Sappi Limited

Registration number: 1936/008963/06
JSE code: SAP
ISIN code: ZAE000006284
Issuer code: SAVVI
("Sappi" or "the company")

Second quarter results for the period ended March 2022

Short-form SENS announcement

* N/M not meaningful

	Quarter ended			Half-year ended		
US$ million	**Mar 2022**	**Mar 2021**	% Change	**Mar 2022**	**Mar 2021**	% Change
Sales	1 858	1 284	45%	3 555	2 447	45%
EBITDA excluding special items	337	112	201%	577	210	175%
Profit for the period	188	(23)	N/M	311	(40)	N/M
Net debt	1 793	2 070	-13%	1 793	2 070	-13%
Headline EPS (US Cents)	36	(3)	N/M	58	(7)	N/M
Basic EPS (US Cents)	33	(4)	N/M	55	(7)	N/M
EPS excluding special items (US Cents)	35	(1)	N/M	55	(2)	N/M
Net asset value (US Cents)	417	345	21%	417	345	21%

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 generated EBITDA excluding special items of US$337 million, which was three times that of the prior year. Tight global paper markets were the principal factor behind the quarter's success and enabled the implementation of higher selling prices which offset extraordinary cost inflation. The Russian-Ukrainian conflict triggered renewed volatility in global commodity markets and further disrupted already constrained global supply chains, which intensified cost inflation across all regions and all product segments.

Sales volumes in the pulp segment increased by 9% compared to the prior year on the back of robust demand and improved logistics in South Africa. Pulp sales volumes of 396,000 tons included 51,000 tons of BCTMP[(2)] and market pulp. The hardwood dissolving pulp (DP) market price[(3)] rebounded during the latter part of the quarter following positive momentum in global commodity markets including viscose staple fibre (VSF), cotton and polyester. Rising global paper pulp prices, driven by supply constraints due to unplanned production downtime, provided further support for both DP and BCTMP pricing. DP production volumes for the quarter were approximately 57,000 tons below expectation at Saiccor Mill due to unplanned Eskom[(4)] power outages, raw material supply disruptions and operational challenges which severely disrupted the mill stability. However, the equipment related to the Saiccor Mill expansion project performed in line with expectations. In spite of the negative impacts of congestion and inefficiencies associated with the Durban port, sales volumes were optimised and combined with lower than planned production, effected a reduction of the excess DP inventory from 100,000 tons to 44,000 tons.

A significant recovery in graphic paper demand combined with a reduction in supply, ongoing logistical challenges, and a prolonged labour strike at Finnish paper mills led to an unprecedented global shortage of graphic paper. Sales volumes for the segment increased 12% year-on-year and the tight market dynamics allowed all assets to run at full operating rates during the quarter. In order to compensate for escalating cost pressures, a series of selling price increases and energy/freight surcharges were implemented which facilitated margin restoration for the segment.

Packaging and speciality papers sales volumes grew 13% year-on-year, driven by robust global demand and renewed volume growth in Europe. Successful selling price increases and mix improvement offset rising costs and aided margin expansion for the segment. However, periodic contractual commitments deferred some increases in selling prices, particularly in Europe, that are required to restore margins to normalised levels.

Earnings per share excluding special items for the quarter was 35 US cents, which was a further improvement on the 20 US cents in the prior quarter and was indicative of the steadily improving profitability of the group. Special items for the quarter reflected a net expense of US$29 million, which included a negative plantation fair value adjustment of US$13 million and write-off of fixed assets at European mills of US$20 million.

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(1) "year-on-year" or "prior year" is a comparison between Q2 FY2021 versus Q2 FY2022; "quarter-on-quarter" or "prior quarter" is a comparison between Q1 FY2022 and Q2 FY2022.
(2) BCTMP = Bleached thermos-mechanical pulp.
(3) Market price for imported hardwood dissolving pulp into China issued daily by the CCF Group.
(4) Eskom is a South African electricity public utility.

Cash flow and debt
Net cash generated for the quarter was US$105 million, compared to a utilisation of US$53 million in the prior year. This increase was due to significantly improved operating performance, offset somewhat by a rise in working capital related to the higher sales volumes and the inflationary impact of inventories and accounts receivables. For the quarter, working capital as a ratio to net sales of 10% and capital expenditure of US$69 million were in line with expectations.

Progress towards our FY2022 strategic objective to significantly reduce net debt was bolstered by the strong cash generation during the quarter. Net debt of US$1,793 million was US$277 million less than the prior year and is reflective of the substantially improved profitability of the group. In terms of the relevant banking facilities, the covenant leverage ratio reduced to 2.0 times at the end of March 2022, which was a considerable improvement on the 6.7 times last year and 2.9 times in the prior quarter. Liquidity comprised cash on hand of US$440 million and US$689 million from the undrawn committed revolving credit facilities (RCF) in South Africa and Europe.

Outlook
Markets across all of our key product segments remain encouraging and selling prices continued to rise in April. Continuing tight graphic paper markets provide an opportunity to maintain profitability in Europe and North America. Additionally, the demand in the packaging and specialities segment remains robust.

DP market indicators remain positive despite operating curtailments in April within the textile value chain in China due to another wave of Covid-19 infections. The differential between cotton and VSF prices continues to be elevated, which should support DP pricing. Subsequent to quarter-end, the market price for hardwood DP increased sharply to US$1,100 per ton. The benefit of the improved DP pricing will be realised in the fourth quarter due to the lag in certain contractual pricing. DP sales volumes in the third quarter will be lower than the prior quarter due to scheduled annual maintenance shuts at Cloquet, Ngodwana and Saiccor Mills, which will have an estimated US$50 million impact on profitability.

In early April, heavy rainfall and extreme storms in the KwaZulu-Natal province of South Africa led to widespread flooding and destruction of infrastructure. Saiccor, Tugela and Stanger Mills, as well as the export warehouse facilities at the Durban port, were impacted and production was temporarily halted. There was no material damage to any of the plants and mill operations resumed from 21 April 2022. Although the Port of Durban officially resumed operations, export deliveries could be negatively impacted for some time due to damage to access roads, congestion and limited availability of vessel space. The estimated impact of the floods was described in a SENS announcement issued on 21 April 2022. We anticipate that there will be no material impact on EBITDA for the year. However, after external insurance proceeds, the estimated net loss of approximately US$28 million will be reflected as a special item expense in the third quarter.

An inflationary macroeconomic environment continues to exert pressures on our cost base across all regions. Additionally, geopolitical volatility within Europe poses a risk to energy and natural gas supplies in the region. We therefore anticipate delivery, chemicals and energy costs to increase further in the third quarter. To counteract the cost inflation, we will continue to focus on improved operating efficiencies, price and mix management.

As previously disclosed, capital expenditure is estimated to be US$395 million for FY2022.

In light of the favourable operating environment, the group is in a strong position to maintain the recent momentum and the underlying EBITDA for the third quarter should be consistent with that of the second quarter subject to the impacts of the annual maintenance shuts.

Any reference to future financial performance included in this announcement, has not been reviewed or reported on by the company's auditors.

On behalf of the board

S R Binnie
Director

G T Pearce
Director

12 May 2022

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 12 May 2022 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/2022/jse/isse/SAVVI/sappiQ2022.pdf

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