Chief Financial Officer's report continued

Section 5
Balance sheet

Summarised balance sheet

(US$ million)	2020	2019
Property, plant and equipment	3,103	3,061
Right-of-use assets	101	–
Plantations	419	451
Net working capital	441	452
Other assets	296	291
Net post-employment liabilities	(306)	(298)
Other liabilities	(465)	(508)
Employment of capital	3,589	3,449
Equity	1,632	1,948
Net debt	1,957	1,501
Capital employed	3,589	3,449

Sappi has 19 production facilities in eight countries, capable of producing approximately 4 million tons of pulp and 5.7 million tons of paper. For more information on our mills, their production capacities and products, please refer to the **Where we operate** section.

During 2020, capital expenditure for property, plant and equipment was US$351 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)	2020	2019
Cost	9,348	9,033
Accumulated depreciation and impairment	6,245	5,972
Net book value	3,103	3,061

The group incurred capital expenditure of US$351 million during the year on various capital improvement projects. This was largely offset by depreciation of US$287 million and foreign currency exposure of US$57 million due to the strengthening of the US Dollar against the ZAR and the EUR.

Right-of-use assets

The group adopted International Financial Reporting Standards (IFRS) 16 *Leases* at the beginning of the fiscal year applying the modified retrospective transition approach and did not restate comparatives. This resulted in the group recognising right-of-use assets of US$91 million at adoption.

(US$ million)	2020	2019
Cost	126	–
Accumulated depreciation	(25)	–
Net book value	101	–

Section 5 continued

Plantations

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

We currently have access to approximately 534,000 hectares of owned, leased and contracted land of which approximately 399,000 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 2020 and 2019 fiscal year-ends are shown in the table below:

Net working capital

(US$ million)	2020	2019
Inventories	673	709
Trade and other receivables	584	718
Trade and other payables and provisions	(816)	(975)
Net working capital	441	452

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$441 million in 2020 from US$452 million in 2019. The material movements in working capital are discussed below:

- Inventories decreased by US$36 million, caused mainly by reduced inventory levels. This was partially offset by an unfavourable currency translation impact of US$3 million
- Receivables decreased by US$134 million following lower net selling prices and decreased volumes in the fourth quarter. This was partially offset by an unfavourable currency translation impact of US$16 million
- Payables decreased by US$159 million largely due to a reduction in trade payables due to lower sales volumes, decreases in bonus accruals, accruals for capital expenditure and rebates and an unfavourable currency translation impact of US$1 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:

Chief Financial Officer's report continued

Section 5 continued

Defined benefit liabilities

(US$ million)	2020	2019
Defined benefit obligation	(1,600)	(1,525)
Fair value of plan assets	1,294	1,227
Net balance sheet liability	(306)	(298)
Cash contributions to defined benefit plans/subsidies	36	36
Income statement charge (credit) to profit or loss	25	26
Cash contributions deemed 'catch-up'*	16	17

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

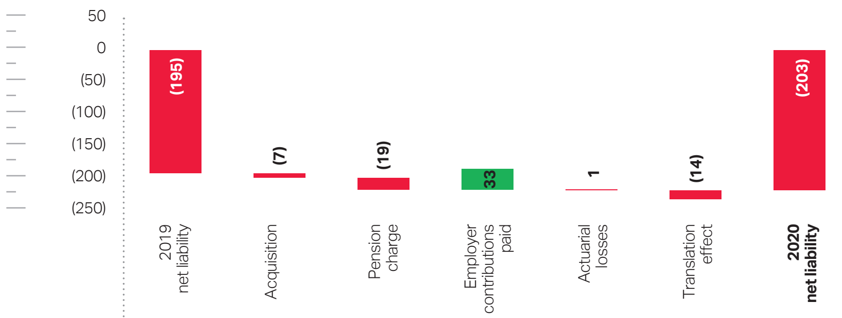
Gross liabilities from all our plans increased by US$75 million from US$1,525 million to US$1,600 million over the year. The main cause of the increase was due to a drop in discount rates in regions where we hold significant liabilities.

Fair value of plan assets rose by US$67 million from US$1,227 million to US$1,294 million over the year due to favourable investment returns of assets in our funded plans from outperforming bonds.

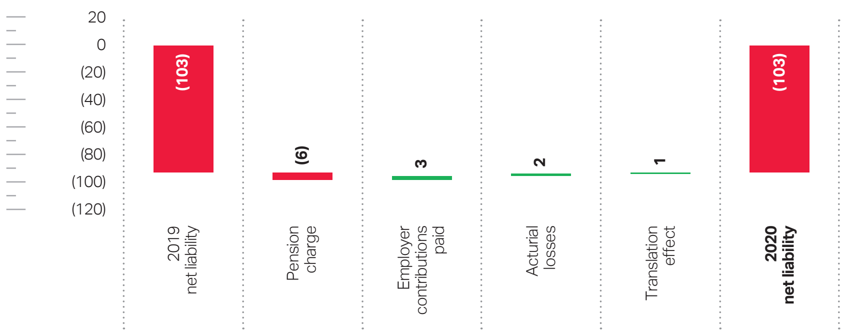
Included in the net balance sheet liability above is a net loss of US$12 million resulting from movements of local results relative to the reporting currency.

The increase in liabilities exceeded the increase in assets, which contributed to an increase in the overall net liability by US$8 million from US$298 million to US$306 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 Group 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)



Section 5 continued

Equity

Year-on-year, equity decreased by US$316 million to US$1,632 million as summarised below:

Equity reconciliation

(US$ million)	2020
Equity as at September 2019	1,948
Profit (loss) for the year	(135)
Dividend paid	–
Actuarial losses	(31)
Share-based movements and other	9
Movement in hedging reserves	3
Foreign currency movements	(162)
Equity as at September 2020	1,632

The group incurred a loss for the year of US$135 million, actuarial losses of US$31 million, adverse foreign currency movements of US$162 million offset by share-based payments and movements in hedging reserves of US$12 million.

Debt

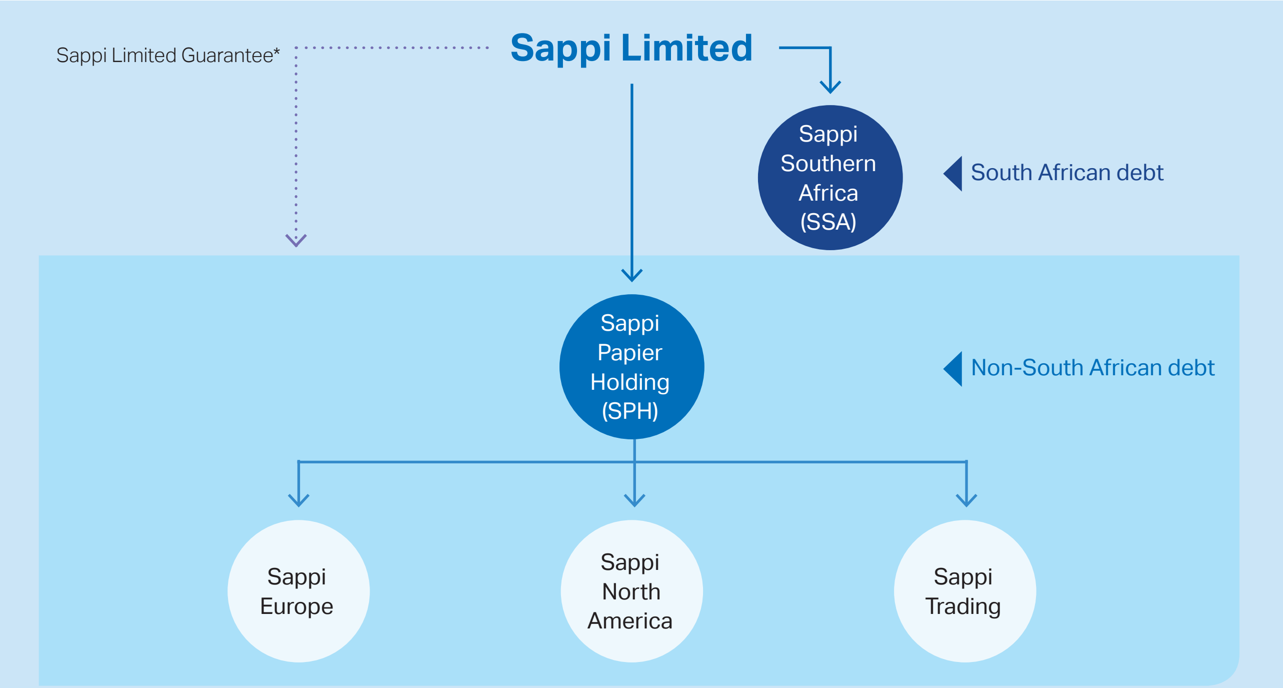
Debt is a major source of funding for the group. In the management of debt, we focus on net debt, which is the sum of current and non-current interest-bearing borrowings and bank overdrafts, net of cash and cash equivalents.

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 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 the pages that follow.

Chief Financial Officer's report continued

The diagram below depicts our debt funding structure.



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

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

- In November 2019 the acquisition of Matane Mill in Canada was finalised. The purchase price was financed with a new eight-year term loan from the Oesterreichische Kontrollbank in Austria. The term loan has a 74 million tranche and a CAD129 million tranche, with both tranches amortising in equal instalments from December 2021 to December 2027.
- Sappi Southern Africa had two debt maturities in fiscal 2020, the SSA06 ZAR745 million bond maturing in April 2020 and the ZAR400 million term loan with the Land Bank. These maturities were refinanced with a new bond, the 2023 SSA07 ZAR1,080 million bond, together with available cash resources.

Structure of net debt and liquidity

We consider the group liquidity position to be sufficient, with cash holdings of US$279 million at financial year end, and US$582 million of unutilised committed RCFs.

The structure of our net debt at September 2020 and 2019 is summarised below:

(US$ million)	2020	2019
Long-term debt	**1,942**	1,713
Senior unsecured debt	**1,649**	1,465
Securitisation funding	**256**	366
IFRS16 *Leases**	**105**	–
Less: Short-term portion	**(69)**	(118)
Net short-term debt/(cash)	**15**	(212)
Overdrafts, RCF and short-term loans	**225**	64
Short-term portion of long-term debt	**69**	118
Less: cash	**(279)**	(393)
Net debt	**1,957**	1,501

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

Movement in net debt

The movement of our net debt from fiscal 2019 to fiscal 2020 is summarised in the table below:

	US$ million
Net debt at September 2019	1,501
First time adoption of IFRS 16 *Leases*, at year end	105
Cash impact of IFRS 16 *Leases*, during fiscal 2020	23
Net cash paid for Matane acquisition	160
Net cash utilised in 2020	97
Currency translation, fair value and other non-cash adjustments	71
Net debt at September 2020	1,957

Group debt profile

We show the major components and maturities of our net debt at September 2020 below. These are split between our debt in South Africa and our debt outside South Africa.

				Maturity (Sappi fiscal years)				
	Amount US$ million	Interest rates (local currencies)	Fixed/ variable	2021	2022	2023	2024	Thereafter
South Africa								
Short-term notes	41	4.77%	Variable	41				
Private placement	88	9.25%	Fixed				88	
2023 Bond	63	8.06%	Variable			63		
Gross debt	191							
less cash	(59)			(59)				
Net South African debt	132			(19)	0	63	88	0
Non-South African								
Securitisation (US$)	98	1.50%	Variable		98			
Securitisation (EUR)	158	1.40%	Variable		158			
IFRS 16 *Leases*	105	Various	Mixed	24	18	15	14	34
OeKB term loan 1	24	1.40%	Fixed	24				
OeKB term loan 2	154	2.30%	Fixed	21	21	21	21	70
OeKB term loan 3 (CAD)	96	4.10%	Fixed		14	14	14	55
OeKB term loan 3 (EUR)	86	1.50%	Fixed		12	12	12	49
Other bank debt (EUR)	69	0.30%	Variable	68	0.3	0.4	0.2	0
Revolving credit facility	116	1.80%	Variable	116				
2023 Public bonds (EUR)	407	4.00%	Fixed			407		
2026 Public bonds (EUR)	523	3.13%	Fixed					523
2032 Bonds (US$)	221	7.50%	Fixed					221
IFRS adjustments	(14)							(14)
Gross debt	2,045							
less cash	(220)			(220)				
Net non-South African debt	1,825			33	332	470	62	938
Net group debt	1,957			14	322	533	149	938

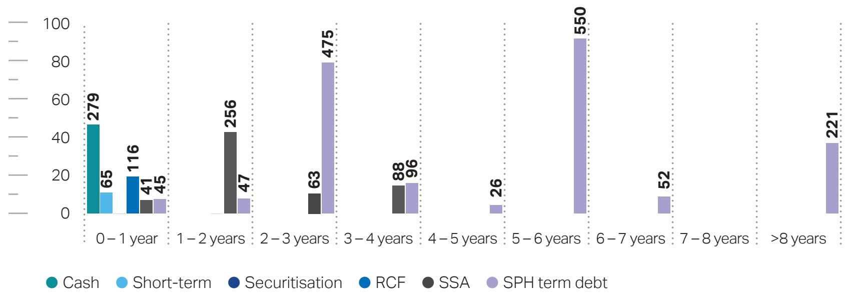
The majority of our non-South African long-term debt is guaranteed by Sappi Limited, the group holding company.

Chief Financial Officer's report continued

Section 5 continued

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

Debt maturity profile (US$ million)



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

Covenants

Non-South African covenants

Financial covenants apply to US$360 million of our non-South African bank debt, the €525 million RCF and the non-South African securitisation facility.

However, in view of the uncertainty due to Covid-19 the banking group has agreed to suspend the measurement of financial covenants until September 2021. This suspension is subject to normal conditions for this kind of assistance, which only apply during the suspension period, and include 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.

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.

South African covenants

Separate covenants also apply to the RCF 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 to net interest paid is not less than 2.5-to-1.

Below we show that for the year ended September 2020 the South African financial covenants were comfortably met.

South African covenants	2020	Covenant
Net debt to equity	11.82%	<65%
EBITDA to net interest	7.61	>2.50

Section 5 continued

Credit ratings

Global Credit Ratings: South African national rating
Sappi Southern Africa Limited: AA (za)/A1+(za)/Stable Outlook (June 2020)

Moody's
Sappi Corporate Family Rating: Ba2/NP/Stable Outlook (February 2020)
SPH Debt Rating:

- 2023/2026 Bonds and RCF: Ba2/Stable Outlook (February 2020)
- 2032 Bonds: B1

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

- 2023/2026/2032 Bonds and RCF: BB- Stable Outlook (September 2020)

Section 6

Share price performance

Sappi share price – September 2018 to September 2020.

Sappi share price – September 2017 to September 2020 (ZAR/share)

Conclusion

The consequences of the pandemic will have a prolonged impact on the Sappi business and will change the timing of our long-term plans but not the principles. In the short to medium term we will focus on sustainable financial health and driving operational excellence. Strengthening the balance sheet by reducing debt, growing EBITDA and cash generation and optimising processes globally will receive the highest attention.

The medium- to long-term strategy will focus on new opportunities by expansions or conversions with a view to commercialising new products at scale. Opportunities in our growth segments of DP and packaging and speciality papers will be explored in conjunction will growth in adjacent businesses. Underlying all the above initiatives will be a drive towards finding sustainable solutions with our customers and communities to meet the changing business and environmental needs.

Fiscal 2020 provided challenges few would have anticipated. We have weathered the storm and vindicated earlier strategic decisions. The year ahead will be challenging, but less so when compared to the year before.

GT Pearce
CFO