Sappi Limited

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First quarter results for the period ended December 2020

Short-form SENS announcement

	Quarter ended		
US$ million	**Dec 2020**	**Dec 2019**	**%**
Sales	1 163	1 302	-11%
EBITDA excluding special items	98	139	-29%
Profit for the period	(17)	24	-171%
Net debt	2 056	1 916	7%
Headline EPS (US Cents)	(3)	4	-175%
Basic EPS (US Cents)	(3)	4	-175%
EPS excluding special items (US Cents)	(1)	6	-117%
Net asset value (US Cents)	327	379	-14%

Sappi is a leading global provider of powerful everyday materials made from woodfibre-based renewable resources. Together with our partners, we are quickly moving toward a more circular economy.

Our raw material offerings (such as dissolving pulp, wood pulp and biomaterials) and end-use products (packaging and specialities papers, graphic papers, casting and release papers and forestry products) are manufactured from woodfibre sourced from sustainably managed forests and plantations, in production facilities powered, in many cases, with bio-energy from steam and existing waste streams. Many of our operations are energy self-sufficient.

Sappi works to build a thriving world by acting boldly to support the planet, people and prosperity.

Commentary on the quarter

Despite the ongoing challenges of the Covid-19 pandemic ("Covid"), the group outperformed the guidance for EBITDA provided at the end of the last quarter as the profitability in all reporting segments exceeded expectations. EBITDA excluding special items for the quarter increased to US$98 million compared to US$82 million for the previous quarter. The improvement was due mainly to dissolving pulp ("DP") markets and graphic paper demand in North America recovering at a faster rate than anticipated. These benefits were partially offset by the impact of the Ngodwana Mill maintenance shut, which had been rescheduled from the third quarter of last year, as well as the scheduled Somerset Mill maintenance shut.

Ensuring the safety of our employees and supporting our customers and communities is a priority and our comprehensive Covid action plan remains relevant and in place. During the quarter, the global surge of Covid infections and the related employee absenteeism put all of our operations under pressure. In spite of the unprecedented obstacles that have arisen as a result of the pandemic and through the dedication and resilience of our workforce, our mills remained fully operational.

The economic effects of the Covid pandemic continued to impact performance with graphic sales still well below 2019 levels. The pandemic also severely affected global shipping and container availability which somewhat reduced our DP sales volumes in the quarter.

DP markets tightened considerably and market prices rallied by US$106/ton through the quarter. Key drivers behind the price increase included DP capacity curtailment, resurgent viscose staple fibre ("VSF") demand and prices, higher paper pulp prices and a weaker US$/Renminbi exchange rate. The shipping challenges referred to above combined with the Ngodwana Mill shut and reduced production volumes from the Saiccor Mill due to the temporary halting of the calcium line, reduced DP sales volumes by 16% compared to the same quarter last year. The segment also includes 53,000 tons of bleached chemi-thermo mechanical pulp ("BCTMP") from the Matane Mill which were sold in external markets.

Packaging and specialities sales volumes in all three regions experienced encouraging growth compared to the prior year. While demand for most categories was positive, some non-essential products in Europe were affected by the Covid-related lockdowns and other governmental measures. Profitability was partially reduced by lower selling prices linked to depressed pulp prices. The postponement of the shut at the Ngodwana Mill from the third quarter of last year to the current quarter reduced EBITDA in the segment to marginally below the corresponding quarter in the prior year.

Graphic paper demand continued to slowly recover from the impact of Covid and volumes were down 19% compared to the same quarter last year, an improvement on the 32% reduction experienced in the prior quarter. While North America recorded a strong recovery, soft coated mechanical ("CM") demand in Europe, weak export markets in South America and Australasia and low selling prices were a drag on profitability in this segment. The group took production downtime of 125,000 tons in the quarter, entirely in Europe, which was less than the 321,000 tons required by the group in the prior quarter. South African newsprint and uncoated woodfree demand continued to be adversely impacted by the weaker domestic economy.

Net finance costs were US$34 million compared to US$20 million in the equivalent quarter last year. The increase includes a non-cash fair value adjustment expense of US$13 million from the revaluation of the conversion rights related to the convertible bonds issued during the quarter. This is discussed in more detail in the cash flow section.

Earnings per share excluding special items for the quarter was a loss of 1 US cent.

Cash flow and debt

Net cash generated for the quarter was zero, compared to a cash outflow of US$278 million in the equivalent quarter last year, which included the purchase of the Matane Mill for US$158 million. Capital expenditure of US$82 million was lower than the US$112 million last year, which was mainly due to the timing of payments for the expansion of DP capacity at the Saiccor Mill.

Net debt for the quarter increased by US$99 million to US$2,056 million as a result of Euro and ZAR denominated debt being converted at stronger quarter end exchange rates. At the end of December 2020, liquidity comprised cash on hand of US$410 million and US$622 million from the committed revolving credit facilities ("RCF") in South Africa and Europe, respectively.

Sappi Southern Africa Limited issued 5-year convertible bonds with a principal amount of ZAR1.8 billion during the quarter. The bonds are convertible into ordinary shares of Sappi Limited subject to shareholder approval on 3 February 2021. Prior to shareholder approval, the revaluation of the fair value of the equity option is charged to the income statement. Following shareholder approval, there is no subsequent requirement to fair value the option. The net proceeds from the bonds will be used to fund the remaining capital expenditure required for the expansion of the Saiccor Mill.

The covenant suspension period negotiated in 2020 is applicable to our debt facilities financial covenants until September 2021 with the first measurement due at the end of December 2021.

Outlook

There has been a pronounced recovery of pricing and demand in DP markets. As of 29 January 2021, the Chinese market price had improved to US$895/ton, driven by a number of positive factors including low inventory levels, rebounding textile demand, higher VSF prices and favourable US$/Renminbi currency movements. The full benefit of the rising DP prices will be phased through future quarters due to the quarterly lag in contract pricing. A strengthening ZAR/US$ exchange rate is expected to negate some of the pricing benefits for the South African DP segment. Despite the improved market conditions, we are encountering logistical and production challenges at our South African DP facilities as a result of Covid. Notably, a severe second wave of Covid infections in South Africa has necessitated a prioritisation of oxygen supplies into the health care sector. Consequent restrictions on the procurement and transport of oxygen to the South African mills have resulted in a temporary curtailment of DP production at the Ngodwana Mill in the second quarter.

Underlying demand for packaging and speciality products remains resilient as consumer preferences default to more sustainable alternatives. We continue to ramp-up sales and production in North America and Europe following the completion of the Somerset and Maastricht conversions. However, Covid may adversely impact demand for certain non-essential consumer products.

The global resurgence of Covid and associated extended lockdowns and restrictions on economic activity are expected to stall the graphic market recovery, particularly in Europe. A rapid and significant rise in paper pulp costs is expected to reduce margins in this segment. Whilst we have announced selling price increases in most of our markets to mitigate this risk, there will be a lag before the benefits of the increases are realised. The recent series of paper machine and mill closures or conversions in the industry are expected to improve the supply/demand balance resulting in a recovery of operating rates in the coming quarter and year.

The strong demand of our packaging and speciality grades combined with the sharp recovery in DP markets support our strategic focus as we transition the business towards higher growth segments.

Capital expenditure in FY2021 is estimated to be US$400 million and includes the approximately US$100 million related to the Saiccor Mill expansion project. The increase in estimated capital expenditure from the previous guidance of US$370 million is as a result of the strengthening ZAR and Euro relative to the US$. The Saiccor Mill expansion project is scheduled to start production during the fourth quarter.

Second quarter earnings will be tempered by the production curtailments related to oxygen availability at our Ngodwana Mill, global logistical challenges and the negative impact of Covid on our European graphics segment. However, there are no material annual maintenance shuts planned for the quarter and we anticipate good performance from our packaging and specialities segment. Therefore, we expect the second quarter EBITDA to improve relative to the first quarter.

On behalf of the board

S R Binnie
Director

G T Pearce
Director

3 February 2021

Short form announcement
This short-form announcement is the responsibility of the directors. It is only a summary of the information in the full announcement and does not contain full or complete details. Any investment decision should be based on the full announcement accessible on 3 February 2021 via the JSE link and also available the sappi website at www.sappi.com.

Copies of the full announcement may be requested by contacting Jeanine Olivier on telephone: +27 (0)11 407 8307, email: Jeanine.Olivier@sappi.com.

The JSE link is as follows:

https://senspdf.jse.co.za/documents/2021/jse/isse/SAVVI/sappiQ121.pdf

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