Sappi Limited

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Second quarter results for the period ended March 2021

Short-form SENS announcement

	Quarter ended			Half-year ended		
US$ million	**Mar 2021**	**Mar 2020**	%	**Mar 2021**	**Mar 2020**	%
Sales	1 284	1 308	-2%	2 447	2 610	-6%
EBITDA excluding special items	112	131	-15%	210	270	-22%
Profit for the period	(23)	2	-1250%	(40)	26	-254%
Net debt	2 070	1 879	10%	2 070	1 879	10%
Headline EPS (US Cents)	(3)	2	-250%	(7)	6	-217%
Basic EPS (US Cents)	(4)	-	-	(7)	5	-240%
EPS excluding special items (US Cents)	(1)	4	-125%	(2)	10	-120%
Net asset value (US Cents)	345	329	5%	345	329	5%

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
The steady recovery from the ongoing challenges of the Covid-19 pandemic continued during the second quarter. A strong packaging and specialities performance combined with solid results from dissolving pulp (DP) offset the weak demand and margin squeeze in graphic paper. Consequently, group EBITDA excluding special items of US$112 million was a further increase on the US$98 million achieved in the first quarter. The North American and South African regions recorded improvements in profitability. This was in contrast to Europe where extended lockdowns and restrictions on economic activity hindered the performance. Logistics issues across all regions, including congested networks, shipping line schedule disruptions, lack of containers and vessel space constraints negatively impacted sales volumes and delivery costs in a number of product categories.

Our comprehensive Covid-19 action plan is fully entrenched in all of our operations and employee safety remains a top priority. The rate of employee and contractor infections reduced significantly during the quarter across all regions and as a consequence there was minimal impact on mill operations.

A positive highlight for the quarter was the continued rapid recovery of DP markets. The Chinese market price surged by US$340 per ton during the quarter to US$1,066 per ton and peaked in April to the highest level since May 2012. The key factors supporting the positive sentiment in the sector include continued tight DP supply, low VSF inventory levels throughout the textile value chain, improved apparel retail demand in the US and Asia which favourably impacted all textile fibre prices, higher paper pulp prices and a continued weaker US$/Renminbi exchange rate. Due to the lag impact of selling prices incorporated into our major contracts, these higher DP prices will only be realised in future quarters. A relative increase in costs related to the stronger ZAR/US$ exchange rate partially offset the US Dollar selling price gains during the quarter. Included in the DP segment were 57,000 tons of bleached chemi-thermo mechanical pulp (BCTMP) and paper pulp sales volumes.

Sales volumes in the packaging and specialities segment increased by 25% compared to last year due to a further ramp-up of board products in North America and strong containerboard demand in South Africa. While demand for most categories in Europe was positive, some non-essential products were affected by Covid-19-related lockdowns. Profitability in Europe was partially reduced by lower selling prices.

The steady rate of recovery in graphic paper demand over the last two quarters slowed and sales volumes in the segment were 17% lower than the same quarter last year. Market capacity closures enabled Sappi to gain market share but the pressure on input costs, particularly pulp, and rising delivery charges impacted profitability negatively.

Earnings per share excluding special items for the quarter was a loss of 1 US cent, a decrease from the 4 US cents generated in the equivalent quarter last year.

Cash flow and debt

Capital expenditure of US$70 million was comparable to the equivalent quarter of last year. Net cash utilised for the quarter was US$53 million compared to a breakeven in the equivalent quarter last year and was primarily due to an increase in working capital from improving operations. Net debt increased by only US$14 million from December 2020 to US$2,070 million, benefiting from a stronger US Dollar which reduced the Euro denominated debt converted at a lower rate. Liquidity comprised cash on hand of US$350 million and US$660 million available from the undrawn committed revolving credit facilities (RCF) in South Africa and Europe.

Favourable market conditions provided the group with the opportunity to refinance the €350 million 2023 bonds during the quarter at par. Strong investor demand provided the opportunity to upsize the replacement 2028 bond to €400 million at a coupon 3.625%, with the additional proceeds used to repay the partly drawn RCF in Europe.

The net finance costs of US$46 million included a further non-cash fair value adjustment of US$16 million arising from the revaluation of the conversion rights for the Sappi Southern Africa R1.8 billion convertible bonds issued in the first quarter. The requirement for revaluations is applicable to the period between the bond placement and shareholder approval for the issue of new shares, which was obtained at the AGM in February, and therefore no further revaluation adjustments will be required. Also included in the finance costs was US$3 million relating to the refinancing of the 2023 bonds.

The covenant suspension period ends in September 2021 and financial covenants have to be measured again from December 2021. The following leverage covenants (net debt:EBITDA) have been agreed with our banking group as we exit the covenant suspension period: December 2021: 5.50; March 2022: 5.25; June 2022: 4.75; September and December 2022: 4.50 and March 2023: 4.25. The interest coverage covenant will be reinstated at its previous level of 2.50 times.

Outlook

DP market indicators remain positive and demand from our customers currently exceeds our capacity. As at 30 April 2021, the Chinese DP market price was US$1,100 per ton. However, pricing for VSF and other textile fibres has reduced in recent weeks. Much of the benefit from the material recovery of DP prices in the second quarter will be realised in subsequent quarters due to the lag in contractual pricing. A prolonged stronger ZAR/US$ exchange rate will temper some of the pricing benefits for the South African DP segment.

The underlying demand in the packaging and specialities segment in North America and South Africa remains robust and our focus is shifting to improving margins through machine efficiencies, mix optimisation and price realisation. However, as long as there is uncertainty in Europe regarding the continuing lockdowns due to Covid-19, the sluggish economic activity in this region is expected to impact demand for non-essential consumer products.

Graphic paper markets remain challenging and demand is still well below the long term pre-Covid-19 trend levels. The persistent weak demand in Europe is likely to keep the market in oversupply and diminish pricing power. The lag in sales price increase realisation in combination with rising raw material and logistics costs could exacerbate the margin squeeze even further in that region.

Ongoing worldwide logistical challenges of container shortages, port congestion and availability of vessel capacity pose a risk to export volumes from all regions in the third quarter.

Capital expenditure in FY2021 is estimated to be US$400 million and the Saiccor Mill expansion project is expected to commence production in the fourth quarter. Liquidity headroom within the group is good. The successful reinstatement of our leverage covenants as described earlier provides a comfortable level of headroom when covenant measurement commences again from December 2021.

Given the favourable market conditions for DP and packaging and specialities, offset partially by the weak graphic paper demand and global logistical challenges, we expect the third quarter EBITDA to improve relative to the second quarter. However, earnings in the European business will be lower due to rising pulp costs.

On behalf of the board

S R Binnie
Director

G T Pearce
Director

6 May 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 6 May 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/sappiQ221.pdf

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