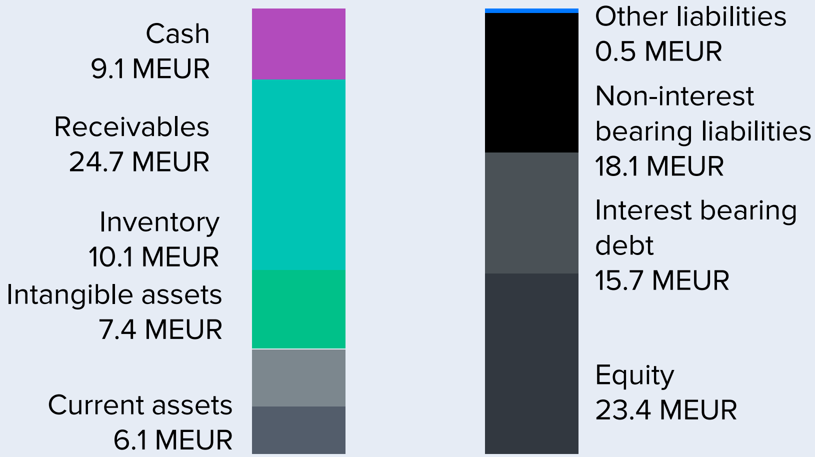
Net sales (MEUR) and EBIT-%



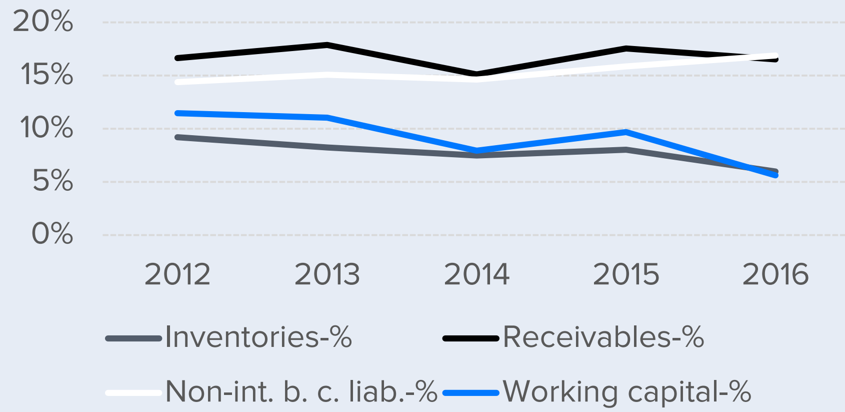
Gross margin-%



Balance sheet structure, Q3'17



Working capital



Lähde: Inderes, Martela

Estimates 1/2

We expect clear earnings growth

In the coming years, we expect to see Martela's result to improve significantly from the weak 2017 level. This is based on the view that a) we don't expect the problems seen in 2017 to continue b) revenue decline is not very probable in the future in our view. We estimate that profitability will increase to about 3.5% EBIT margin in the coming years (2017e 1.9%) and EPS to be in the 0.7-0.8 EUR range (2017e: 0.25 EUR. 2016 0.81 EUR).

Net sales will recover during 2018-2020

Martela's revenue declined during 2016-2017, mainly due to the strategic choices of pulling out of operating own sales channels in Russia and Poland. We estimate the combined revenue of these countries in 2015 to have been about 10-15 MEUR. In addition, the company lost revenues due to significant IT problems.

The IT-system problems continuing into 2018 seem unlikely, and the investments made into sales teams together with the improved market environment should offer some support to revenue for next year. Due to these reason we estimate 2018 revenues to increase by about 5% and 2% annually in 2019 and 2020. the long term revenue growth estimate in our models is 1%.

Revenue in Finland set to recover in 2018

In its Q3'17 report Martela stated that new orders had increased in Finland, surpassing the comparison period's level. Martela is the market leader in Finland and has historically developed steadily. With the absence of IT-system problems, we expect to see sales in Finland recover to the 2016 level of 95.2 MEUR in 2018, translating to growth of about 6% in relation to this year. For the long term, we have estimated annual growth of 2% after 2018.

Sweden and Norway to show moderate growth

Martela's product and service offering is in our view competitive in the Nordic countries, and we believe the company will be able to maintain its market share in the regions in the upcoming years. The company also reported additions to all of its sales teams during Q3'17, and we expect to see these to reflect to 2-3% annual growth in Norway and Sweden in the upcoming years. For the Other-segment we have not forecasted growth at all, reflecting the conservative nature of our estimates.

Gross margin declining slightly

We expect Martela's gross margins to decrease slightly in the coming years from the 44.3% of 2016 to about 43-44% and stay constant for the next few years. Pressure for companies to cut back on costs and improving efficiency of working environments puts short term pressure on margins. On the other part the strong market position and larger focus on services will help maintaining the margins.

Fixed cost base set to remain as is

We expect the number of personnel to increase to about 520 from the 504 at the end of Q3'17 in the coming years due to recruitments in the sales. Simultaneously we expect personnel costs to remain at the 55 TEUR annual cost witnessed in 2016-2017. Together these mean that the total personnel costs should amount to about 29 MEUR, or 24% of sales. We also expect the other business expenses to remain constant at about 14% of revenues, which means them to be in the region of 17-18 MEUR per year.

Tax percentage normalizing

Martela's tax percentage was exceptionally high in 2016 at 41%. We believe this was partially due to the company being unable to fully deduct losses in Poland in its taxation. We expect the 2017 tax percentage to be about 39%, and 22% in 2018.

Investments and cash flow

We expect Martela's annual investments to decline slightly from the 2016-2017 level in the next few years and to be about 2.5 MEUR (2016: 2.9 MEUR), mostly due to the completion of the IT-systems project. At the moment there are no foreseeable major investment needs apart from normal maintenance investments, and we estimate the annual investments to amount depreciations in the long term. Due to the modest investment needs cash flow is expected to be strong and the company can maintain high dividend level.

Estimates 2/2

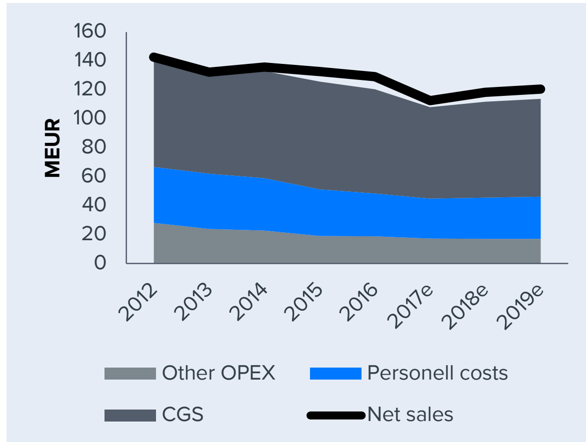
Long term EBIT-margin will rise to 3.5%

With the aforementioned estimates, Martela's IFRS EBIT margin will rise to 3.5% in 2018-2019 (2017e: 1.9%). In 2020 the EBIT margin will be 3.6% and then settle to a long term (terminal) level of 3.5%. The EPS in our estimates for 2017 is 0.25 EUR (2016: 0.81 EUR) 0.68 EUR in 2018, and 0.78 EUR in 2019.

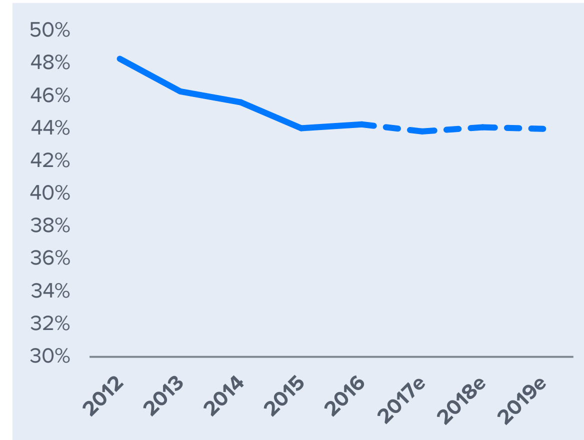
We highlight that the improvement in the profitability margin is based solely on the already completed cost reduction and efficiency improvement programs, Finnish operations returning to the 2016 level, and Sweden and Norway achieving 2.3% annual growth. In addition to these, we expect the IT problems to be resolved and not meaningfully influencing the 2018 result.

Should the Lifecycle strategy prove successful in the Nordic countries, there is a possibility for much higher margins to be achieved. At the moment we have however opted not to include notable margins growth in our estimates, as we want to witness clear indications of the success of set strategy before including the potential and higher expectations in our estimates. Our estimates are cautious for a reason, and are clearly under the guidance of the 8% EBIT-margin given by the company.

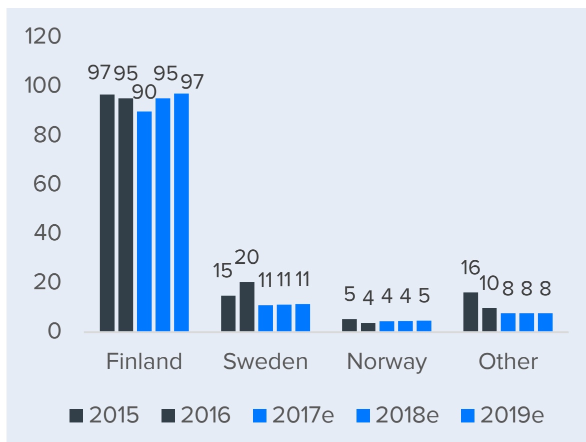
Martela cost structure, 2012-2019e



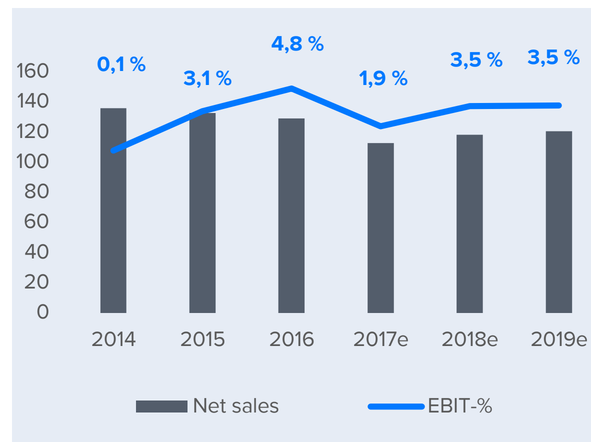
Martela's gross margin -%



Martela's net sales 2015-2019e



Martela's net sales and EBIT-% 2014-2019e



Source: Martela, estimates: Inderes

Estimates

	FY15	FY16	Q1'17	Q2'17	Q3'17	Q4'17e	FY17e	Q1'18e	Q2'18e	Q3'18e	Q4'18e	FY18e	FY19e	FY20e
Net sales	**132,8**	**129,1**	**24,8**	**25,8**	**29,4**	**32,8**	**112,8**	**26,0**	**27,1**	**30,8**	**34,5**	**118,4**	**120,7**	**123,1**
-Finland	96,7	95,2	19,1	19,7	24,0	27,0	89,8	20,2	20,9	25,4	28,6	95,2	97,1	99,0
-Sweden	14,8	20,4	3,2	3,3	2,2	2,2	10,9	3,2	3,4	2,2	2,3	11,1	11,4	11,8
-Norway	5,2	3,7	1,4	0,5	1,0	1,5	4,4	1,4	0,5	1,0	1,5	4,5	4,6	4,7
-Other	16,1	9,8	1,1	2,3	2,1	2,1	7,6	1,1	2,3	2,1	2,1	7,6	7,6	7,6
CGS	-74,3	-72,0	-13,7	-14,2	-16,8	-18,7	-63,3	-14,5	-15,1	-17,2	-19,3	-66,2	-67,6	-69,3
Gross margin	**58,5**	**57,2**	**11,1**	**11,6**	**12,6**	**14,1**	**49,4**	**11,5**	**11,9**	**13,6**	**15,2**	**52,2**	**53,1**	**53,8**
Employee benefits expenses	-32,3	-29,7	-6,9	-7,6	-6,1	-6,9	-27,6	-7,2	-7,2	-7,2	-7,2	-28,6	-29,2	-29,2
Other operating expenses	-19,1	-18,9	-4,3	-4,3	-4,3	-4,5	-17,3	-4,3	-4,3	-4,3	-4,3	-17,0	-17,2	-17,8
Other operating income	0,4	0,5	0,0	0,1	0,3	0,1	0,5	0,1	0,1	0,1	0,1	0,3	0,3	0,3
EBITDA	**7,5**	**9,1**	**0,0**	**-0,2**	**2,5**	**2,7**	**5,0**	**0,1**	**0,6**	**2,3**	**3,9**	**6,9**	**7,1**	**7,1**
Depreciation	-3,4	-2,9	-0,6	-0,7	-0,8	-0,7	-2,8	-0,7	-0,7	-0,7	-0,7	-2,8	-2,8	-2,7
EBIT (reported)	**4,1**	**6,2**	**-0,6**	**-0,9**	**1,7**	**2,0**	**2,2**	**-0,6**	**-0,1**	**1,6**	**3,2**	**4,1**	**4,2**	**4,4**
Net financials	-0,7	-0,5	0,0	-0,1	-0,2	-0,2	-0,4	-0,2	-0,2	-0,1	-0,1	-0,5	-0,1	0,0
Pre-tax profit	**3,4**	**5,6**	**-0,7**	**-1,0**	**1,6**	**1,8**	**1,7**	**-0,7**	**-0,2**	**1,5**	**3,2**	**3,6**	**4,1**	**4,4**
Taxes	-0,9	-2,3	0,0	-0,2	-0,1	-0,4	-0,7	0,2	0,1	-0,3	-0,7	-0,8	-0,9	-0,9
Net earnings	**2,5**	**3,3**	**-0,7**	**-1,2**	**1,5**	**1,4**	**1,0**	**-0,6**	**-0,2**	**1,1**	**2,5**	**2,8**	**3,3**	**3,5**
EPS (excl. NRI)	**0,61**	**0,97**	**-0,16**	**-0,30**	**0,37**	**0,34**	**0,25**	**-0,14**	**-0,05**	**0,27**	**0,59**	**0,68**	**0,78**	**0,85**
EPS	**0,61**	**0,81**	**-0,16**	**-0,30**	**0,37**	**0,34**	**0,25**	**-0,14**	**-0,05**	**0,27**	**0,59**	**0,68**	**0,78**	**0,85**

	FY15	FY16	Q1'17	Q2'17	Q3'17	Q4'17e	FY17e	Q1'18e	Q2'18e	Q3'18e	Q4'18e	FY18e	FY19e	FY20e
Net sales growth-%	**-2,3 %**	**-2,8 %**	**-10,8 %**	**-19,0 %**	**-16,6 %**	**-4,3 %**	**-12,7 %**	**4,8 %**	**4,8 %**	**5,0 %**	**5,3 %**	**5,0 %**	**2,0 %**	**2,0 %**
-Finland	-	-1,6 %	-1,5 %	-13,2 %	-9,4 %	1,5 %	-5,7 %	6,0 %	6,0 %	6,0 %	6,0 %	6,0 %	2,0 %	2,0 %
-Sweden	-	37,9 %	-39,6 %	-45,9 %	-51,1 %	-51,1 %	-46,6 %	0,0 %	2,0 %	2,0 %	4,0 %	1,8 %	3,0 %	3,0 %
-Norway	-	-29,2 %	75,0 %	-28,6 %	11,1 %	15,4 %	18,9 %	2,0 %	2,0 %	2,0 %	2,0 %	2,0 %	2,0 %	2,0 %
-Other	-	-39,1 %	-52,2 %	-4,2 %	-38,2 %	23,5 %	-22,4 %	0,0 %	0,0 %	0,0 %	0,0 %	0,0 %	0,0 %	0,0 %
Gross margin-%	**44,0 %**	**44,3 %**	**44,8 %**	**45,0 %**	**42,8 %**	**43,0 %**	**43,8 %**	**44,1 %**	**44,1 %**	**44,1 %**	**44,1 %**	**44,1 %**	**44,0 %**	**43,7 %**
EBITDA-%	5,6 %	7,0 %	0,0 %	-0,8 %	8,5 %	8,3 %	4,4 %	0,5 %	2,2 %	7,3 %	11,3 %	5,8 %	5,8 %	5,8 %
EBIT-% (reported)	**3,1 %**	**4,8 %**	**-2,5 %**	**-3,5 %**	**5,9 %**	**6,1 %**	**1,9 %**	**-2,2 %**	**-0,4 %**	**5,1 %**	**9,3 %**	**3,5 %**	**3,5 %**	**3,6 %**
Pre-tax profit-%	2,5 %	4,4 %	-2,7 %	-4,0 %	5,4 %	5,6 %	1,5 %	-2,8 %	-0,9 %	4,7 %	9,1 %	3,1 %	3,4 %	3,6 %
Net earnings-%	1,9 %	2,6 %	-2,7 %	-4,8 %	5,2 %	4,3 %	0,9 %	-2,2 %	-0,7 %	3,7 %	7,1 %	2,4 %	2,7 %	2,9 %

Sensitivity analysis

Sensitivity analyses

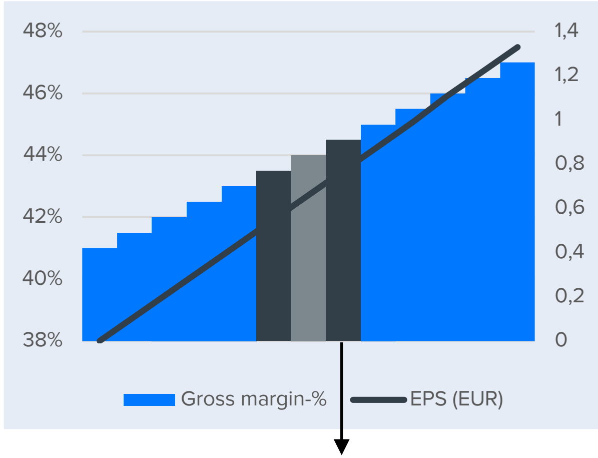
There is still a moderate amount of uncertainty in our estimates as the earnings potential post withdrawal from Russia and Poland is unclear. In addition to this, the full effect of the cost reduction and efficiency programs is not fully known due to the IT system problems covering the company's profitability level in 2017. Also the potential in revenue growth is burdened with the poor visibility especially due to the changes in strategy concerning Sweden and Norway. Due to the above, we have demonstrated the EPS development in two different scenarios. In the analyses we test two factors; gross margin and revenue.

Gross margin sensitivity analysis

In the first analysis, Martela's gross margin in 2018 fluctuates between 41% and 47%, with all other parameters remaining constant. We find this range to be sensible and achievable for the company. With the gross margins fluctuating between these two figures the 2018 EPS fluctuates between 0.00 and 1.33 EUR. It is worth noting that the slope for the EPS is steeper than that of the gross margin, meaning that EPS growth is faster in percentages than the delta in gross margin. This reflects the earnings leverage for Martela quite well in our opinion.

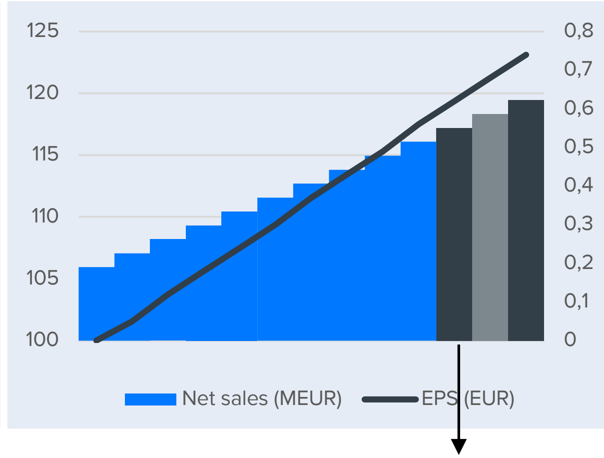
The grey zone represents our view of the most probable scenario. We find a gross margin settling somewhere between 43.5-44.5% to be most likely for 2018, giving an EPS range of 0.55-0.77 EUR.

Gross margin sensitivity analysis



Estimated probable EPS range

Net sales sensitivity analysis



Estimated probable EPS range

Revenue sensitivity analysis

Correspondingly the revenue sensitivity analysis measures the 2018 revenue's delta in the range of -6% and +6% from the year 2017, with all other parameters remaining constant. The revenue fluctuates between 106-119 MEUR, with the EPS between 0.0-0.74 EUR. The grey area represents what we find to be the most likely zone for 2018 revenue, this being between 117-119 MEUR numerically. Within that area, Martela's EPS is somewhere between 0.62 and 0.74 EUR.

Valuation and recommendation 1/2

Valuation multiples

We value Martela mainly with the P/E-figure. After the IT problems and withdrawal from Russia and Poland, the company's precise earnings potential is currently unclear. In addition to these, the success of the Nordic Lifecycle strategy is difficult to predict. Due to these uncertainties, it is beneficial to evaluate Martela's share value through the use of sensitivity analyses. The balance sheet based P/B-figure and revenue based EV/sales-multiples also give objective point of views to value the share.

With our current estimates, 2018 P/E figure is about 11x, which we consider a moderate level. With our 2019 estimates, the P/E figure is about 10x, reflecting a small improvement in earnings that we have predicted. We expect to see Martela continue its generous dividend policy and the dividend to grow in the upcoming years. We emphasize that the dividend is strongly dependent on the earnings that the company manages to generate. If the company's earnings fall behind our estimates, the dividends will also probably fall below our estimates.

The current dividend yield that we expect is a relatively attractive 5-6% for the next few years. The accurate 2018 earnings potential is uncertain, and we have therefore demonstrated the share value in a matrix where the 2018 EBIT-% is in the range of 2-5%. The underlying assumption in the matrix is that P/E will be in the range of 8-13x, which we consider to be justified. The forward 12 month P/E has been about 10x in 2015-2017.

Share valuation matrix

	P/E	8	9	10	11	12	13
EBIT-%	2,0 %	2,9	3,2	3,6	4,0	4,3	4,7
	2,5 %	3,8	4,2	4,7	5,2	5,6	6,1
	3,0 %	4,6	5,2	5,8	6,4	7,0	7,5
	3,5 %	5,5	6,2	6,9	7,6	8,3	9,0
	4,0 %	6,4	7,2	8,0	8,8	9,6	10,4
	4,5 %	7,4	8,3	9,2	10,1	11,0	12,0
	5,0 %	8,2	9,3	10,3	11,3	12,4	13,4

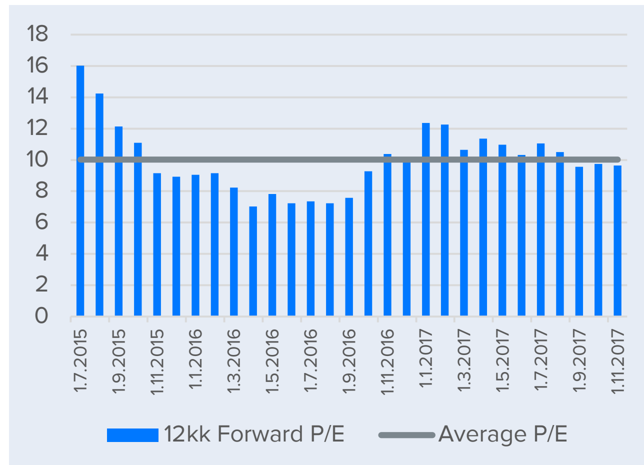
According to the matrix, the share price is in the range of 5.8-9.6 EUR in 2018, providing EBIT-% is between 3-4% (2016: 4.8%). The P/E will most likely be in the 10-12x region. The share price variation is quite large in this scenario, nearly 4 euros, and this illustrates well how sensitive Martela's earnings are to changes in profitability.

The share has clear upside potential in the positive scenario

In our view Martela has potential to increase its profitability to higher levels that are shown in the sensitivity analysis. This would, in our opinion require a clear success in the Nordic Lifecycle-strategy. The company has a goal to achieve a EBIT-margin of 8% in 2018. If the company succeeds in this we estimate that the 2018 earnings would be about 1.7 EUR EPS. Assuming a P/E of 10-12x, the share value would be 17-20 EUR.

	2016	2017e	2018e	2019e
Share price	12,84	7,44	7,44	7,44
EV	48,2	28,2	27,3	26,0
MCAP	53,4	30,9	30,9	30,9
EV/Sales	0,4	0,3	0,2	0,2
P/Sales	0,4	0,3	0,3	0,3
EV/EBITDA	5,3	5,6	4,0	3,7
EV/EBIT	7,8	13,0	6,7	6,2
P/E	16,0	30,1	10,9	9,5
P/BV	2,1	1,3	1,2	1,1
Dividend / share	0,37	0,37	0,47	0,50
Dividend yield-%	2,9 %	5,0 %	6,3 %	6,7 %

Martela's 12 month Forward P/E 2015-2017



Source: Inderes

Valuation and recommendation 2/2

Peer group analysis

It is difficult to construct a good peer group for Martela, as there are very few publicly traded office furniture companies in Europe and in the Nordic countries. There is only one other listed office furniture company in The Nordics, Lammhults Design Group AB.

For our peers we have chosen well known international office furniture companies that alongside Martela are associated with design and high quality. These are especially US traded Knoll, Steelcase and Herman Miller. HNI Group manufactures, in addition to office furniture, different kinds of fireplaces, thus it is not directly comparable to the other peers. Lammhults Design is one of Sweden's largest office furniture manufacturers and therefore an obvious choice for the peer group. It does however also operate in other fields of design in addition to office furniture's.

Martela's peer group

The following aspects need to be taken into account when analyzing the peer group:

- A substantial part of Martela's net sales are generated from Finland and the company is thus highly dependent on the development of the Finnish economy, unlike the other peers.
- The large companies in the peer group here are over 60x the size on Martela in market cap, thus their risk profile is much smaller.
- A considerable part of Martela's net sales are generated from services, whereas the peers are mostly purely product oriented.
- The companies presented here differ in their capital structure from each other, meaning that their risk profile is different as well.

Martela's peers

Peer group 23.11.2017 Reuters

	P/E		EV/EBITDA		EV/Sales
	2017e	2018e	2017e	2018e	2017e
HNI Corporation	17,6	13,7			
Herman Miller	16,6	15,1	8,3	0,1	0,9
Knoll inc	14,6	12,9	8,7	7,4	1,1
Steelcase	14,0	15,4	6,3	6,7	0,6
Lammhults	12,1	8,9	9,1	7,5	0,7
MEDIAN	**14,6**	**13,7**	**8,5**	**7,0**	**0,8**
AVERAGE	**15,0**	**13,2**	**8,1**	**5,4**	**0,8**
Martela*	**30,1**	**10,9**	**5,6**	**4,0**	**0,3**

*Inderes Estimate

Taking account the previous aspects the median peer group EV/EBITDA 2018e multiplier is 7.0x and the P/E 2018e multiplier is 13.7x. These multiples and our estimates would indicate a share value of 9.4-12.6 EUR for Martela.

After the IT problems and withdrawal from Russia and Poland, the earnings' potential is burdened with uncertainty for the time being. For this reason objective valuation multiples are in our view the equity value in comparison to the book value (P/B) and the enterprise value in comparison to sales (EV/Sales). With these multiples, Martela's share is clearly undervalued compared to the peer group multiples. This is however completely justified in our view when considering the small size of Martela and its dependency on the Finnish economic development.

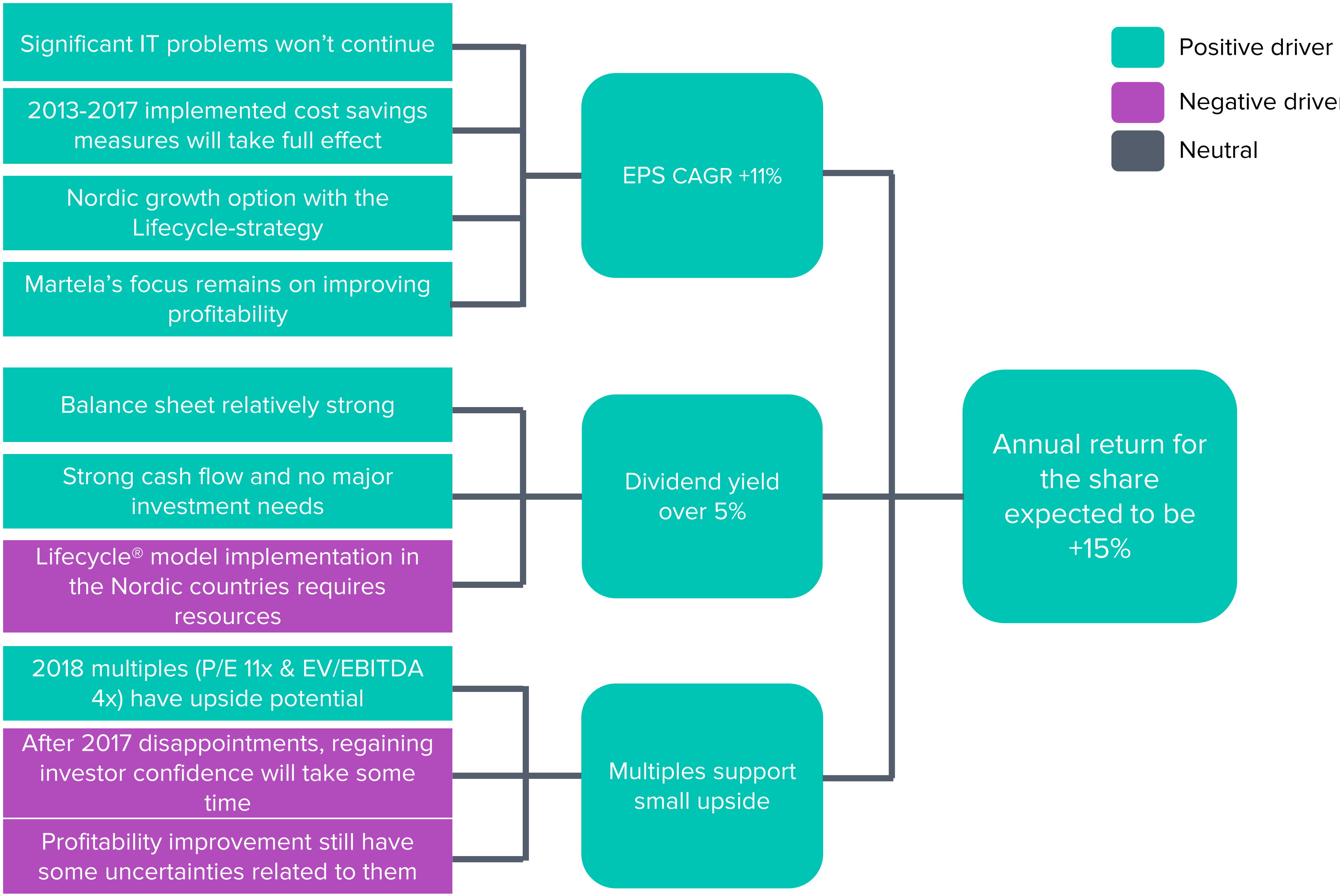
Our view is that Martela's multiples have some upside potential in relation to the peer group. Providing that investor confidence towards Martela improves and Martela succeeds in improving profitability from the current level, there is a clear upside potential through multiple expansion and earnings growth.

Recommendation

We find Martela's valuation level to be low in both relative and absolute terms. In our opinion the risk/return profile of the share is attractive, as we don't think it is likely that the 2017 type problems continue in 2018 and the cost reduction and efficiency programs will have full effect on the profitability from 2018 onwards. We set our target price of Martela to 8.0 EUR (prev. 9.0 EUR) and reiterate our previous Accumulate-recommendation.

We see clear upside in the share due to earnings growth and multiple expansion. Our target price reflects 2018 12x P/E-figure for the share. In the positive scenario the share has significantly more upside potential. If Martela achieves its 2018 EBIT-margin target of 8% the EPS would according to our estimates be about 1.7 euros. In this scenario the share price would be about 20 euros assuming acceptable P/E-multiple of 12x.

Martela value drivers 2018-2020e



Source: Inderes

Peer group valuation

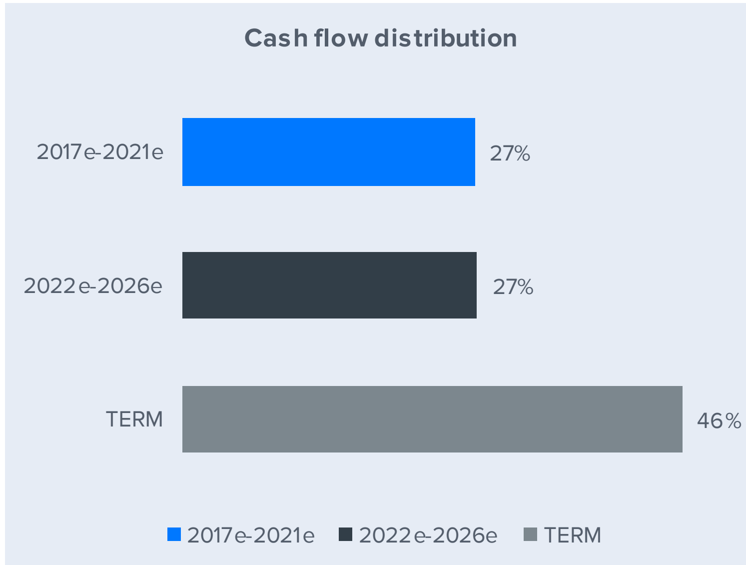
Company	Share price	MCAP MEUR	EV MEUR	EV/EBIT 2017e	EV/EBIT 2018e	EV/EBITDA 2017e	EV/EBITDA 2018e	EV/Sales 2017e	EV/Sales 2018e	P/E 2017e	P/E 2018e	Dividend yield-% 2017e	Dividend yield-% 2018e	P/B 2017e
HNI	33,64	1236	1480							17,6	13,7	3,4	3,5	2,9
Herman Miller	34,45	1743	1860	10,8	0,1	8,3	0,1	0,9	0,0	16,6	15,1		2,1	3,4
Knoll	20,63	861	1042	10,9	9,3	8,7	7,4	1,1	1,0	14,6	12,9	3,0	3,5	2,9
Steelcase	14,45	1419	1496	8,4	8,7	6,3	6,7	0,6	0,5	14,0	15,4	3,3	3,5	2,3
Lammhults Design	47,20	35	57	13,1	9,7	9,1	7,5	0,7	0,6	12,1	8,9	3,8	4,3	0,9
Martela (Inderes)	**7,44**	**31**	**28**	**13,0**	**6,7**	**5,6**	**4,0**	**0,3**	**0,2**	**30,1**	**10,9**	**5,0**	**6,3**	**1,3**
Average				**10,8**	**6,9**	**8,1**	**5,4**	**0,8**	**0,5**	**15,0**	**13,2**	**3,4**	**3,4**	**2,5**
Median				**10,8**	**9,0**	**8,5**	**7,0**	**0,8**	**0,6**	**14,6**	**13,7**	**3,3**	**3,5**	**2,9**
Premium/discount-% vs. to median				**19%**	**-26%**	**-34%**	**-44%**	**-68%**	**-60%**	**103%**	**-21%**	**49%**	**82%**	**-57%**

Source: Reuters / Inderes. Notification: Inderes' MCAP does not include treasury shares

DCF model

DCF model (MEUR)	2016	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e	TERM
EBIT (operating profit)	**6,2**	**2,2**	**4,1**	**4,2**	**4,4**	**4,4**	**4,4**	**4,4**	**4,5**	**4,5**	**4,6**	
+ Depreciation	2,9	2,8	2,8	2,8	2,7	3,0	2,6	2,6	2,7	2,7	2,7	
- Paid taxes	-2,2	-1,0	-0,8	-0,9	-0,9	-0,9	-0,9	-0,9	-0,9	-0,9	-0,9	
- Tax, financial expenses	-0,1	-0,1	-0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
+ Tax, financial income	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
- Change in working capital	5,6	-1,9	-0,5	-0,2	-0,2	-0,1	-0,1	-0,1	-0,1	-0,1	-0,1	
Operating cash flow	**12,4**	**2,0**	**5,5**	**6,0**	**6,0**	**6,3**	**6,0**	**6,1**	**6,1**	**6,2**	**6,3**	
+ Change in other long-term liabilities	-0,2	-0,4	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
,- Gross CAPEX	-2,6	-2,1	-2,8	-2,6	-4,2	-3,1	-2,7	-2,8	-2,8	-2,8	-2,9	
Free operating cash flow	**9,6**	**-0,5**	**2,8**	**3,4**	**1,8**	**3,2**	**3,3**	**3,3**	**3,3**	**3,4**	**3,4**	
+/- Other	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
FCFF	9,6	-0,5	2,8	3,4	1,8	3,2	3,3	3,3	3,3	3,4	3,4	35,2
Discounted FCFF		-0,6	2,5	2,7	1,3	2,1	1,9	1,8	1,6	1,5	1,3	13,8
Sum of FCFF present value		**30,0**	**30,6**	**28,1**	**25,4**	**24,1**	**22,0**	**20,0**	**18,2**	**16,6**	**15,2**	**13,8**
Debt free DCF		**30,0**										
- Interesting bearing debt		-8,3										
+ Cash and equivivalents		13,4										
-Minorities		0,0										
-Dividend/capital return		-1,5										
Equity value DCF		**33,6**										
Equity value DCF per share		**8,08**										

WACC	
Tax-% (WACC)	20,0 %
Target debt ratio (D/(D+E)	20,0 %
Cost of debt	6,0 %
Equity Beta	1,30
Market risk premium	5,00 %
Liquidity premium	2,80 %
Risk free interest rate	3,0 %
Cost of equity	12,3 %
Average cost of capital (WACC)	10,8 %



Profit and loss account

(MEUR)	2014	2015	2016	2017e	2018e	2019e
Net sales	**136**	**133**	**129**	**113**	**118**	**121**
Costs	-132	-125	-120	-108	-111	-114
EBITDA	**3,9**	**7,5**	**9,1**	**5,0**	**6,9**	**7,1**
Depreciation	-3,8	-3,4	-2,9	-2,8	-2,8	-2,8
EBIT	**0,2**	**4,1**	**6,2**	**2,2**	**4,1**	**4,2**
NRIs in EBIT	*0,0*	*0,0*	*-0,7*	*0,0*	*0,0*	*0,0*
EBIT (excl. NRIs)	*0,2*	*4,1*	*6,9*	*2,2*	*4,1*	*4,2*
Net financial items	-0,8	-0,7	-0,5	-0,4	-0,5	-0,1
Associated companies	0,0	0,0	0,0	0,0	0,0	0,0
Pre-tax profit	**-0,6**	**3,4**	**5,6**	**1,7**	**3,6**	**4,1**
Other items	0,0	0,1	0,0	0,0	0,0	0,0
Taxes	-0,1	-0,9	-2,3	-0,7	-0,8	-0,9
Minorities	0,0	0,0	0,0	0,0	0,0	0,0
Net earnings	**-0,7**	**2,5**	**3,3**	**1,0**	**2,8**	**3,3**
Net earnings (excl. NRI)	*-0,7*	*2,5*	*4,0*	*1,0*	*2,8*	*3,3*
Extraordinaries	0,0	0,0	0,0	0,0	0,0	0,0
Profit for period	**-0,7**	**2,5**	**3,3**	**1,0**	**2,8**	**3,3**
EPS	*-0,18*	*0,61*	*0,80*	*0,25*	*0,68*	*0,78*
EPS (excl. NRIs)	***-0,18***	***0,61***	***0,97***	***0,25***	***0,68***	***0,78***

Balance sheet

Assets (MEUR)	2014	2015	2016	2017e	2018e
Non-current assets	**17**	**14**	**14**	**13**	**13**
Goodwill	0	0	0	0	0
Intangible assets	5	5	6	6	6
Tangible assets	10	9	7	7	6
Associated companies	0	0	0	0	0
Other investments	1	1	1	1	1
Other non-current assets	0	0	0	0	0
Deferred tax assets	0	0	0	1	1
Current assets	**37**	**42**	**42**	**35**	**37**
Inventories	10	11	8	7	7
Other current assets	0	0	0	0	0
Receivables	21	23	21	21	22
Cash and equivalents	6	8	13	7	8
Balance sheet total	**54**	**56**	**56**	**48**	**51**

Liabilities (MEUR)	2014	2015	2016	2017e	2018e
Equity	**20**	**23**	**25**	**25**	**26**
Share capital	7	7	7	7	7
Retained earnings	13	15	17	17	18
Shares repurchased	-1	-1	0	0	0
Revaluation reserve	0	0	0	0	0
Other equity	1	1	1	1	1
Minorities	0	0	0	0	0
Non-current debt	**8**	**10**	**7**	**5**	**5**
Deferred tax liabilities	1	1	1	1	1
Provisions	0	0	0	0	0
Long term debt	7	8	6	4	4
Convertibles	0	0	0	0	0
Other long term liabilities	1	1	0	0	0
Current debt	**26**	**24**	**24**	**19**	**20**
Short term debt	6	3	2	0	0
Payables	20	21	22	19	20
Other current liabilities	0	0	0	0	0
Balance sheet total	**54**	**56**	**56**	**48**	**51**

Recommendation history

Date	Recommendation	Target price	Share price
8.6.2015	Accumulate	3,20 €	2,90 €
12.8.2015	Accumulate	3,20 €	3,02 €
30.10.2015	Accumulate	3,70 €	3,33 €
18.1.2016	Buy	5,00 €	4,35 €
5.2.2016	Buy	5,90 €	5,10 €
10.3.2016	Accumulate	5,90 €	5,33 €
2.5.2016	Buy	6,90 €	5,72 €
13.6.2016	Buy	7,50 €	6,54 €
10.8.2016	Accumulate	7,70 €	7,07 €
23.9.2016	Buy	10,00 €	8,15 €
19.10.2016	Buy	11,00 €	9,50 €
1.11.2016	Accumulate	11,40 €	10,55 €
21.12.2016	Buy	12,50 €	10,80 €
4.1.2017	Reduce	13,50 €	13,82 €
17.1.2017	Accumulate	13,50 €	12,00 €
3.2.2017	Buy	14,00 €	12,16 €
28.4.2017	Accumulate	14,00 €	12,46 €
2.6.2017	Buy	14,00 €	12,04 €
19.6.2017	Buy	13,00 €	11,20 €
9.8.2017	Accumulate	11,00 €	10,00 €
23.10.2017	Reduce	8,10 €	8,14 €
3.11.2017	Accumulate	9,00 €	7,87 €
27.11.2017	Accumulate	8,00 €	7,44 €

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Recommendation	Upside potential*
Buy	> 15%
Accumulate	5 - 15%
Reduce	-5 - 5%
Sell	< -5%

Potential regarding to 12 month target price

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Estimates

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Recommendation

2014, 2015, 2016
Recommendation and estimates

2012, 2016
Recommendation

2012, 2016, 2017
Recommendation and estimates

2017
Recommendation

2017
Recommendation

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