

Sappi Limited
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 JSE code: SAP
 ISIN code: ZAE000006284
 Issuer code: SAVVI
 ("Sappi")

First quarter results for the period ended December 2022

Short-form SENS announcement

US\$ million	Quarter ended		% Change
	Dec 2022	Dec 2021	
Sales	1 660	1 697	-2%
EBITDA excluding special items	290	240	21%
Profit for the period	190	123	54%
Net debt	1 241	1 917	-35%
Headline EPS (US Cents)	34	22	55%
Basic EPS (US Cents)	34	22	55%
EPS excluding special items (US Cents)	30	20	50%
Net asset value (US Cents)	447	353	27%
Dividend per share (US cents)	15	-	N/M

N/M - Not meaningful

Sappi is a leading global provider of everyday materials made from woodfibre-based renewable resources. As a diversified, innovative and trusted leader focused on sustainable processes and products, we are building a more circular economy by making what we should, not just what we can.

Our raw material offerings (such as dissolving pulp, wood pulp, biomaterials and timber) and end-use products (specialities and packaging 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.

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

Commentary on the quarter(1)

The group delivered another strong performance, which was well above pre-Covid-19 levels and the best ever first quarter results. EBITDA excluding special items of US\$290 million was 21% above the prior year (which included an additional sales week) and in line with guidance provided in the prior quarter. The positive results were underpinned by year-on-year pricing gains for paper products which offset cost inflation, lower sales volumes and delivered an EBITDA margin of 17.5%.

The lower profits relative to the record levels in the prior quarter were reflective of the slowing global economy. Ongoing geopolitical turmoil in Russia/Ukraine, rampant inflation, rising interest rates and an underperforming Chinese economy all continued to weigh heavily on our markets, which resulted in a softening of demand for our products. In addition, a rapid downstream inventory accumulation in all our major product categories also suppressed underlying demand. This inventory build began with the lifting of Covid-19 restrictions in late 2021 and the subsequent chronic global logistical bottlenecks which hindered material flows. Recent improvements in global supply chains resulted in a reduction in delivery lead times and a surge in customer inventory levels.

A series of price increases in the previous year neutralised the impact of cost inflation and lower sales volumes in the graphic papers segment. Margins remained healthy but reduced relative to the highs of recent quarters. Sales volumes were down 31% compared to the prior year and production rates were optimised to match sales.

Underlying demand in the packaging and speciality papers segment remained relatively stable. Selling price realisation more than offset the lower sales volumes and supported year-on-year margin expansion for the segment. Sales volumes were down 14% compared to the prior year, driven primarily by the large customer inventory build.

The same market dynamics of elevated retailer stock levels and general concerns over negative consumer sentiment adversely impacted demand for all textile fibres. Viscose staple fibre (VSF) pricing came under pressure and producers lowered their production significantly. As a result, the hardwood dissolving pulp (DP) market price⁽²⁾ followed VSF trends and decreased to US\$900 per ton by quarter end. Despite the recent DP pricing pressures, the net average sales price for the pulp segment was 9% higher than the prior year. The pricing gains were offset by an 8% reduction in sales volumes, linked primarily to low activity in China, and substantially higher costs, which squeezed margins in the segment.

Earnings per share excluding special items for the quarter was 30 US cents, which was a substantial improvement on the 20 US cents in the prior year. Special items increased earnings by US\$6 million due to a positive plantation fair value adjustment.

(1) "year-on-year" or "prior/previous year" is a comparison between Q1 FY2023 versus Q1 FY2022; "quarter-on-quarter" or "prior/previous quarter" is a comparison between Q1 FY2023 and Q4 FY2022.

(2) Market price for imported hardwood dissolving pulp into China issued daily by the CCF Group.

Cash flow and debt

Net cash generated for the quarter was US\$23 million compared to a utilisation of US\$11 million in the prior year. The higher cash generation was due to improved profitability offset somewhat by a larger outflow of working capital due to higher selling prices incorporated into receivables. Capital expenditure of US\$58 million was below last year but in line with our plan and will increase from the second quarter as the Somerset PM2 conversion and expansion project gains momentum.

The improved cash generation contributed to a significant reduction in net debt, which ended the quarter at US\$1,241 compared to the prior year of US\$1,917 million. An increase in net debt compared to the prior quarter was driven by a weakening of the US Dollar, which increased the Euro-denominated debt converted at a higher rate. Liquidity comprised cash on hand of US\$593 million and US\$668 million from the committed unutilised revolving credit facilities (RCF) in South Africa and Europe.

In October 2022, a tender offer to purchase for cash a portion of the outstanding 3.125% Senior Notes due 2026 was concluded. As a result, US\$206 million of the aggregate principal amount of the 2026 bonds in the tender offer was repurchased at a purchase price of 92.41% (plus accrued and unpaid interest).

Outlook

Although the global economy will undoubtedly face significant challenges in 2023, the recent easing of the energy crisis in Europe, slowing of global inflation and the opening of the Chinese economy are positive economic indicators. Nevertheless, the short-term outlook is expected to be negatively impacted by the combination of the final phase of the downstream inventory destocking cycle, the resulting impact on sales volumes across all market segments and the relatively high cost base – albeit this is starting to turn.

The opening of the Chinese economy following the relaxation of Covid-19 restrictions and strengthening of the Renminbi against the US Dollar represents upside potential toward the second half of the calendar year for the DP segment. VSF producer operating rates and pricing are slowly increasing and order activity in China has resumed in recent weeks.

Downstream inventory levels for our paper products declined in recent months but remain at historically elevated levels. It may take a further few months before order activity normalises.

Cost inflation is expected to recede in FY2023. Specifically, lower European natural gas prices are expected to have a positive impact on European costs. Globally, paper pulp prices are expected to decline as new Latin American capacity enters the market. It should be noted that pulp prices in the US and Europe are lagging relative to Asia and therefore it may take time for benefits to be realised. Logistics bottlenecks are steadily improving, and delivery costs are anticipated to reduce through FY2023. Similarly, chemical costs have started to decline in recent weeks.

Capital expenditure is estimated to be US\$430 million for FY2023 and includes US\$70 million for the Somerset PM2 conversion and expansion project.

The divestment of three European mills announced in September 2022 is expected to close during the second quarter. The cash proceeds and receivables will be collected in the second and third quarters.

Factoring in the protracted macroeconomic uncertainty, and coming off three quarters of outperformance, we anticipate a return to a normalised level of earnings in FY2023. The second quarter will likely be the most challenging with a recovery in earnings expected later in the financial year. EBITDA for the second quarter of FY2023 is expected to be below that of the first quarter.

On behalf of the board

SR Binnie
Director

GT Pearce
Director

08 February 2023

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 from 08 February 2023 via the JSE link and also available on the home page of the Sappi website at www.sappi.com.

Copies of the full announcement may be requested by contacting Rosa Moodley on telephone: +27 (0)11 407 8515, email: Rosa.Moodley@sappi.com.

The JSE link is as follows:

<https://senspdf.jse.co.za/documents/2023/jse/isse/SAVVI/sappiQ1.pdf>

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