Chief Financial Officer's Report continued

Section 5
Balance sheet

Summarised balance sheet

US$ million	2021	2020
Property, plant and equipment	3,325	3,103
Right-of-use assets	110	101
Plantations	477	419
Net working capital	403	441
Other assets	364	296
Net post-employment liabilities	(197)	(306)
Other liabilities	(566)	(465)
Employment of capital	3,916	3,589
Equity	1,970	1,632
Net debt	1,946	1,957
Capital employed	3,916	3,589

Sappi has 19 production facilities in 10 countries, capable of producing approximately 3.9 million tons of pulp and 5.5 million tons of paper. For more information on our mills, their production capacities and products, please refer to the **Where we operate** section.

During 2021, capital expenditure for property, plant and equipment was US$374 million. The capacity replacement value of property, plant and equipment for insurance purposes has been assessed at approximately US$22 billion.

Property, plant and equipment
The cost and depreciation related to our property are set out in the table below.

Book value of property, plant and equipment

US$ million	2021	2020
Cost	9,908	9,346
Accumulated depreciation and impairment	6,583	6,243
Net book value	3,325	3,103

The group incurred capital expenditure of US$374 million during the year. This was largely offset by depreciation of US$289 million while the weaker US Dollar resulted in foreign currency translation gains of US$160 million.

Plantations
We regard ownership of our plantations in South Africa as a key strategic resource as it provides access to low cost fibre for pulp production and ensures continuity of supply on an important raw material input source.

The South African region has access to approximately 394,000 hectares of land of which approximately 258,000 hectares are planted with pine and eucalyptus. These plantations provide approximately 67% of the wood requirements for our South African mills.

During the year, there were market price increases coupled with higher average fair value rates. These increases were offset by the rising cost of fuel and an increase in the discount rate. As we manage our plantations on a sustainable basis, the growth for the year was offset by timber felled during the year.

Our plantations are valued on the balance sheet at fair value less the estimated costs of delivery, including harvesting and transport costs. In notes 2.3.4 and 11 to the financial statements, we provide more detail on our accounting policies for plantations, how we manage our plantations as well as the major assumptions used in the calculation of fair value.

Working capital

The component parts of our working capital at the 2021 and 2020 fiscal year ends are shown in the table below:

Net working capital

US$ million	2021	2020
Inventories	841	673
Trade and other receivables	703	584
Trade and other payables and provisions	(1,141)	(816)
Net working capital	403	441

Optimising working capital remains a key focus area for us and appropriate targets are incorporated into the management incentive schemes for all businesses. The working capital investment is seasonal and typically peaks during the third quarter of each financial year.

Net working capital decreased to US$403 million in 2021 from US$441 million in 2020. The material movements in working capital are discussed below:

- Inventories increased by US$168 million, caused mainly by increased inventory levels and an unfavourable currency translation impact of US$25 million.
- Receivables increased by US$119 million following higher net selling prices and increased volumes in the fourth quarter combined with an unfavourable currency translation impact of US$7 million.
- Payables increased by US$325 million largely due to increases in trade payables on higher sales volumes, increases in bonus accruals and accruals for rebates and a favourable currency translation impact of US$40 million.

Post-employment liabilities

We operate various defined benefit pension/lump sum plans, post-employment healthcare subsidies and other employee benefits in the various countries in which we operate. A summary of defined benefit assets and liabilities (pension and post-employment healthcare subsidies) is as follows:

Defined benefit liabilities

US$ million	2021	2020
Defined benefit obligation	(1,523)	(1,600)
Fair value of plan assets	1,329	1,294
Net balance sheet liability	(194)	(306)
Cash contributions to defined benefit plans/subsidies	50	36
Income statement charge (credit) to profit or loss	28	25
Cash contributions deemed 'catch-up'*	30	16

* *'Catch-up' is cash contributions paid to defined benefit plans in excess of current service cost.*

Gross liabilities from all our plans reduced by US$77 million from US$1,600 million to US$1,523 million over the year. The main cause of the reduction was due to an increase in discount rates in regions where we hold significant liabilities.

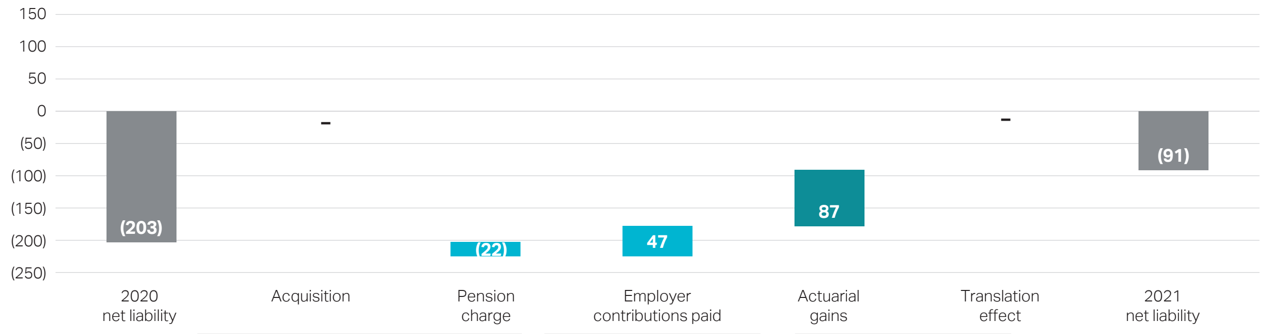
Fair value of plan assets rose by US$35 million from US$1,294 million to US$1,329 million over the year due to favourable investment returns of assets in our funded plans from outperforming bonds.

Included in the net balance sheet liability above is a net loss of US$2 million resulting from movements of local results relative to the reporting currency.

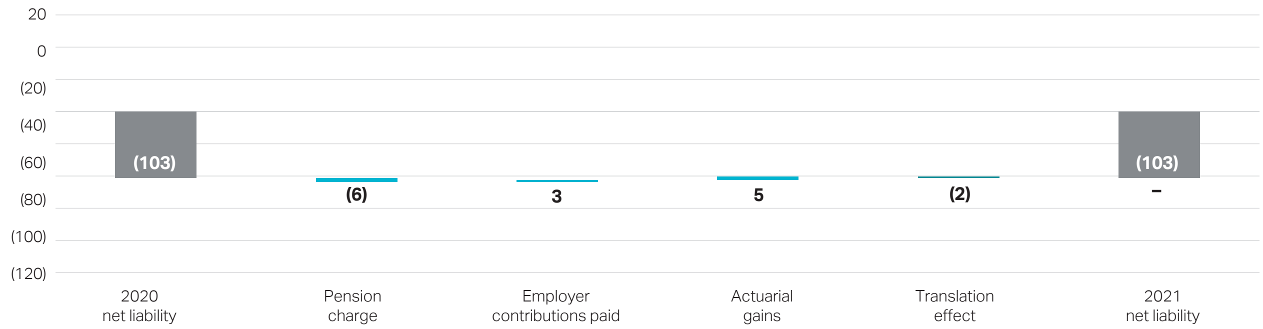
Section 5 continued

The decrease in liabilities, coupled with the increase in assets, contributed to a reduction in the overall net liability by US$112 million from US$306 million to US$194 million over the year. A reconciliation of the movement in the balance sheet over the year is shown graphically below and disclosed in more detail in note 28 of the annual financial statements.

Sappi Limited defined benefit pensions balance sheet movement (US$ million)



Sappi Limited post-retirement medical aid subsidy balance sheet movement (US$ million)



Equity

Year-on-year, equity increased by US$338 million to US$1,970 million as summarised below:

Equity reconciliation US$ million	2021
Equity as at September 2020	1,632
Profit for the year	13
Dividend paid	–
Actuarial gains	90
Issue of shares	26
Convertible bond – equity portion	39
Share-based movements	8
Movement in hedging reserves	(2)
Foreign currency movements	164
Equity as at September 2021	1,970

The group realised a profit for the year of US$13 million and recorded actuarial gains of US$90 million. Convertible bonds were issued during the first quarter and subsequent to shareholder approval the equity portion of the convertible bond of US$39 million was reclassified to equity. During the fourth quarter holders of the convertible bonds elected to convert, and shares to the value of US$26 million were issued. Share-based payments of US$8 million and foreign currency movements of US$164 million accounted for the remainder of the movement during the year.

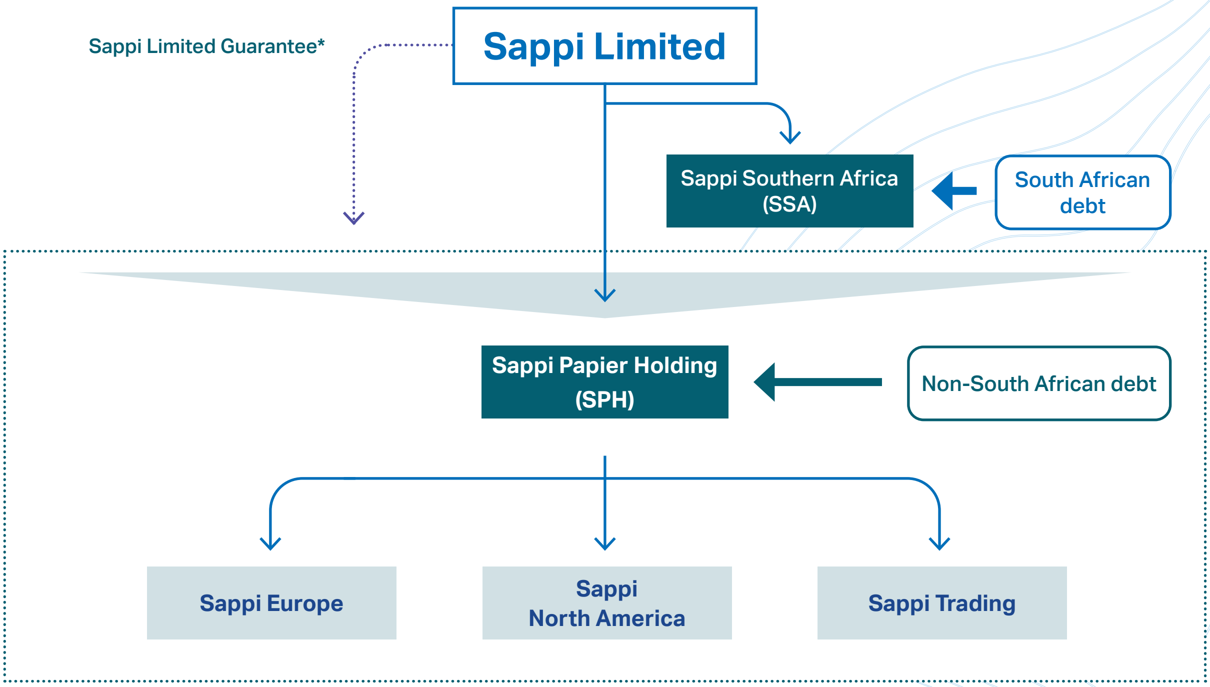
Debt

Debt is a major source of funding for the group. In the management of debt, we focus on net debt, which is the sum of current and non-current interest-bearing borrowings and bank overdrafts, net of cash and cash equivalents.

Debt funding structure

The Sappi group principally takes up debt in two legal entities. Sappi Southern Africa Limited issues debt in the local South African market for its own funding requirements and Sappi Papier Holding GmbH (SPH), which is Sappi's international holding company, issues debt in the international money and capital markets to fund our non-South African businesses. SPH's long-term debt is supported by a Sappi Limited guarantee and the financial covenants on certain of its debt agreements are based on the ratios of the consolidated Sappi Limited group. The covenants applicable to the debt of these two entities and their respective credit ratings are discussed on page 130.

The diagram below depicts our debt funding structure.



* Sappi Limited provides guarantees for long-term non-South African debt.

Section 5
Balance sheet continued

Below we highlight the main financing activities that occurred during the year:

- In November 2020 Sappi Southern Africa placed a new seven-year Convertible Bond, with an interest coupon of 5.25% and a conversion share price of ZAR33.1636, a premium of 32.5% of the share price at the time of bond placement.
- SPH's securitisation programme of €330 million matured in January 2022 and was extended to January 2024 during the fiscal year.
- SPH's EUR350 million 2023 public bond was refinanced and upsized in March 2021, with a new EUR400 million 2028 bond at a coupon of 3.625%.

Structure of net debt and liquidity

We consider the group liquidity position to be sufficient, with cash holdings of US$366 million at financial year end, and US$732 million of unutilised committed revolving credit facilities.

The structure of our net debt at September 2021 and 2020 is summarised below:

US$ million	2021	2020
Long-term debt	**2,157**	1,942
Senior unsecured debt	**1,769**	1,649
Securitisation funding	**337**	256
IFRS 16 *Leases**	**119**	105
Less: Short-term portion	**(67)**	(69)
Net short-term debt/(cash)	**(211)**	15
Overdrafts, revolving credit facility (RCF) and short-term loans	**88**	225
Short-term portion of long-term debt	**67**	69
Less: cash	**(366)**	(279)
Net debt	**1,946**	1,957

* *IFRS 16 accounting standard adopted from fiscal 2020.*

Movement in net debt

The movement of our net debt from fiscal 2020 to fiscal 2021 is summarised in the table below:

	US$ million
Net debt at September 2020	**1,957**
Increase of IFRS 16 *Leases*	**34**
Net impact of SSA Convertible Bond	**(48)**
Net cash generated in 2021	**(29)**
Currency translation, fair value and other non-cash adjustments	**32**
Net debt at September 2021	**1,946**

Group debt profile

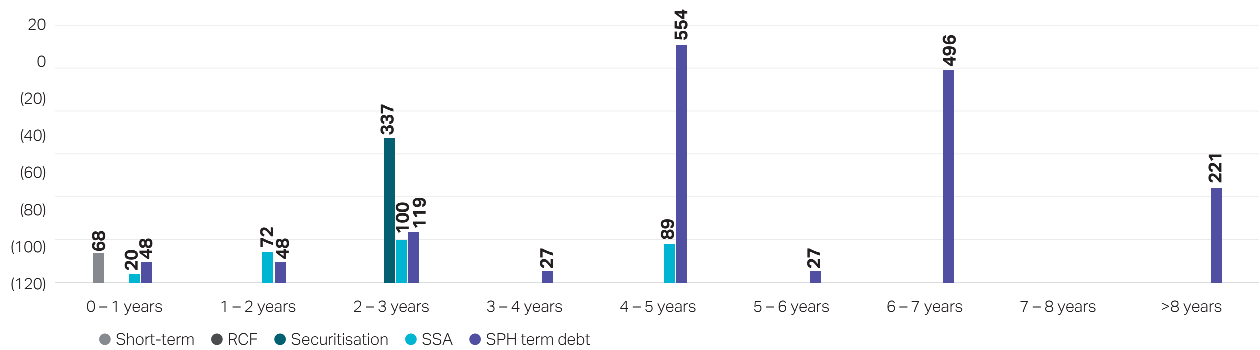
We show the major components and maturities of our net debt at September 2021 below. These are split between our debt in South Africa and our debt outside South Africa.

	Amount US$ million	Interest rates (local currencies)	Fixed/ variable	Maturity (Sappi fiscal years) 2022	2023	2024	2025	Thereafter
South Africa								
Short-term notes	20	6.00%	Variable	20				
SSA07 Public bond	72	6.20%	Fixed		72			
SAA08 Public bond	100	9.25%	Fixed			100		
Convertible bond	89	5.25%	Fixed					89
Gross debt	281							
less cash	(156)			(156)				
Net South African debt	125			(136)	72	100	0	89
Non-South African								
Securitisation (US$)	126	1.70%	Variable			126		
Securitisation (EUR)	210	1.70%	Variable			210		
IFRS 16 *Leases*	120	Various	Mixed	24	20	18	14	44
OeKB term loan 1	134	2.30%	Fixed	21	21	91		
OeKB term loan 2 (CAD)	102	4.10%	Fixed	15	15	15	15	44
OeKB term loan 2 (EUR)	87	1.50%	Fixed	12	12	12	12	37
Other bank debt (EUR)	68	0.30%	Variable	68				
2028 Public bonds (EUR)	469	4.00%	Fixed					
2026 Public bonds (EUR)	527	3.63%	Fixed					469
2032 Bonds (US$)	221	7.50%	Fixed					527
IFRS adjustments	(33)							(33)
Gross debt	2,031							
less cash	(210)			(210)				
Net non-South African debt	1,821			(70)	68	473	40	1,309
Net group debt	1,946			(206)	140	574	40	1,398

The majority of our non-South African long-term debt is guaranteed by Sappi Limited, the group holding company.

A diagram of the debt maturity profile for Sappi fiscal years is shown below:

Debt maturity profile (US$ million)



* *Excludes IFRS 16 lease with an average time to maturity of approximately four years.*

Section 5
Balance sheet continued

Covenants
Non-South African covenants

Financial covenants apply to US$322 million of our non-South African bank debt, the €525 million Revolving Credit Facility and the non-South African securitisation facility.

In view of the uncertainty due to Covid-19 the banking group agreed in 2020 to suspend the measurement of financial covenants until September 2021. This suspension is subject to normal conditions for this kind of assistance and included no dividend payments, maximum capex spending limits, a minimum liquidity requirement and no M&A activity without prior bank approval. Covenant measurement will commence again with effect from the December 2021 quarter. The covenants applicable from December 2021 are described below and are calculated on a rolling last four quarter basis and must be met at the end of each quarter.

- Ratio of group net debt to EBITDA ex SI:

December 2021	March 2022	June 2022	September 2022 to December 2022	March 2023
5.50	5.25	4.75	4.50	4.25

- Ratio of group EBITDA ex SI to net interest expense should not be less than 2.50-to-1.

South African covenants

Separate covenants also apply to the Revolving Credit Facility of our Southern African business.

These covenants are calculated on a rolling last four quarter basis and require that at the end of March and September each year, with regard to Sappi Southern Africa Limited and its subsidiaries:
- the ratio of net debt to equity at the end of March and September is not greater than 65%; and
- the ratio of EBITDA ex SI to net interest paid is not less than 2.5-to-1.

Below we show that for the year ended September 2021 the South African financial covenants were comfortably met.

South African covenants	2021	Covenant
Net debt to equity	**9.15%**	<65%
EBITDA ex SI to net interest	**8.14**	>2.50

In addition to the financial covenants referred to above, our bonds and certain of our bank facilities contain customary affirmative and negative covenants restricting, among other things, the granting of security, incurrence of debt, the provision of loans and guarantees, mergers and disposals and certain restricted payments. As regards dividend payments, in terms of the international bond indentures, any cash dividends paid may not exceed 50% of net profit excluding special items after tax and certain other adjustments, calculated on a cumulative basis.

Credit ratings

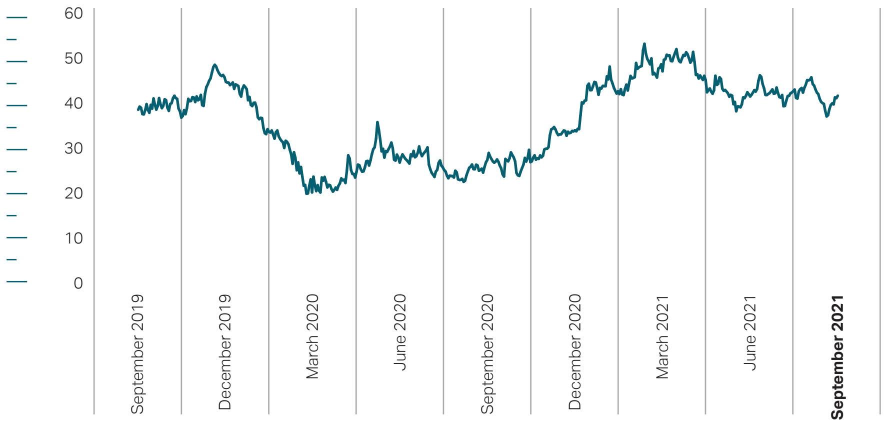
Global Credit Ratings: South African national scale rating Sappi Southern Africa Limited: AA (za)/A1+(za)/Stable Outlook (June 2021)

Moody's
Sappi Corporate Family Rating: Ba2/NP/Negative Outlook (December 2020)
SPH Debt Rating:
- 2028/2026 Bonds: Ba2/Negative Outlook (December 2020)
- 2032 Bonds: B1/Negative Outlook (December 2020)

S&P Global Ratings
Corporate Credit Rating: BB-/B/Stable Outlook (September 2020)
SPH Debt Rating:
- 2026/2028/2032 Bonds: BB- Stable Outlook (September 2020)

Section 6

Share price performance



Conclusion

Demand recovery post the peak of the pandemic exceeded expectations and contributed to an improved liquidity situation at year end. Gearing ratios remain high and the near-term focus will be on strengthening the balance sheet but matching that with delayed maintenance capital expenditure. Additionally, Science Based Targets will require committed capital expenditure and managing cash flows with commitments will be the challenge.

Logistics challenges are expected to persist in the year ahead placing strain on the management of working capital. Finished goods inventory levels and the availability of raw materials to service increased demand levels will require additional focus. The sharp increase in variable costs has emphasised the commitment to driving operational excellence in order to restore margins to sustainable levels.

The four key fundamentals of our Thrive25 strategy are sufficiently flexible to accommodate the intervention of the pandemic and the subsequent recovery. The short-term focus will be to strengthen the balance sheet by reducing debt and maximising cash generation. The medium to longer-term strategy will be to invest in growth opportunities and achieve our sustainability goals.

GT Pearce

Chief Financial Officer

08 December 2021