2020 Risk Report

Risk factors

In addition to other information in our annual integrated report, you should carefully consider the following factors before deciding to invest in our ordinary shares. The following summary is dated 06 December 2020 and describes many of the risks that could affect Sappi Limited. However, the risks and uncertainties our company faces are not limited to those described below.

There may be additional risks that we do not know of or deem immaterial based on information available to us at the date of this summary that may also adversely affect our business. Our business, financial condition and results of operations could be materially adversely affected by any of these risks, resulting in a decline in the trading price of our ordinary shares.

Risks related to our industry

We operate in a cyclical industry, which has, in the past, resulted in substantial fluctuations in our results

The markets for our pulp and paper products are commodity markets and are affected by changes in industry capacity and output levels as well as cyclical changes in the world economy. As a result of periodic supply and demand imbalances in the pulp and paper industry, these markets historically have been highly cyclical, with volatile pulp and paper prices.

In recent years, turmoil in capital and credit markets, coupled with uncertainty created by economic and geopolitical developments such as those resulting from the Covid-19 pandemic, Brexit and changing trade practices in the United States, have had a continued adverse effect on the world economy. These factors have consequently affected, and may continue to adversely affect, the markets for our products insofar as they cause decreased demand for our products and/or decreases in achievable selling prices. The timing and magnitude of demand and price fluctuations in the pulp and paper market have generally varied by region and type of pulp and paper. Prolonged or significant imbalances between supply of and demand for our core products may require us to impair operating assets and implement capacity reduction measures.

A significant increase in pulp or pulpwood prices could adversely affect our non-integrated and partially integrated operations should they be unable to raise paper prices sufficiently to offset the effects of increased input costs. Increases in other input costs including (but not limited to) those for energy and chemicals may affect our operations if we cannot raise paper prices sufficiently.

Most of our dissolving pulp (DP) sales contracts are multi-year contracts. The price terms under most of those contracts are reset on a quarterly basis. Because of the short-term duration of paper and DP pricing arrangements, we are subject to cyclical decreases in market prices for these products, such as the cyclical decrease that has affected DP prices in recent years. This decrease was primarily due to the combined impact of (i) the ongoing United States/China trade dispute and related imposition of tariffs on Chinese exports to the United States, which reduced demand for textiles produced in China, (ii) excess viscose staple fibre capacity and increased competition in the viscose staple fibre market adversely affecting pricing in that market, (iii) a weaker US$/RMB exchange rate impacting the US$ prices Chinese customers are willing to pay, and (iv) the absence of an attractive alternative market for swing producers due to weakness in paper pulp prices.

Moreover, uncertainty regarding Covid-19 may exacerbate the adverse impact of depressed DP prices on our profitability. In response to uncertainty regarding Covid-19, some major customers had notified us of their intention to reduce DP purchase volumes below their contractual volume commitments, which may adversely affect sales in future periods. We have received in the past, and may in future receive, other customer requests to reduce contracted DP volumes. These requests have adversely affected our profitability and could continue to do so in the future. A downturn in paper or DP prices or a prolonged period of depressed market prices for these products, including any continuation or further deterioration of current market prices for DP, could have a material adverse effect on our business, results of operations and financial condition.

We face risks related to the Covid-19 pandemic, which may have material adverse effects on our business, financial position, results of operations and cash flows

Beginning in December 2019, a new strain of the coronavirus (Covid-19) spread rapidly throughout the world, including in North America and Europe (where, respectively, 29% and 50% of our group sales in fiscal 2020 were produced). This pandemic and associated governmental responses have adversely affected workforces, consumer sentiment, economies and financial markets, and, together with decreased consumer spending, have led to an economic downturn in many of our markets.

The Covid-19 pandemic and actions taken by governments across the world to reduce the spread of the virus have created significant uncertainty in the markets where we operate. The pandemic and such actions have had, and are likely to continue to have, negative impacts on our business, such as causing significant declines in demand for our products, changes in consumer behaviour and preferences, disruptions in our manufacturing and supply chain operations, lower capacity utilisation and/or unscheduled downtime or shutdowns at some or all of our facilities, disruptions to our capital expenditure initiatives, limitations on our employees' ability to work and travel, significant changes in the economic or political conditions in markets where we operate and related currency and commodity volatility, restrictions on our access to sources of liquidity, reductions or withdrawals of credit insurance coverage, and unfavourable working capital movements.

Declines in demand for DP and graphic paper have necessitated, and are likely to continue to require, downtime on various machines in all regions, resulting in lower capacity utilisation and profitability and have had, and may continue to have, an adverse impact on our business, results of operations and financial condition.

As shutdowns spread across different countries and industries, supply of key raw materials may become affected. In addition, our customers, service providers or suppliers may experience financial distress, file for bankruptcy protection or insolvency, go out of business, or suffer disruptions in their businesses due to Covid-19, and we expect an increase in bad debt provisions, which in each case could negatively impact our business, results of operations and financial condition. Elevated inventory levels throughout our supply chain through to end markets due to the Covid-19 pandemic may also adversely affect our own business and that of our customers, including through delaying the impact of any recovery in economic conditions following any easing of lockdown and social distancing measures by governments in the markets in which we operate as existing inventories are sold off. Many of our customers could not take delivery of ordered products during the pandemic and have requested us to retain such products, which has placed additional demands on our warehousing capacity. A Covid-19 outbreak in our workforce could result in disruptions in our operations and unscheduled downtime or shutdowns at some or all of our facilities. Due to the pandemic, certain of our capital expenditure projects were disrupted, including the postponement of all material discretionary projects, and the shifting of annual maintenance shutdowns to as late as possible.

Given the dynamic nature of this outbreak (including its impact on the global economy and the applicable governmental responses), the extent to which Covid-19 impacts the group's business, results of operations and financial condition will depend on future developments, which remain highly uncertain and cannot be accurately predicted at this time.

The markets for pulp and paper products are highly competitive, and some of our competitors have advantages that may adversely affect our ability to compete with them

We compete against many pulp and paper producers located around the world. A trend towards consolidation in the pulp and paper industry has created larger, more focused pulp and paper companies. Some of these companies benefit from greater financial resources or operate mills that produce pulp and paper products at a lower cost than our mills or benefit from government subsidies. Some of our competitors also have advantages over us, including lower raw material, energy and labour costs and fewer environmental and other governmental regulations with which to comply. As a result, we cannot assure you that each of our mills will remain competitive. Furthermore, we cannot assure you that we will be able to take advantage of consolidation opportunities that may arise, or that any failure to leverage growth opportunities would not make us less competitive. Increased competition, due to, among others, a decrease in import duties under the terms of free trade agreements or any potential revocation or non-renewal of the imposition of anti-dumping duties on Chinese and Indonesian coated paper imports into the United States by the United States International Trade Commission, could cause us to lose market share, increase expenditures or reduce pricing, any of which could have a material adverse effect on our operations' results. In addition, competition may result from our inability to increase our products' selling prices sufficiently or in time to offset the effects of increased costs that could lead to a loss in market share, and aggressive pricing by competitors may force us to decrease prices in an attempt to maintain market share.

Developments in digitalisation, including media alternatives to newsprint and paper advertising, the declining use of printing and writing papers and related changes in consumer preferences may affect the demand for our products

Consumer preferences may change due to the availability of alternative products or services, including less expensive product grades, or due to pressure from consumers for more environmentally friendly solutions. In addition, trends in advertising, electronic data transmission and storage, mobile devices and the internet could adversely affect on traditional print media and other paper applications, including our products and those of our customers. Over the past 10 to 15 years, the pulp and paper industry has encountered a growing transformation in consumer preferences. During this time, readership and circulation of newspapers and magazines have been declining; meanwhile, accessibility to, and use of, the internet has increased and mobile devices, including digital tablets, have become commonplace. As a result, digital alternatives to many traditional paper applications are now readily available and started adversely affecting demand for certain paper products. For example, advertising expenditure has gradually shifted away from the more traditional forms of advertising, such as newspapers, magazines, radio and television, which tend to be more expensive, towards greater use of electronic and digital forms of advertising on the internet via mobile phones and other electronic devices, which tend to be less expensive. While the extent of these trends cannot be predicted with certainty, competition from electronic media, for example, has led and may continue to lead, to weaker demand for certain of our products, including coated woodfree and mechanical paper historically used in print publishing and advertising. Generally, demand for graphic papers, which product category represented 57% of our sales in fiscal 2020, continues to exhibit long-term structural decline in Europe and North America, which we expect to continue. This decline has adversely affected the profitability of our graphic papers activities, including increased production downtimes impacting operating rates and machine efficiency. There is no guarantee that we will be able to make, or retain, market share gains to partially offset such decline.

The trend of digitalisation may further accelerate in response to the Covid-19 pandemic, with significant proportions of the populations in our markets working remotely and consuming less print media for the duration of governmental lockdowns and social distancing measures implemented and any such trend may persist following the Covid-19 pandemic. In the face of such structurally declining demand for graphic papers, any failure to grow our packaging and speciality papers and DP businesses could have a material adverse effect on our results of operations, prospects and financial condition.

Global economic conditions could adversely affect our business, results of operations and financial condition

In the past, demand for our paper products declined and pulp prices and demand have decreased during times of global economic recession. Economic recession, sovereign debt crises and other macro-economic events (including in response to the Covid-19 pandemic) have in the past led, and may in future lead, to slower economic activity, inflation and deflation concerns, reduced corporate profits, reduced or cancelled capital spending, adverse business conditions and liquidity concerns resulting in significant recessionary pressures, increased unemployment and lower business and consumer confidence.

The outlook for the world economy is currently subject to significant uncertainty, particularly in light of the impact of the Covid-19 pandemic, which may lead to prolonged periods of economic uncertainty, downturn, recession or depression in many countries where our customers and Sappi operate. Many national governments have instituted rescue policies mitigate the effects of a recession. Certain countries have fallen into recession and a significant risk remains that measures taken by governments and central banks may not prevent the global economy from declining. Any such downturn, recession or depression could have a material adverse effect on our business, results of operations and financial condition.

Finally, we cannot predict the timing, duration or effect of any other downturn in the economy that may occur in the future. These economic risks and others that we may not anticipate could adversely affect the group's business, results of operations, financial condition or prospects.

The availability and cost of insurance cover can vary considerably from year to year due to events beyond our control. This can result in us paying higher premiums and periodically being unable to maintain appropriate levels or types of insurance

The insurance market remains cyclical and catastrophic events can change the state of the insurance market, leading to sudden and unexpected increases in premiums and deductibles and inadequacy or unavailability of coverage due to reasons unconnected with our business. In addition, the ongoing Covid-19 pandemic may result in changes in the structure and practices of the insurance market, an increasing frequency of disputes with insurers or an inability to recover from our insurance providers. Furthermore, volatility in the global financial markets can adversely affect the insurance market and could result in some of our insurers failing and being unable to pay their share of claims.

We have renewed our calendar 2020 asset and business interruption insurance cover at less favourable rates than 2019. The maximum self-insured retention for any one property damage occurrence is US$23.8 million (€20.5 million), with an annual aggregate of US$38.4 million (€33.0 million). We cannot predict whether past or future events will result in more or less favourable terms for 2021. For property damage and business interruption insurance, cost-effective cover is not generally available to full replacement value. As at September 2020, the annual limit for claims under our property damage and business interruption insurance policy was US$872.4 million (€750.0 million). If we were to experience property damage or business interruption losses exceeding any such policy limits, this could have a material adverse effect on our group's business, results of operations, financial condition or prospects.

Since fiscal 2011, our property damage insurance policy has been Euro-denominated as most of our assets are based in Euro-denominated jurisdictions. We place the insurance for our plantations on a standalone basis into international insurance markets. Fires had a significant adverse impact on our plantations in fiscal 2007 through 2010, and similarly significant adverse effects may occur in the future, which may not be covered by our insurance in full.

Furthermore, we may incur liabilities that are not covered by insurance. Given the diversity of our operations, we may not always be able to predict all risks to which we are exposed and as a result, we may not be covered by insurance in specific instances, including the ongoing Covid-19 pandemic. We cannot assure you that actual losses will not exceed our insurance coverage or that such excess will not be material.

New technologies may affect our ability to compete successfully

We believe that new technologies or novel processes may emerge and that existing technologies may be further developed in the fields where we operate. These technologies or processes could impact production methods or product quality in these fields. Unexpected rapid changes in employed technologies or the development of novel processes that affect our operations and product range could render the technologies we utilise or the products we produce obsolete or less competitive in the future. Difficulties in assessing new technologies may impede us from implementing them and competitive pressures may force us to implement these new technologies at a substantial cost. Any such development could materially and adversely affect our results of operations.

Innovation and the development of new products to meet customer expectations play an important role in our industry, particularly in growing segments such as packaging and speciality papers. Failure to invest in research and development or to proactively develop new products or processes may negatively affect our ability to compete successfully. In particular, the packaging and speciality papers business is characterised by a high level of customisation and specialisation to meet specific customer requirements. Further, our competitors may have greater financial or other resources that allow them to develop or otherwise access new products or processes before we do. To compete successfully, we must continually develop and introduce new products and services timeously to keep pace with technological and regulatory developments and achieve customer acceptance. We may not be able to respond to these competitive pressures or acquire or develop new technologies on a timely basis or at an acceptable cost. In addition, the services and products that we provide to customers may not meet our customers' needs or preferences. If we do not assess and respond to changing customer expectations, preferences and needs timeously, our financial condition, results of operations or cash flows could be adversely affected.

In addition, we are exposed to risks inherent to innovation and new technologies, such as those related to customer acceptance of new products. Therefore, we may incur certain costs relating to developing and marketing new products and we cannot guarantee that the profitability of or demand for such products will meet our expectations.

The cost of complying with or addressing liabilities under environmental, health and safety laws may be significant

Our operations are subject to a wide range of requirements, including conditions in our permits, arising from environmental, health and safety laws and regulations in the various jurisdictions where we operate. Such laws and regulations govern, among other things, water supply and consumption, the use of renewable and other fuels, the control of air emissions (including greenhouse gases (GHGs)) and water discharges, the management, reduction and disposal of hazardous and solid wastes, the clean-up of contamination, the protection of fisheries and other natural resources, the purchase and use of safety equipment, workplace safety training and the monitoring of workplace hazards.

Although we strive to ensure that our facilities comply with all applicable environmental requirements, including any permits required for our operations, we have in the past been, and may in the future be, subject to governmental enforcement actions or other claims or sanctions for failure to comply with environmental requirements. Impacts from historical or current operations, including the land disposal of waste materials or unpermitted releases of hazardous materials, may require costly investigation and clean-up. In addition, we could become subject to liabilities resulting from personal injury, property damage or natural resources damage. Expenditures to comply with future environmental, health and safety requirements and the costs related to addressing any potential environmental, health and safety liabilities, sanctions and claims could have a material adverse effect on our business and financial condition.

We expect to continue to incur significant expenditures to maintain compliance with applicable environmental laws, to install or upgrade pollution control equipment at our mills and to meet any new regulatory requirements, including those related to mandatory waste reduction targets or potential stricter air emissions standards in the United States, Canada, Southern Africa and Europe. We may also face constraints or restrictions on our production, or our ability to expand production, due to these requirements.

In addition, we may not have identified or addressed all sources of environmental, health and safety risks, and there can be no assurances that we will not incur losses related to any such environmental, health and safety risks, that the capital and operating costs of compliance with existing and future environmental, health and safety laws and regulations will not continue to increase or that any such losses or costs incurred will not have a material adverse impact on our results of operations, financial condition or prospects.

Risks related to our business

Our significant indebtedness may impair our financial and operating flexibility

Our significant level of indebtedness and the terms of our indebtedness could negatively affect our business and liquidity. As at September 2020, our net interest-bearing debt and lease liabilities (current and non-current interest-bearing borrowings plus overdraft and lease liabilities, less cash, cash equivalents and short-term deposits) amounted to US$1,957 million. While reducing our indebtedness is one of our priorities, opportunities to grow our businesses will continue to be evaluated, and the financing of any future acquisition or capital investment may include the incurrence of additional indebtedness.

The level of our debt may have significant consequences for our business, including:
- making it more difficult for us to satisfy our obligations
- limiting our ability to obtain additional financing, which could restrict, among other things, our ability to leverage growth opportunities
- diverting a substantial portion of our cash flow from operations to meet debt service obligations
- exposing us to increases in interest rates because a portion of our debt bears interest at variable rates
- placing us at a competitive disadvantage to certain of our competitors with lower levels of indebtedness
- increasing our vulnerability to economic downturns and adverse changes in our business
- limiting our ability to withstand competitive pressure
- restricting the activities of certain group companies under the covenants and conditions in certain of our financing arrangements.

Our ability to refinance our debt or incur additional debt, the terms of our existing and additional debt and our liquidity could be affected by several adverse developments, including due to turmoil in debt and other financial markets, which could result in tight credit restrictions and credit being available at higher cost.

Since 2006, the group's credit ratings have been downgraded to sub-investment grade by Standard & Poor's (S&P) and Moody's Investor Service. Most recently, Moody's Investor Service downgraded our credit rating in February 2020 from 'Ba1' to 'Ba2,' citing declining operating profitability in recent periods. Adverse developments in our credit ratings or financial markets, including due to the impacts of the ongoing Covid-19 pandemic or renewed turmoil in the European sovereign debt markets, any further downgrades in South African government bonds or deterioration of general economic conditions may affect our credit ratings or negatively impact our ability to incur additional debt as well as the amount and terms of the debt we can issue.

Our liquidity will be adversely affected if we must repay all or a portion of our maturing debt from available cash or through using our existing liquidity facilities. In addition, our results of operations will be adversely impacted to the extent the terms of the debt we can issue are less favourable than the terms of the debt being refinanced. We may also need to agree to stricter covenants that place additional restrictions on our business. For example, in connection with the Covid-19 pandemic, we have agreed to comply with additional covenants for the duration of the suspension of testing of the financial maintenance covenants, including restrictions on dividend payments, maximum capital expenditure spending limits, a minimum liquidity requirement, limitations on the incurrence of indebtedness, and restrictions on acquisitions. In addition, a portion of our debt bears interest at a variable rate. Fluctuations in the applicable rates may increase our overall interest expenses and have a material adverse effect on our ability to service our debt obligations.

We are subject to South African exchange controls, which may restrict the transfer of funds directly or indirectly between our subsidiaries or between the parent company and our subsidiaries and can restrict our subsidiaries' activities. We may also incur tax costs in connection with these transfers of funds. These exchange controls have affected the geographic distribution of our debt. As a result, acquisitions in North America and Europe have typically been financed with indebtedness incurred by our subsidiaries in those regions. Consequently, our ability or the ability of any of our subsidiaries to make scheduled debt payments will depend on financial and operating performance, which will depend on various factors beyond our control, such as prevailing economic and competitive conditions. If we, or any of our subsidiaries, cannot achieve operating results or otherwise obtain access to funds sufficient to enable us to meet our debt service obligations, we could face substantial liquidity problems. As a result, we might need to delay investments or dispose of material assets or operations. The timing of and the proceeds to be realised from any such disposition would depend on the circumstances at the time.

We require a significant amount of financing to fund our business and our ability to generate sufficient cash depends on many factors, some of which are beyond our control

Our ability to fund our working capital, capital expenditure and research and development requirements to engage in future acquisitions, make payments on our debt, fund post-retirement benefit programmes and pay dividends depends on our future operating performance. Our principal sources of liquidity are cash generated from operations and availability under our credit facilities and other debt arrangements. Our ability to generate cash depends, to some extent, on general economic, financial, competitive, market, regulatory and other factors, many of which are beyond our control. Our cash flow from operations may be adversely impacted by a downturn in world-wide economic conditions (including due to the effects of the Covid-19 pandemic), which would result in a decline in global demand for our products.

Our business may not generate sufficient cash flow from operations and additional debt and equity financing may not be available to us in a sufficient amount to enable us to meet our liquidity needs. If our future cash flows from operations and other capital resources are insufficient to fund our liquidity needs, we may be required to obtain additional debt or equity financing, refinance our indebtedness or reduce or delay our capital expenditures and research and development investments. We may not secure such alternative funding resources timeously or on satisfactory terms. The failure to do so could have a material adverse effect on our business, results of operations and financial condition.

We may not be successful in implementing, or may not realise all the expected benefits from, our strategic initiatives

As part of our overall business strategy, we are implementing strategic initiatives to improve profitability, including cost-saving projects, measures to increase production capacity and enhance productivity and investment in our DP business and higher-margin packaging and speciality papers business. Any future growth, cost savings or productivity enhancements that we realise from such efforts may differ materially from our estimates, or we may not be able to successfully implement part or all of our initiatives. The benefit of cost savings or productivity enhancements that we realise may be offset, in whole or in part, by reductions in pricing or volume, or through increases in other expenses, including raw material, energy or personnel, or the demand for our products may decline.

Regarding our recent investments in additional DP capacity, including the capacity expansion project at our Saiccor Mill that commenced in fiscal 2019, several of our competitors have announced or implemented additional production capabilities, and total supply capacity currently outstrips demand for DP. In addition, there is significant overcapacity and competition (and therefore pricing pressure) in the key downstream market of viscose staple fibre production; the Chinese textile market has been adversely affected by the ongoing United States/China trade dispute and related imposition of tariffs on Chinese exports to the United States, which has reduced demand for textiles produced in China, and a weaker RMB/US$ exchange rate; and the paper pulp market has not recently been an attractive alternative market for swing producers due to weak paper pulp prices. These factors have adversely affected, and may continue to adversely affect, the price of DP. As we increase production capacity and enhance productivity and investment in the DP segment, our exposure to the DP market may grow.

There can be no assurance that any of these initiatives will be completed as anticipated or that the benefits we expect from any strategic initiative will be achieved timeously or at all.

We carry out numerous capital expenditure projects, which, if delivered late, over budget or without achieving the projected quality improvements, capacity increases or cost reductions, could materially adversely affect our results of operations, competitiveness and financial position

In executing our strategy, we carry out numerous capital expenditure projects. During fiscal 2020, capital expenditure amounted to US$351 million. There is a risk that capital expenditure projects may not be completed on time, may not deliver the expected quality improvements, capacity increases or cost reductions or may exceed the allocated capital budget. Such effects may result from supplier performance and skill levels, ineffective project management and controls or delays in achieving customer acceptance, among others. Any such delays, cost overruns, production interruptions, failures to deliver expected performance and any other problems experienced in connection with implementing any capital project could impact our projects' financial return metrics, hamper our normal operations, delay our products' path to market or cause us to lose market share and may adversely affect our results of operations, competitiveness and financial position.

Continued volatility in equity markets and continuing low yields or increased rates of default in the bond markets could adversely affect the funded status and funding needs of our post-employment defined benefit funds

Several global economic factors (including the ongoing Covid-19 pandemic) currently make the general outlook for the forthcoming fiscal years uncertain. The equity and bond markets (including sovereign debt markets) have been volatile in the current fiscal year and may remain volatile and move in uncertain and unusual ways in the forthcoming fiscal years. This will lead to significant swings in the value of the assets and liabilities of our funded and unfunded defined benefit schemes.

Generally, but not always, rising corporate bond yields reduce our net balance sheet liabilities, whereas falling bond yields increase our net balance sheet liabilities. Equity markets have deteriorated in recent months and bond yields are, and may remain, relatively low in North America and Europe. This could negatively affect the funded status of our post-employment defined benefit arrangements. In addition, volatility in our net balance sheet liabilities resulting from the relative change in the value of assets and liabilities may be further enhanced by investment strategies, resulting in exposure to various classes of assets.

Existing and potential changes in statutory minimum requirements may also affect the amount and timing of funding we need to pay. Most funding requirements consider yields on assets such as government bonds or interbank interest rate swap curves, depending on the basis. Although statutory easements in the pace of funding on these bases have provided some contribution relief to us, as long as yields on these asset classes remain low, we expect to have to pay additional contributions to meet onerous minimum funding targets, which could adversely affect our financial position and results of operations.

In addition, our pension and post-retirement funds hold various bonds as part of their fund assets, including sovereign bonds issued by Austria, Belgium, France, Germany, Italy, Switzerland, South Africa, the United Kingdom and the United States of America. Any significant decline in value or default of such securities, including in the context of a renewed local or regional sovereign debt crisis or due to the economic impacts of the Covid-19 pandemic and associated governmental responses, could negatively affect the funded status of our post-employment defined benefit arrangements.

Fluctuations in the value of currencies, particularly the Rand and Euro relating to the US Dollar, have in the past had, and could in the future have, a significant impact on our results of operations

Exchange rate fluctuations have in the past, and may, in the future, affect the competitiveness of our products relating to the products of pulp and paper companies based in other countries.

Fluctuations in the exchange rate between currencies, particularly the Rand and Euro and, to a lesser extent, the Chinese Renminbi, relating to the US$, have in the past had, and could in the future have, a significant impact on our earnings, the competitiveness of our exports, the prices of imported competitors' products and the costs of our raw materials. A weaker EUR/US$ exchange rate places pressure on our North American business by increasing the levels of imports into the United States and making our exports from the United States less competitive. Further, a stronger ZAR/US$ exchange rate may place margins under pressure in our Southern Africa segment, as this lowers the effective Rand pricing for DP (priced in US Dollar). A weaker RMB/US$ exchange rate has in the past had, and may in the future have, an adverse impact on US Dollar DP prices due to the role of the Chinese textile industry as the major global purchaser of DP.

Since the adoption of the Euro by the European Union on 1 January 1999 (when the Euro was trading at approximately US$1.18 per Euro), it has fluctuated against the US Dollar, reaching a low of approximately US$0.83 per Euro in October 2000 before trading at approximately US$1.16, US$1.09 and US$1.16 per Euro at the end of fiscal 2020, 2019 and 2018, respectively.

The value of the Rand against the US Dollar has fluctuated considerably, moving against the US Dollar from a low of approximately ZAR5.66 per US Dollar in December 1998 to approximately ZAR17.13, ZAR15.14 and ZAR14.14 per US Dollar at the end of fiscal 2020, 2019 and 2018, respectively.

There are risks relating to the countries where we operate that could adversely affect our business, results of operations and financial condition

We own manufacturing operations in seven countries in Europe, two states in the United States, Canada and in South Africa. We also own plantations in South Africa. We also sell our products to customers in various countries world-wide. As a result, our operations are subject to various economic, fiscal, monetary, regulatory, operational and political conditions. Our presence in these countries exposes us to risks such as material changes in laws and regulations, political, financial and social changes and instabilities, exchange controls, risks related to relationships with local partners and potential inconsistencies between commercial practices, regulations and business models in different countries. The occurrence of such events could adversely affect our business, results of operations and financial condition.

Our business may be impacted by reputational risks relating to our local partners. Any such reputational risks or negative media coverage could adversely impact our business.

In South Africa, where we own and lease significant amounts of land (394,000 ha) that supply our Sappi Forests operations, we are subject to claims for restitution of land under certain land reform initiatives, such as the Restitution of Land Rights Act, 1994. In the past 10 years, we have settled claims related to 39,950.21 ha of which claimants took ownership of 8,151 ha and claims for 11,271 ha in which claimants preferred to seek compensation. The balance of the land has been withdrawn from the claim by the Restitution on Land Rights Commission or the claim was rejected by the Land Claims Court.

More recently, there has been a debate in South Africa surrounding proposals for expropriation of land without compensation, as set out in the amended draft Expropriation Bill that was published for public comment on 6 December 2019, and updated shortly after year end, on 9 October 2020. The governing party and parliament are in favour of a constitutional amendment in this regard. Any change in such land reform policies or delays in processing land claims and approving settlements by the South African authorities may increase our costs and adversely affect our business, results of operations and financial condition.

Uncertainties relating to international trade policies, new tariffs and other trade measures may adversely affect our business, results of operations and financial condition

A substantial proportion of the products we manufacture in our European, North American and Southern African operations is destined for export to other countries world-wide, particularly in Asia. As a result, our business may be impacted by uncertainties related to international trade policies, such as the recent tariffs dispute between the United States and China. The Chinese textile industry, the main purchaser of DP globally, has been adversely affected by the ongoing trade dispute between the United States and China, contributing to declines in the market prices for DP. Any escalation of the trade dispute between the United States and China or the European Union and any corresponding tariffs, additional tariffs or other trade restrictions may adversely affect the price competitiveness of either our or our customers' products, increase costs or lead to reduced activity and investment levels in our own or our customers' industries in general. These could adversely affect our business, results of operations and financial condition.

The inability to recover increasing input costs through increased prices of our products has had, and may continue to have, an adverse impact on our profitability

The selling prices of the majority of the products we manufacture and the purchase prices of many of the raw materials we use generally fluctuate in correlation with global commodity cycles. In the past and possibly into the future, we experienced increasing costs of several materials due to global trends beyond our control.

In some countries, electricity generation companies compete for the same raw materials, namely wood and wood chips, in the same markets as us, driving prices upwards, especially during winter in the Northern hemisphere. Although oil prices have significantly decreased from the historical highs of 2008, they could return to high levels in the future because of, among other things, political instability in the oil-producing regions of the world. This impacts the oil-based commodities required by our business in the areas of energy (including electricity), transport and chemicals.

As has occurred in previous years, a major potential consequence of the increase in the price of input commodities is our inability to counter this effect through increased selling prices, resulting in reduced operating profit and negatively affecting business planning.

While we continue to implement procedures to reduce our cost of commodity inputs, the hedging techniques we apply on our raw materials and products are on a small scale and short term in nature, other than our maintenance of a high level of economic pulp integration. Moreover, in the event of significant increases in the prices of pulp, our non-integrated and partially integrated operations could be adversely affected if they cannot raise paper prices by amounts sufficient to maintain margins, or if they can only implement such price increases with a certain lag time relative to input cost increases.

If we cannot obtain energy or raw materials at reasonable prices, or at all, it could adversely affect our operations

We require substantial amounts of oil-based chemicals, as well as fuels, water and other raw materials for our production activities and transportation of our timber and other products. We partly rely on third parties for our supply of energy resources and, to a certain extent, timber and pulp, which are consumed in our operations. In addition, our operations depend on access to electricity generated by local utilities and power plants, which can be unpredictable at times. For example, Eskom, the state-owned electricity company in South Africa, has in recent years struggled to meet demand and, in some cases, has requested that we reduce our demand, leading to temporary shutdowns of certain of our South African production facilities.

Eskom has warned that electricity shortages and conditions of intermittent supply could persist for some time and the South African government has announced a plan to restructure Eskom into three separate businesses (encompassing generation, transmission and distribution) in response to the recent power generation problems and a substantial debt burden. In addition, to address its substantial debt burden, Eskom implemented a tariff increase in 2020. Further tariff increases in 2021 have been approved by the National Energy Regulator of South Africa (Nersa) and could result in a substantial increase in the cost of electricity to consumers over the next three years.

The prices for and availability of these energy supplies, water and raw materials may be subject to change or curtailment, due to, among other things, new laws or regulations, imposition of new taxes or tariffs, interruptions in production by suppliers, world-wide price levels, drought or other severe weather and market conditions.

Environmental litigation aimed at protecting forests and species habitats as well as regulatory restrictions on cutting or harvesting may cause significant reductions in the amount of timber available for commercial harvest in the future. In addition, future legal challenges and regulations concerning the promotion of forest health and the response to and prevention of wildfires could affect timber supplies in the jurisdictions where we operate. In Canada, affected indigenous communities and other stakeholders must be consulted, and potentially accommodated, in connection with the grant of timber rights in public forests. The availability of harvested timber may further be limited by fire, insect infestation, disease, ice and windstorms, droughts, floods and other nature and man-made causes, thereby reducing supply and increasing prices.

The prices of various sources of energy supplies and raw materials have significantly increased in the past and may further increase significantly from current levels in the future. An increase in energy and raw material prices could materially adversely affect our results of operations, plantation valuation and financial condition.

A limited number of customers account for a significant amount of our revenues

We sell a significant portion of our products to several significant customers. During fiscal 2020, 2019 and 2018, no customer individually represented more than 10% of our total revenue. As a significant portion of our sales revenue is generated through sales to a limited number of customers, any adverse development affecting our significant customers or our relationships with such customers could adversely affect our credit risk profile, business and results of operations. In addition, we rely globally on credit insurance for our arrangements with certain customers. At the end of fiscal 2020, 70% of the group's receivables were insured or covered by letters of credit and bank guarantees. Our credit insurer has reduced cover on certain of our customers following the outbreak of Covid-19, and such customers have requested extended payment terms. The withdrawal or unavailability of such credit insurance may impact our ability to engage with such customers.

In response to uncertainty regarding Covid-19, some major customers had notified us of their intention to reduce DP purchase volumes below their contractual volume commitments, which could materially reduce sales volumes in future periods. In the past, and possibly into the future, we received customer requests to reduce contracted DP volumes. These requests have adversely affected our profitability and could continue to do so in the future.

Adverse changes to economic or market conditions could negatively impact our significant customers, which in turn could materially adversely affect our results of operations and financial position

Adverse changes in economic conditions have had and may continue to have a negative impact on our significant customers. Such changes cannot be predicted, and their impacts may be severe. These impacts include customers experiencing financial distress, filing for bankruptcy protection or insolvency, going out of business, or otherwise suffering disruptions in their businesses, which could in turn have a negative impact on our business. A disruption in the ability of our significant customers to access adequate sources of liquidity could also cause serious disruptions or an overall deterioration of their businesses, which could lead to a significant reduction in future orders of our products and the inability or failure on their part to meet their payment obligations to us, any of which could have a material adverse effect on our operating results and financial position. Similarly, sustained adverse changes in market conditions for our significant customers' products, such as lower demand, lower prices or increased competition, could also reduce future orders of our products and have a material adverse effect on our results of operations and financial position.

In addition, our customers may experience financial distress, file for bankruptcy protection or insolvency, go out of business, or suffer disruptions in their businesses due to the Covid-19 pandemic and associated government responses. Accordingly, we expect an increase in bad debt provisions, which in each case could negatively impact our business, results of operations and financial condition. In DP, sustained significant overcapacity of viscose staple fibre, the primary product produced by our DP customers, combined with a weak textile market, the primary market for viscose staple fibre sales, and the effects of a weaker Chinese RMB, have contributed to DP prices declining to historic lows. If low prices and weak margins prevail in the market for viscose staple fibre, or if prices for competing fibres in the textile industry such as cotton and polyester were to decrease significantly, our DP business could continue to be adversely affected. Similarly, the closure of many clothing retailers due to lockdowns and social distancing measures implemented in response to the Covid-19 outbreak has led to negative pressure on textile demand and, in turn, DP which is used in the production of viscose textiles. Order activity for graphic papers has also slowed markedly since the beginning of the outbreak.

Such adverse changes could also lead to consolidation in the industries in which our significant customers participate, as evidenced by the current trend towards consolidation in the North American print, publishing and distribution industries. Such consolidation could increase our dependence on a few key customers, which could lead to less favourable terms and lower sales prices for our products.

Because of the nature of our business and workforce, we may face challenges in the retention of staff and the employment of skilled people that could adversely affect our business

We are facing an ageing demographic work profile among our staff due to our industry's mature nature and the rural and often remote locations of our mills, together with the generally long tenure of employees at the mills. As a result, we are likely to experience groups of employees leaving the company in a relatively short time of one another and may have difficulty attracting qualified replacements. The potential risks we face include loss of institutional memory, skills, experience and management capabilities. We may be unable to attract and retain sufficient qualified replacements when and where necessary to avoid an adverse impact on our business. In certain regions like North America, relatively low unemployment rates also make it more difficult to find local resources and skills.

A large percentage of our employees is unionised, and wage increases or work stoppages by our unionised employees may have a material adverse effect on our business

A large percentage of our employees is represented by labour unions under collective bargaining agreements, that need to be renewed from time to time. In addition, we have in the past sought and may in the future seek, or be obligated to seek, agreements with our employees regarding workforce reductions, closures and other restructurings. We may not be able to negotiate acceptable new collective bargaining agreements or future restructuring agreements, which could result in labour disputes. We may also become subject to material cost increases or additional work rules imposed by agreements with labour unions. This could increase expenses in absolute terms and/or as a percentage of sales.

Although we believe we have good relations with our employees, work stoppages or other labour disturbances have occurred in the past, and may occur in the future, which could adversely impact our business. In recent years, certain of our unionised employees in Southern Africa have participated in strike actions that have resulted in interruptions in our business operations. Any strike actions or other labour disruptions, or any related negotiations that result in onerous terms for us, may have an adverse effect on our business and profitability.

The prevalence of HIV/AIDS, specifically in Africa, exposes us to certain risks, which may have an adverse effect on our Southern African operations

The Southern African region has one of the highest infection rates of HIV/AIDS in the world. Although we initiated a comprehensive HIV/AIDS management programme in the early 1990s to address the effects of the disease and its impact on our employees and our business, our operations, and in particular our Southern African operations, continue to be exposed to certain risks related to HIV/AIDS. We incur and will continue to incur costs related to the prevention, detection and treatment of the disease. However, we cannot guarantee that any current or future management programme will help prevent or reduce the infection rate among our employees and any potential effect thereof on the mortality rate. We may be exposed to lost workers' time associated with the disease and a potential loss of skills, which may adversely affect our operations.

Abnormal or severe events affecting our plantations, such as fires and droughts, may adversely impact our ability to supply our Southern African mills with timber from the region

The Southern African landscape is prone and ecologically adapted to frequent fires. The risk of uncontrolled fires entering and burning significant areas of plantation is high. In 2007 and 2008, Southern Africa experienced a number of abnormal weather events (hot, dry conditions fanned by extremely strong winds), which resulted in disastrous plantation fires across vast areas of eastern South Africa affecting 14,000 hectares of our plantations. These abnormal weather conditions might be more frequent in the future due to climate change. In addition, because the transformation of land ownership and management in Southern Africa has been moving ownership and management of plantations to independent growers, we have less ability to directly manage fire risk, as well as risks of other abnormal or severe events, such as pathogen and pest infestations. Consequently, the risk of plantation fires or other abnormal or severe events remains high and may be increasing.

The availability of harvested timber may also be limited by other abnormal weather conditions, such as droughts. Continued or increased losses of our wood sources from drought conditions or fire could jeopardise our ability to supply our mills with timber from the region.

The effects of climate change may have an impact on our business

There are transitional (policy and legal actions, technology changes, market responses and reputational considerations) and physical (acute and chronic) risks associated with climate change. In terms of transitional risks, concerns about global warming and efforts to reduce carbon emission footprints, as well as legal and financial incentives favouring alternative fuels, are leading to the increased use of sustainable, non-fossil fuel sources for electricity generation. Sappi faces operational risks related to climate change in all three geographic regions where it operates. We may also incur additional costs for electricity supplies and/ or to purchase emissions allowances or pay carbon taxes applicable to our operations in certain jurisdictions, including Europe and South Africa. Governments in the regions where we operate are looking to accelerate decarbonisation and, in certain instances, achieve climate neutrality by 2050. Although we have decarbonisation plans in each region where we have manufacturing operations and while we are working to reduce the amount of electricity purchased, in certain regions like South Africa this is largely based on coal (due to Eskom's high dependency on this fossil fuel), with negative implications for Scope 2 GHG emissions. There is a chance that this might impact us, or that constrained capital expenditure or other factors might mean we cannot achieve such plans, that we do not achieve them timeously or that our competitors' decarbonisation plans could be more effective than ours. In addition, some factors, such as Scope 3 GHG emissions that lie in our supply chain, are to a certain extent unpredictable as they are outside our control. Should our competitors manage their Scope 3 emissions more effectively, this could have a reputational impact.

In terms of physical risk, climate change leading to different weather patterns, such as higher rainfall, drought and increased temperatures, could cause the spread of disease and pestilence into our plantations and fibre sources far beyond their traditional geographic spreads, increasing the risk that wood supply necessary to our operations may be negatively impacted. A preliminary climate change investigation conducted by Sappi Forests' scientists in fiscal 2019 indicated that climate change is likely to be more significant in Southern Africa compared to the world average, including decreased spring rainfall and higher temperatures, the combined effect of which is likely to increase tree stress and adversely impact our South African forests and plantations.

The effects of climate change may also impact our business to the extent they result in reduced availability of woodfibre or demand for our products. Wildfires in Europe and North America over the past few years have been among the most destructive and expensive on record, and the risks of plantations fires in South Africa are increasing.

For example, if the spruce bark beetle *(Ips typographus)* outbreak in Sappi's key wood procurement areas in Europe continues, it could have profound impacts on forest ecosystems and forestry. In 2019, in Germany approximately 68% of total harvested volumes were fellings due to insect outbreaks and other climate change-related impacts. In response, forest owners are considering converting spruce *(Picea abies)* stands to other coniferous species or other broadleaves species that are more resilient than spruce to climate change-related adverse impacts. As the spruce is a strategically important species both for Sappi's and our suppliers' mechanical and chemical pulp production, the possible long-term changes in availability might have a strategic impact both in terms of production technologies and product portfolios.

Should our strategy to mitigate the related risks, including raw materials shortages, not be successful, our business may be adversely impacted.

Additionally, the increased emphasis on water footprint in Southern Africa is causing increased focus on the location of forestry plantations, which could affect the granting of water use licences, the quality and quantity of ground water, the use of water by our operational units, the quality of water released back into natural water systems and the control of effluent discharges. The cost, availability and use of our water supply also directly impact our input costs and operating profit.

Our manufacturing and forestry operations are inherently dangerous, and we may be subject to risks related to the health and safety of our employees

We operate several manufacturing facilities and conduct various forestry operations, all of which are inherently dangerous. Although we employ safety procedures in training our employees and contractor employees, as well as in the design and operation of our manufacturing facilities and forestry operations, accidents resulting in injury or death have occurred at our facilities in the past and could occur in the future.

Any such accidents or incidents could also result in environmental impacts, equipment damage and/or production delays, which could harm our business and results of operations. The potential liability resulting from any such incident, to the extent not covered by insurance, and any negative publicity associated therewith could harm our business, reputation, financial condition or results of operations. Whether or not a claim against us succeeds, its defence may be costly, and the existence of any claim may adversely impact our reputation, financial condition or results of operations.

Unforeseen shutdowns or disruptions at our production facilities or affecting our information technology systems may adversely impact our business

Our pulp and paper mills and our production facilities are central to our business and are subject to operational risks. These risks include, but are not limited to, fire or explosions, accidents, severe weather and natural disasters, mechanical, operational or structural failures, unplanned production or power disruptions, political turmoil, pandemics and related governmental responses (including Covid-19) or social unrest. Shutdowns, outages or deficiencies resulting from such events could have a material adverse effect on our business and financial condition if such shutdowns, outages or deficiencies continued for an extended time or if we cannot restart or remedy production timeously.

We also use information technologies to securely manage our operations and various business functions. We rely on various technologies to process, store and report on our business and interact with customers, vendors and employees. Despite our security design and controls, and those of our third-party providers, we or our third-party providers have in the past been, and in the future could become, subject to cyber-attacks that could result in operational disruptions or the misappropriation of sensitive data. There can be no assurance that such disruptions or misappropriations and the resulting repercussions will not adversely impact our reputation, financial condition or results of operations.

We depend on a reliable and efficient supply chain to deliver products to our customers in a timeframe that meets their expectations. Several factors, many of which are beyond our control, could disrupt the operation of our supply chain and jeopardise our ability to fulfil our customers' orders. Inclement weather, natural disasters, transportation interruptions or inefficiencies, port or traffic congestion, labour shortages or disruptions, oil price increases, unrest or pandemics (including Covid-19) could impair our ability to supply our customers or maintain an appropriate logistics chain and levels of production and inventory, all of which could adversely affect our reputation, business, results of operations and financial condition. Disruptions of this nature could have a material adverse effect on our business, financial condition or results of operation, particularly if the disruptions were to continue for an extended time.

Risks related to our indebtedness

To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash will depend on many factors beyond our control

Our ability to make payments on our indebtedness, refinance our indebtedness, and fund planned capital expenditures and working capital requirements will partly depend on our ability to generate cash in the future. Our ability to generate cash is, to a certain extent, subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

We cannot assure you that we will generate sufficient cash flow from operations, that we will realise operating improvements on schedule or that future borrowings will be available to us in an amount sufficient to enable us to service and repay our indebtedness or to fund our other liquidity needs. If we are unable to satisfy our debt obligations, we may have to undertake alternative financing plans, such as refinancing or restructuring our indebtedness, selling assets, reducing or delaying capital investments or seeking to raise additional capital. We cannot assure you that any refinancing or debt restructuring would be possible, that any assets could be sold or that, if sold, the timing of the sales and the amount of proceeds realised from those sales, or that additional financing could be obtained on acceptable terms.

If we default under any of our debt financing arrangements, we may not be able to meet our payment obligations

Some of our credit facilities contain covenants that restrict some of our corporate activities, including our ability to:
- make acquisitions or investments
- make loans or otherwise extend credit to others
- incur indebtedness or issue guarantees
- create security
- sell, lease, transfer or dispose of assets
- merge or consolidate with other companies
- make a substantial change to the general nature of our business.

In addition, certain of our credit facilities require us to comply with certain affirmative covenants and specified financial covenants and ratios. Our ability to comply with these covenants and restrictions may be affected by events beyond our control, including prevailing economic, financial and industry conditions. If we breach any of these covenants or restrictions, we could be in default under the credit facilities and other indebtedness. This would permit the lending banks under our credit facilities or our bondholders to take certain actions, including declaring all amounts that we have borrowed under the credit facilities and other indebtedness to be due and payable, together with accrued and unpaid interest and other fees, if any. The lending banks could also refuse to extend further credit under their facilities. Borrowings under debt instruments that contain cross-acceleration or cross-default provisions may also be accelerated and become due and payable.


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