

sappi

Risk Report

2019



RISK REPORT

Risk factors

In addition to other information contained 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 2019 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 that we deem immaterial based on information available to us at the date of this summary which 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 by 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 the capital and credit markets, coupled with uncertainty created by economic and geopolitical developments such as Brexit and changing trade practices in the United States, has led to decreased availability of credit and an increased cost of capital. This had a continued adverse effect on the world economy, which in turn affected, and may continue to adversely affect, the markets for our products insofar as it causes decreases in demand for our products and/or decreases achievable selling prices. The timing and magnitude of demand and price fluctuations in the pulp and paper

market have generally varied by region and by 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 the prices for pulp or pulpwood could adversely affect our non-integrated and partially integrated operations if they are unable to raise paper prices sufficiently to offset the effects of increased input costs. During the fourth quarter of FY19 we announced that we have signed an agreement to acquire the Canadian 270,000 tons per annum Matane high yield hardwood pulp mill from Rayonier Advanced Materials. The acquisition was subsequently completed on 03 November 2019.

The main benefits of the acquisition include:

- Increases Sappi's pulp integration for its fast-growing packaging businesses in both North America and Europe
- Supports Sappi's 2020Vision to grow in higher margin growth segments
- Reduces Sappi's cost of pulp
- Reduces the volatility of earnings through the pulp cycle
- Establishes certainty of supply for Sappi's increasing need for high yield pulp to support its recent investments.

Increases in other input costs including (but not limited to) those for energy and chemicals, which may affect our operations if we are unable to raise paper prices sufficiently.

The majority of our woodfree paper sales consist of sales to merchants. However, the pricing of products for merchant sales can generally be changed with 30 to 90 days' advance notice to the merchant.

Sales to converters may be subject to notice periods of six to 12 months for price changes. Although we have entered into longer-term fixed-price agreements of six to 12 months primarily for packaging paper and newsprint sales in Southern Africa. Such agreements accounted for

approximately 6% of consolidated group sales during FY19.

Most of our dissolving wood pulp sales contracts are multi-year contracts. Price terms under most of those contracts are reset on a quarterly basis. As a result, of the short-term duration of paper and dissolving wood pulp pricing arrangements, we are subject to cyclical decreases in market prices for these products, such as the cyclical decrease that affected dissolving wood pulp prices in recent years.

A downturn in paper or dissolving wood pulp prices or prolonged periods of depressed market prices for these products, could have a material adverse effect on our business, results of operations and financial condition.

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 have advantages over us, including lower raw material, energy and labour costs and fewer environmental and other governmental regulations to comply with. As a result, we cannot assure you that each of our mills will remain competitive.

We also cannot assure you that we will be able to take advantage of consolidation opportunities which may arise, or that any failure to exploit opportunities for growth would not make us less competitive. Increased competition, including as a result of a decrease in import duties in accordance with 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

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the United States by the U.S. 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 the results of our operations. In addition, competition may result from our inability to increase the selling prices of our products sufficiently or in time to offset the effects of increased costs, which 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 as a result of the availability of alternative products or services, including less expensive product grades, or because of pressure from consumers for more environmentally friendly solutions. In addition, trends in advertising, electronic data transmission and storage, mobile devices and the internet could have adverse effects on traditional print media and other paper applications, including our products and those of our customers. Over the last 10 to 15 years, the pulp and paper industry 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 have begun to adversely affect 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 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. In recent months, we experienced a faster decline in demand for printing and writing papers than in prior periods. In the face of such structurally declining demand for printing and writing papers, any failure to grow our dissolving wood pulp and packaging and speciality papers 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 decreased during times of global economic recession. Economic recession, sovereign debt crises and other macro-economic events have in the past led 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 economic recovery in some of our markets remains slow. Certain countries have fallen back into recession and a significant risk remains that measures taken by governments and central banks may not prevent the global economy from falling back into recession. The turmoil in the sovereign debt markets as a result of the European debt crisis resulted in market uncertainty generally and in worsening economic conditions, particularly in Europe. We are still negatively

impacted by the slow recovery of various economies in the regions in which we operate. Furthermore, we are unable to predict the timing or rate of any recovery.

Finally, we cannot predict the timing, duration or effect of any other downturn in the economy that may occur in 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 as a result of events beyond our control, and 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, volatility in 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 2019 asset and business interruption insurance cover at more favourable rates than in 2018. The maximum self-insured retention for any one property damage occurrence is US\$22.4 million (€20.5 million), with an annual aggregate of US\$36.1 million (€33 million). We are unable to predict whether past or future events will result in more or less favourable terms for 2020. For property damage and business interruption insurance, cost-effective cover is not generally available to full replacement value. As at September 2019, the annual limit for claims under our property damage and business interruption insurance policy was US\$820.4 million (€750 million). If we were to experience property damage or business interruption losses

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in excess of 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. While the impact of fires on our plantations during fiscal 2011 to 2019 was substantially less than that in fiscal years 2007 through 2010, we are unable to assure you that this will remain so for the foreseeable future.

We may also 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. While we believe our insurance policies provide adequate coverage for reasonably foreseeable losses, we are unable to 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 in which 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, in particular 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. In order to compete successfully, we must continually develop and introduce new products and services in a timely manner 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 the needs or preferences of our customers. If we do not timely assess and respond to changing customer expectations, preferences and needs, our financial condition, results of operations or cash flows could be adversely affected.

We are also exposed to risks that are inherent to innovation and new technologies, such as those related to customer acceptance of new products. As a result, 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 legislation on business,

including environmental, health and safety laws and regulations in the various jurisdictions in which we operate. Such laws govern, among other things, water supply and consumption, the use of renewable and other fuels, the control of emissions and discharges, the management and disposal of hazardous substances and solid waste, the clean-up of contamination, 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 for failure to comply with environmental requirements. Impacts from historical operations, including the land disposal of waste materials, or our ongoing operations 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 any potential environmental, health and safety liabilities and claims could have a material adverse effect on our business and financial condition.

We expect to continue to incur expenditures and may face operational constraints to maintain compliance with applicable environmental laws, to upgrade pollution control equipment at our mills and to meet any new regulatory requirements, including those related to potential stricter air-emissions standards in the United States, Southern Africa and Europe.

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 costs of compliance with environmental, health and safety laws and regulations will not continue to

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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 level of indebtedness and the terms of our indebtedness could negatively affect our business and liquidity. As of September 2019, our net interest-bearing debt (current and non-current interest-bearing borrowings plus overdraft, less cash, cash equivalents and short-term deposits) amounts to US\$1,501 million. While reduction of 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 exploit 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 contained 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 a number of adverse developments, including as a result of turmoil in debt and other financial markets, which could result in tight credit restrictions and credit being available at higher cost.

Even though Moody's Investors Service upgraded Sappi's corporate family rating to Ba1 from Ba2, future adverse developments in our credit rating and financial markets, including as a result of renewed turmoil in the European sovereign debt markets or deterioration of general economic conditions, may negatively impact our ability to issue additional debt as well as the amount and terms of the debt we are able to issue.

Our liquidity will be adversely affected if we must repay all or a portion of our maturing debt from available cash or through use of our existing liquidity facilities. In addition, our results of operations will be adversely impacted to the extent the terms of the debt we are able to 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. 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 activities of our subsidiaries. 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 the United States and Europe were typically financed with indebtedness incurred by companies in those regions. As a consequence, our ability or the ability of any of our

subsidiaries to make scheduled payments on debt 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, are unable to 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 upon 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, to make payments on our debt, to fund post-retirement benefit programmes and to pay dividends depends upon 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 worldwide economic conditions, which would result in a decline in global demand for our products, such as the current decline in demand for printing and writing papers in Europe and North America, and a softening of prices for some of 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

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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 be able to secure such alternative funding resources on a timely basis 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 high-cost capacity reductions and other cost-saving projects, measures to increase production capacity and enhance productivity and investment in our higher margin packaging and speciality papers and dissolving wood pulp segments.

In the fourth quarter of FY19 we announced that we have signed an agreement to acquire the Canadian 270,000 tons per annum Matane high yield hardwood pulp mill from Rayonier Advanced Materials. The acquisition was subsequently completed on 03 November 2019.

We have also proceeded with the Saiccor 110,000 tons expansion project, completed the Saiccor woodyard upgrade, converted Lanaken PM8 from coated mechanical to woodfree paper production, upgraded the Gratkorn Mill and continued to ramp up paperboard production on PM1 at Somerset in our continued transition towards growing and higher margin segments.

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 implement successfully 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.

With respect to our recent investments in additional dissolving wood pulp capacity, a number of our competitors have announced additional production capabilities, and total supply capacity currently outstrips demand for dissolving wood pulp, which may adversely affect the price of dissolving wood pulp. As we increase production capacity and enhance productivity and investment in the dissolving wood pulp segment, our exposure to the dissolving wood pulp 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 on a timely basis or at all.

We carry out a number of 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 a number of capital expenditure projects. During FY19, capital expenditure amounted to US\$471 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 factors such as supplier performance and skill levels or ineffective project management and controls. Any such delays, cost overruns or failures to deliver expected performance could impact our projects' financial return metrics, hamper our normal operations, delay our products' path to market or cause us to lose

market share. Such delays, unexpected costs, production interruptions and any other problems experienced in connection with the implementation of any capital project 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 currently make the general outlook for the forthcoming fiscal years uncertain. The equity and bond markets (including sovereign debt markets) may remain volatile and move in uncertain and unusual ways in the forthcoming fiscal years leading 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. There is a risk that equity markets will deteriorate, and bond yields may remain relatively low in North America and Europe, which 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 to be paid by us. 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

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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, could negatively affect the funded status of our post-employment defined benefit arrangements.

Fluctuations in the value of currencies, particularly the Rand and Euro in relation 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 in relation to the products of pulp and paper companies based in other countries.

Fluctuations in the exchange rate between currencies, particularly the Rand and Euro in relation to the US Dollar, 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. For example, weaker Euro/US Dollar exchange rates place pressure on our European business, which purchases approximately half of its pulp requirements from non-local suppliers. In addition, a weaker Euro/US Dollar 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 Rand/US Dollar exchange rate may place margins under pressure in

our Southern Africa segment, as this lowers the effective Rand pricing for dissolving wood pulp (which is priced in US Dollar).

Since the adoption of the Euro by the European Union on 01 January, 1999 (when the Euro was trading at around 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\$1.09, US\$1.16 and US\$1.18 per Euro at the end of fiscal 2019, 2018 and 2017, 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 ZAR15.16, ZAR14.15 and ZAR13.56 per US Dollar at the end of fiscal 2019, 2018 and 2017, respectively.

There are risks relating to the countries in which 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 and in South Africa and own plantations in South Africa. We also sell our products to customers in various countries worldwide. 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.

In South Africa, where we own and lease significant amounts of land (379,000 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. 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 are destined for export to other countries worldwide, in particular in Asia. As a result, our business may be impacted by uncertainties related to international trade policies, such as the tariffs dispute between the United States and China. Any such 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 or our customers' industries in general, which could adversely affect our business, results of operations and financial condition.

The inability to recover increasing input costs through increased prices of our products 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. We have in the past experienced, and may in the future experience, increasing costs of a number of raw materials due to global trends beyond our control.

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In some countries, electricity generation companies are competing for the same raw materials, namely wood and woodchips, in the same markets as us, driving prices upwards, especially during winter in the Northern hemisphere. Although oil prices have decreased from the historical highs of 2008, they could return to high levels in the near 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 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 are unable to raise paper prices by amounts sufficient to maintain margins, or if they are only able to implement such price increases with a certain lag time relative to input cost increases.

If we are unable to 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, fuels, water and other raw materials for our production activities and transportation of our timber and other products. We rely partly upon third parties for our supply of the energy resources and, to a certain extent, timber and pulp, which are consumed in our operations. In addition, our operations are dependent on access to electricity generated by

local utilities and power plants, which can at times be unpredictable. The prices for and availability of these energy supplies, water and raw materials may be subject to change or curtailment, respectively, due to, among other things, new laws or regulations, imposition of new taxes or tariffs, interruptions in production by suppliers, worldwide 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 in which we operate.

The availability of harvested timber may further be limited by factors such as fire, insect infestation, disease, ice and wind storms, droughts, floods and other nature and man-made causes, thereby reducing supply and increasing prices. Our acquisition of the 270,000 tons per annum Matane high yield hardwood pulp mill will increase our pulp integration, establish certainty of supply as well as reduce our cost of pulp.

The prices of various sources of energy supplies and raw materials have substantially 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, including Antalis, Birla, Igepa, Lenzing, Lindenmeyr, Papyrus and Veritiv. During fiscal 2019 and 2018, no single 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 have a material effect on our credit risk profile, our business and results of operations. In addition, we rely globally on credit insurance for our arrangements with certain customers. At the end of FY19, 74% of the group's receivables were insured or covered by letters of credit and bank guarantees. The withdrawal or unavailability of such credit insurance may impact our ability to engage with such customers.

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

Adverse changes in economic conditions had and may continue to have a negative impact on our significant customers. Such changes cannot be predicted, and their impacts may be severe. For example, a disruption in the ability of our significant customers to access sources of liquidity could cause serious disruptions or an overall deterioration of their businesses, which could lead to a significant reduction in their 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 results of operations 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.

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

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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.

In light 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 the mature nature of our industry and the rural and often remote location 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 within a relatively short space of time of one another and may have difficulty attracting qualified replacements. The potential risks we face are a 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, for example in North America, low unemployment rates also make it more difficult to find local resources and skills.

A large percentage of our employees are 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 are represented by labour unions under collective bargaining agreements, which 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. Also, we may 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 may occur in the future, which could adversely impact our business. 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 the highest infection rate of HIV/AIDS in the world (7% of adults). Although we initiated in the early 1990s a comprehensive HIV/AIDS management programme 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 the HIV/AIDS pandemic. The objective of the Sappi HIV/AIDS programme is to measure, monitor and manage the disease in order to mitigate the risks posed to employees, the organisation and the communities in which we operate. This programme includes prevalence studies to gauge infection levels, voluntary testing programmes that encourage workers to establish their sero-status, the provision of medical care as well as a major focus on peer educator programmes aimed at education and awareness. Sappi Southern Africa has now reached a position where more than 72% of our Southern African employees check their HIV status every year. Regular HIV counselling and testing (HCT) ensure that we achieve early diagnosis of HIV infection to ensure timely access to care.

Following the first anonymous voluntary prevalence tests in 2003, a fifth comprehensive voluntary study was conducted during 2018 in all of our Southern African operations. Based on a participation rate of greater than 95%, at the locations tested, we estimate that the overall infection rate in our southern African operations has stabilised at approximately 16%, which compares favourably with the national average (19.2%). In response to these survey results, renewed focus has been placed on the HIV/ AIDS management programme so as to further contribute to the effective containment of the pandemic. We estimate that approximately 76% of our employees that are HIV/AIDS positive participate in our HIV/AIDS managed care programmes. Furthermore, the impact of HIV/AIDS on a company is generally reflected in the mortality rate of its employees. Sappi Southern Africa's mortality rate has more than halved from a high level of 1.12% in 2005 to a rate of 0.35% in FY18. However, we cannot guarantee that the situation will not change regarding preventing or reducing the infection rate among our employees and any potential effect thereof on the mortality rate. We may be exposed to lost workers' time due to disease and a potential loss of skill, which may adversely affect our operations.

Catastrophic 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 to, 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 and 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

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conditions might be more frequent as a result of 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 catastrophic events, such as pathogen and pest infestations. As a consequence, the risk of plantation fires or other catastrophic 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.

Concerns about global warming and 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. In all three regions where Sappi operates, climate change could lead to different weather patterns, altering the frequency and intensity of forest disturbances such as insect outbreaks, invasive species, wildfires and storms. These disturbances could reduce forest productivity, change the distribution of tree species and increase the risk that wood supply necessary to our operations may be negatively impacted.

Wildfires in Europe and North America over the past few years have been among the most destructive and expensive on record. However, given SEU's general risk mitigation strategy of sourcing pulp and woodfibre from a variety of sources and regions, we do not anticipate any material impact to raw material supply from climate change in the short- to medium term (five to 10 years).

In SNA, our operations do not currently face material risks associated with

climate change. With the exception of fibre from Brazil for Westbrook Mill, we source from northern hardwood and softwood baskets that have not suffered under any drought conditions or from fire.

In SSA, where our operations are being impacted by climate change, we make significant investment in the prevention of fire, pests and diseases, as well as site species matching to tolerate drought, frost and other weather events. The increased emphasis on water footprint in Southern Africa is causing increased focus on the location of forestry plantations, which could affect 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 have a direct impact on our input costs and operating profit.

Should our strategy to mitigate the related risks of raw materials shortages fail, our business may be adversely impacted.

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 a number of manufacturing facilities and conduct various forestry operations, each of which is inherently dangerous. Although we employ safety procedures 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 incident also could result in environmental impacts, equipment damage and/or production delays, which could harm our business and our 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 or political turmoil. Shutdowns or outages resulting from such events could have a material adverse effect on our business and financial condition if the outages continued for an extended period of time or if we were unable to restart production in a timely manner.

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 could become subject to cyber-attacks, which 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.

Risks related to our indebtedness

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

Our ability to make payments on our indebtedness, to refinance our indebtedness, and to fund planned capital expenditures and working

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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 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.

If the debt under the credit facilities and other indebtedness or any other material financing arrangement that we enter into were to be accelerated, our assets may be insufficient to repay in full our debt.