Sappi Limited

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Third quarter results for the period ended June 2021

Short-form SENS announcement

	Quarter ended			Nine months ended		
US$ million	**Jun 2021**	**Jun 2020**	%	**Jun 2021**	**Jun 2020**	%
Sales	1 393	907	54%	3 840	3 517	9%
EBITDA excluding special items	145	26	458%	355	296	20%
Profit for the period	18	(73)	-125%	(22)	(47)	-53%
Net debt	2 055	1 977	4%	2 055	1 977	4%
Headline EPS (US Cents)	3	(12)	-125%	(4)	(6)	-33%
Basic EPS (US Cents)	3	(13)	-123%	(4)	(9)	-56%
EPS excluding special items (US Cents)	5	(10)	-150%	3	(1)	-400%
Net asset value (US Cents)	362	326	11%	362	326	11%

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 Covid-19 pandemic continued to evolve. In response, countries moved in and out of restrictions of varying stringency over the past 18 months with many facing considerable pressure to relax public health and social measures. A more favourable economic climate in the majority of our trading regions during the quarter boosted financial performance.

The group delivered EBITDA excluding special items of US$145 million, which was a material improvement on the second quarter EBITDA of US$112 million and resulted in an overall return to profit for the quarter of US$18 million. Strong dissolving pulp (DP) prices and an excellent performance from the packaging and specialities segment contributed to the success. These were partially offset by lower profitability in Europe due to significant input cost inflation. Global logistical challenges continued to impact sales volumes and delivery charges escalated materially.

Higher selling prices facilitated a substantial increase in EBITDA for the DP segment compared to the second quarter. The average Chinese market price for hardwood DP during the quarter was US$1,088 per ton, a 19% increase on the prior quarter average price of US$918 per ton. Due to the lag impact of selling prices incorporated into our major contracts, the benefit of higher third quarter DP market prices will only be realised in the fourth quarter. Sentiment generally remained buoyant on the back of steadily improving retail demand in the apparel sector. However, increased stock levels of viscose staple fibre (VSF), yarn and grey fabric through the supply chain exerted some downward pressure on the VSF price and consequently led to a gradual reduction in the DP price to US$1,050 per ton at the end of June. The DP segment sales volumes for the quarter were below expectations and 14% lower than the second quarter due to a loss of production volumes at the Saiccor Mill and shipping delays in both South Africa and North America. The planned maintenance shut at Saiccor Mill in May was extended and the subsequent start-up took longer than planned, which resulted in a production loss of approximately 40,000 tons. Due to Covid-19 travel restrictions, original equipment vendors were unable to travel to South Africa. As a consequence, the execution of a number of critical projects during the shut was negatively impacted. Vessel delays at quarter end further reduced DP sales volumes by 21,000 tons. Included in the DP segment were 37,000 tons of bleached chemi-thermo mechanical pulp (BCTMP) sales volumes

The strategic decision taken to reduce exposure to graphic paper through diversification into packaging and specialities grades continued to yield benefits. The EBITDA in this segment reached a new record high and contributed almost half of the group EBITDA. Sales volumes increased by 23% compared to the equivalent quarter in the prior year. The growth in sales volumes and the improved margins in the segment are reflective of the encouraging progress in North America to optimise the product mix at the Somerset Mill and a strong containerboard performance in South Africa.

Demand for graphic paper improved during the quarter as a result of renewed economic activity as countries eased Covid-19 lockdown restrictions and vaccination programmes gained momentum. Sales volumes in the segment reached 90% of volumes in the pre-Covid-19 equivalent quarter in 2019. The substantial capacity that exited the sector also tightened the market balance. However, profitability in the segment remained under pressure due to spiralling purchased pulp input costs, particularly in Europe, in combination with a lag in selling price increases.

Earnings per share excluding special items of 5 US cents was a substantial improvement on the loss of 1 US cent in the second quarter and the loss of 10 US cents in the equivalent quarter of the prior year and is indicative of the steady recovery from the negative impacts of Covid-19.

Cash flow and debt

Net cash generated for the quarter was US$49 million compared to US$67 million utilised in the equivalent quarter of the prior year primarily as a result of the improved profitability, lower finance charges and a positive movement in working capital. Capital expenditure of US$79 million was comparable to the second quarter and the equivalent quarter of the prior year. The finance charges normalised compared to the two prior quarters with no further charges associated with the revaluation of the equity option for the South African subsidiary's convertible bond. Subsequent to quarter-end, the group has received conversion notices for the convertible bond of just over 26% of the initial offering of ZAR1,800 million. The convertible bond will be settled by the issue of approximately 14 million Sappi Limited shares.

Net debt decreased by US$15 million from March 2021 to US$2,055 million with the cash generation of US$49 million offset by currency movements on the translation of Euro and ZAR debt. The leverage ratio at quarter-end was substantially reduced compared to the second quarter and is expected to continue to reduce progressively as the low EBITDA Covid-19 impacted quarters are eliminated from the calculation. Liquidity remains strong with cash on hand of US$405 million and US$690 million available from the undrawn committed revolving credit facilities (RCF) in South Africa and Europe.

Outlook

Although many businesses have re-opened and Covid-related restrictions have loosened, a new wave of infections is developing in countries around the globe. The negative impact of Covid-19 on global economic activity has diminished but the continuing uncertainties represent an ongoing risk to the business performance. Our focus is to keep our employees safe and encourage participation in vaccination programmes.

A brief period of civil unrest in South Africa during July caused major disruptions to raw material supplies and forced the temporary closure of the Saiccor, Tugela and Stanger Mills in KwaZulu-Natal. A combined total of 28,000 tons of DP and 7,000 tons of paper production were lost, which will have an estimated negative impact on fourth quarter EBITDA of approximately US$16 million. The completion and commissioning of the Saiccor Mill expansion project was also negatively impacted by the unrest and ongoing Covid-19 travel restrictions. Therefore, the start-up is projected to be delayed until early in the new financial year.

The outlook for the DP segment remains positive despite a gradual weakening of market pricing in the third quarter. Prices of VSF, cotton and polyester all increased during July which should support DP prices. The fundamental driver of market dynamics in the DP segment is apparel sales, which continue to improve globally quarter-on-quarter as economic activity resumes. The demand from Sappi's DP customers remains strong and much of the benefit of the elevated third quarter pricing will be realised in the fourth quarter due to the lag in contractual pricing.

The underlying demand in the packaging and specialities segment remains robust particularly in South Africa and North America and opportunities for further growth in sales volumes exist in Europe. The outlook for graphic paper in the fourth quarter is encouraging and market conditions are anticipated to steadily recover as activities in the travel and entertainment sectors normalise. This improvement in combination with global industry capacity closures are expected to tighten market supply and allow for price increase traction. However, purchased pulp, chemicals and logistics cost inflation are anticipated to continue into the fourth quarter and will negatively impact margins.

Global logistical challenges including container shortages, port congestion and availability of vessel capacity are still adversely impacting deliveries in all regions. Furthermore, on 22 July the South African port operator, Transnet, was the victim of a cyber-attack which severely disrupted port, rail and road operations and further exacerbated the congestion and inefficiencies in the Durban Port due to the civil unrest.

Capital expenditure in FY2021 is estimated to be US$400 million and liquidity headroom within the group remains strong.

Given the favourable conditions for DP and packaging and specialties combined with tighter graphic paper markets, despite the loss of production volumes from the South African civil unrest and higher raw material costs, we expect an improvement in the fourth quarter EBITDA relative to the third quarter.

On behalf of the board

S R Binnie
Director

G T Pearce
Director

5 August 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 5 August 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/sappiQ321.pdf

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