

Chief Financial Officer's report continued

Section 2 Financial performance

The discussion in this section focuses on the group financial performance in 2020 compared with 2019. A detailed discussion, in local currencies, of each of our three operating regions follows in section 3.

Income statement

Our group financial results can be summarised as follows:

(Metric tons '000)	2020	2019	% change
Sales volume	6,788	7,622	(11)
US\$ million			
Sales revenue	4,609	5,746	(20)
Variable manufacturing and delivery costs	(2,838)	(3,530)	(20)
Fixed costs	(1,673)	(1,771)	(6)
Sundry items ⁽¹⁾	(41)	(43)	(5)
Operating profit excluding special items	57	402	(86)
Special items	(95)	(19)	-
Operating profit	(38)	383	(110)
Net finance costs	(88)	(85)	4
Taxation	(9)	(87)	(90)
Net profit	(135)	211	(164)
EPS excluding special items (US cents)	(5)	44	(111)

⁽¹⁾ Sundry items include all income and costs not directly related to manufacturing operations such as debtor securitisation costs, commissions paid and received and results of equity accounted investments.

Sales volume

In 2020, sales volume decreased by 834,000 tons compared with 2019. The regional and product segment contributions to sales volume are shown below:

Sales volume (metric tons '000)	2020	2019	% change
North America	1,516	1,379	10
Europe	2,698	3,241	(17)
South Africa	2,574	3,002	(14)
Group	6,788	7,622	(11)
Dissolving pulp	1,315	1,284	2
Packaging and specialities	1,209	1,129	7
Graphics	3,096	3,846	(20)
Forestry	1,168	1,363	(14)

In North America, increases in the packaging and speciality paper and the acquisition of Matane Mill more than offset the reduced DP sales volumes and reduced graphics volumes due to the impact of Covid-19 on market demand.

European volumes decreased by 17% with lower demand in the mechanical coated and coated woodfree markets. The packaging and speciality product segments were in line with previous years' volumes.

Volumes in South Africa decreased by 14% mainly in DP and graphics segments due to the effect of the pandemic. A shift in seasonal changes caused packaging volumes to be marginally down on the previous year.

Capacity utilisation reduced to an average of 78% for the group as weak DP and graphic markets forced us to take 1.1 million tons of production downtime during the year.

Sales volume to capacity	2020 %	2019 %
North America	85	82
Europe	73	88
South Africa	81	94
Group	78	88

Sales revenue

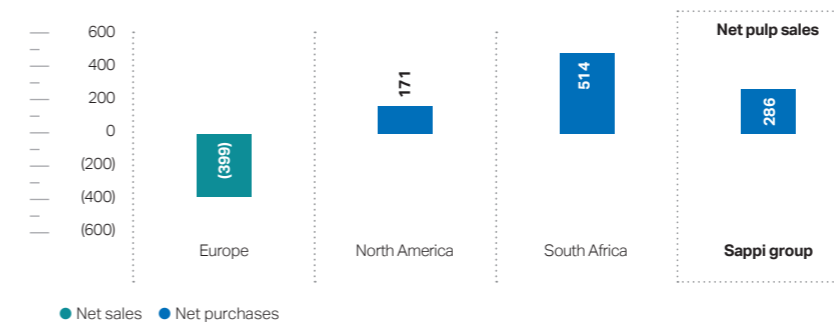
Sales revenue decreased by 20% from US\$5.8 billion in 2019 to US\$4.6 billion in 2020. Selling price and mix changes resulted in sales revenue declining by US\$846 million. Consolidated volumes were down on last year as discussed on the previous page resulting in sales revenue declining by US\$224 million. The stronger US Dollar resulted in a negative US\$67 million conversion impact.

Variable and delivery costs

Variable and delivery costs decreased by US\$692 million from 2019. This is in line with sales volume reductions.

The net pulp purchases and sales of the Sappi group is detailed in the graph below.

Group pulp balance (US\$ million)



The table below reflects the breakdown of variable and delivery costs by type.

Variable manufacturing and delivery costs (US\$ million)	2020	2019	% change
Wood	561	624	(10)
Energy	352	417	(16)
Chemicals	679	811	(16)
Pulp and other	851	1,243	(32)
Delivery	395	435	(9)
Group	2,838	3,530	(20)

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Fixed costs

Fixed costs decreased by US\$98 million from fiscal 2019. This decrease was mainly due to lower personnel cost (US\$56 million) and maintenance cost (US\$18 million) offset by a higher depreciation charge (US\$35 million) as a result of the increased capital spend and the acquisition of Matane. The weaker ZAR and EUR resulted in a decrease in US Dollar costs (US\$44 million). Excluding the currency impact fixed costs decreased by US\$54 million.

Details of the make-up of fixed costs are provided in the table below.

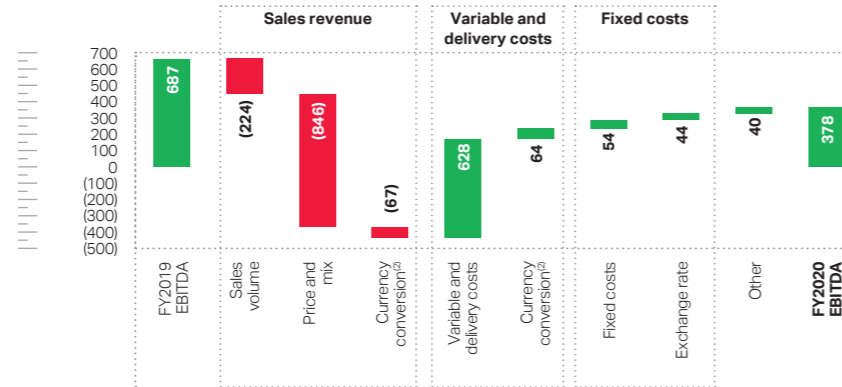
Fixed costs (US\$ million)	2020	2019	% change
Personnel	959	1,014	(6)
Maintenance	217	234	(8)
Depreciation	313	277	13
Other	184	246	(24)
Group	1,673	1,771	(6)

EBITDA and operating profit excluding special items

EBITDA excluding special items decreased to US\$378 million, 45% lower than the previous year. Operating profit excluding special items declined from US\$402 million last year to US\$57 million in 2020.

The EBITDA bridge reflected in the graph below shows the impact on profitability from lower sales volumes and selling prices offset by reduced variable and fixed costs.

Reconciliation of EBITDA excluding special items: 2020 compared to 2019⁽¹⁾



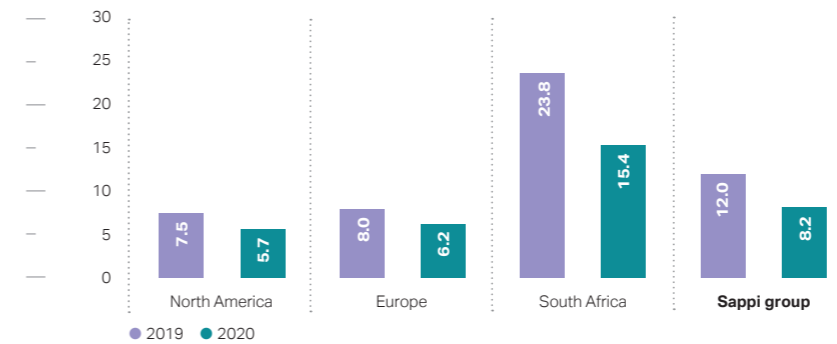
⁽¹⁾ All variances were calculated excluding Sappi Forestry.

⁽²⁾ 'Currency conversion' reflects translation and transactional effect on consolidation.

The tables below detail the EBITDA and operating profit excluding special items of the business for both 2020 and 2019 and the margins of each.

EBITDA excluding special items by region (US\$ million)	2020	2019
North America	79	110
Europe	143	232
South Africa	151	339
Corporate and other	5	6
Group	378	687

EBITDA margin by region (%)



EBITDA excluding special items by product category (US\$ million)	2020	2019
Dissolving pulp	63	304
Packaging and specialties	179	126
Graphics	131	251
Other	5	6
Group	378	687

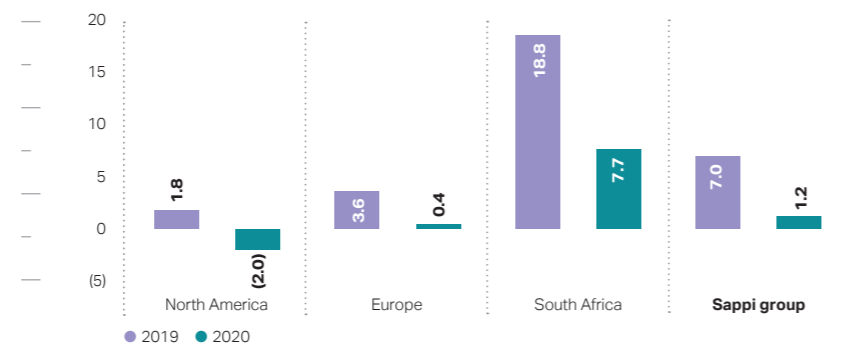
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Operating profit excluding special items by region (US\$ million)	2020	2019
North America	(27)	27
Europe	8	104
South Africa	75	267
Corporate and other	1	4
Group	57	402

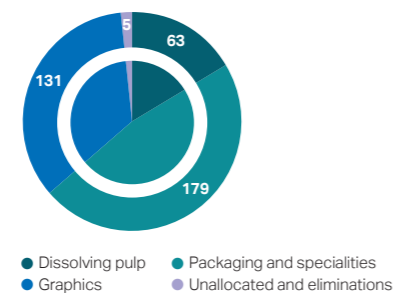
Operating profit margin by region (%)



Operating profit excluding special items by product category (US\$ million)	2020	2019
Dissolving pulp	(2)	245
Packaging and specialities	88	52
Graphics	(30)	101
Other	1	4
Group	57	402

The chart below illustrate that 65% of the group's EBITDA originates from growing markets in the DP and packaging and speciality segments. The graphics segment, which contributes 35% of the EBITDA remains an important strategic component of our business.

EBITDA excluding special items by product 2020: US\$379 million



For information regarding the financial performance of the regions, please refer to section 3 of this report.

Key operating targets

Our financial targets and performance against the key operating targets are dealt with in the Letter to Shareholders section.

Special items

Special items consist of those items that management believe are material, by nature or amount, to the results for the year and require separate disclosure. A breakdown of special items for 2020 and 2019 is reflected in the table below:

Special items – gain/(loss) (US\$ million)	2020	2019
Plantation price fair value adjustment	20	19
Acquisition costs	(6)	(2)
Net restructuring provisions	(34)	–
Profit (loss) on disposal and written off assets	1	(11)
Net asset (impairment) reversals	(15)	(10)
Equity accounted investees impairments	(19)	–
Fire, flood, storm and other events	(42)	(15)
Total	(95)	(19)

The net impact of special items in 2020 was US\$95 million. The major components are described below:

- A positive non-cash US\$20 million plantation price fair value adjustment was recognised following increases to the market price of timber
- Matane acquisition costs amounted to US\$6 million
- The announced closure of Stockstadt's PM2 resulted in restructuring charges of US\$18 million and asset impairment charges of US\$11 million and the closure of Westbrook's PM9 and energy complex resulted in restructuring charges of US\$12 million and asset impairment charges of US\$4 million
- The group's Lignotech equity investment was fully impaired by US\$10 million and its' equity accounted forestry investment was impaired by US\$9 million
- Fire, flood, storm and other events includes turbine damage at the Stockstadt and Alfeld Mills of US\$18 million, fire damaged timber of US\$11 million in South Africa, general closure costs at Stockstadt Mill of US\$4 million, business interruption costs of US\$3 million at Kirkniemi Mill, a settlement accrual of US\$2 million and US\$2 million of bond issuance costs

Net finance costs

(US\$ million)	2020	2019
Finance costs	93	98
Finance income	(5)	(9)
Net foreign exchange gains	–	(4)
Total	88	85

Finance costs of US\$88 million were higher than the prior due to higher net debt following the Matane Mill acquisition and cash utilisation throughout the year due to the impact from Covid-19 on sales volumes and lower average DP prices.

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Taxation

A regional breakdown of the tax charge is provided below.

(US\$ million)	Profit (loss) before tax	Tax (charge) relief	Effective tax rate %
Europe	(103)	9	(9)
North America	(75)	(18)	24
South Africa	52	-	1
Total	126	(9)	7

In Europe, the total tax relief mainly relates to the reassessment and consequent increase in the deferred tax asset and settlements in tax audits at Austrian subsidiaries. This was partially offset by a derecognition of the deferred tax asset in Belgium.

In North America, the company derecognised the deferred tax asset for its US operations after reassessing the recoverability of accumulated losses over the next five years.

The South African tax charge on annual taxable profits is offset by a positive impact from the settlement of a tax audit.

Net profit, earnings per share and dividends

After taking into account net finance costs and taxation, our net profit and earnings per share for 2020, with comparatives for 2019, were as follows:

(US\$ million)	2020	2019
Operating profit	(38)	383
Net finance costs	88	85
Profit (loss) before taxation	(126)	298
Taxation	9	87
Profit (loss) for the period	(135)	211
Weighted average number of shares in issue (millions)	545.5	542.0
Basic earnings per share (US cents)	(25)	39

The directors have elected not to declare a dividend and temporarily halt dividends until such time as market conditions improve.

Section 3

Below we discuss the performance of the regional businesses. The discussion is based on performance in local currencies as we believe this facilitates a better understanding of the revenue and costs in the European and Southern African operations.

North America

(Metric tons '000)	2020	2019	% change
Sales volume	1,516	1,379	10
Dissolving pulp	453	285	59
Packaging and specialities	330	190	74
Graphics	733	904	(19)

	US\$ million 2020	US\$ million 2019	% change	US\$ per ton 2020	US\$ per ton 2019	% change
Sales	1,385	1,466	(6)	914	1,063	(14)
Variable manufacturing and delivery costs	(968)	(924)	5	(639)	(670)	(5)
Contribution	417	542	(23)	275	393	(30)
Fixed costs	(508)	(501)	1	(335)	(363)	(8)
Sundry costs and consolidation entries	64	(14)	(557)	42	(10)	(520)
Operating profit excluding special items	(27)	27	(200)	(18)	20	(190)
EBITDA excluding special items	79	110	(28)	52	80	(35)

EBITDA of US\$79 million was 28% lower than the previous year while EBITDA margin declined from 8% to 6%. The lower profitability was due mainly to the lower DP prices and the impact of Covid-19 on graphics and DP demand. Higher packaging and specialties sales due to the continued ramp-up of the paperboard business and the strong demand for C1S packaging during the pandemic offset some of the sales miss in DP and graphics. As a result of the weak graphics market, the region took 187,000 tons of production downtime to balance supply with balance and to lower fixed costs. During the year, the acquisition of the Matane Mill was completed and the integration of the mill proceeded as planned. Volume for 2020 include 208,000 tons of pulp sales from the Matane Mill. Excluding this volume, sales tons were down 5% versus the previous year.

Europe

(Metric tons '000)	2020	2019	% change
Sales volume	2,698	3,241	(17)
Packaging and specialities	478	477	0
Graphics	2,220	2,764	(20)

	€ million 2020	€ million 2019	% change	€ per ton 2020	€ per ton 2019	% change
Sales	2,067	2,587	(20)	766	798	(4)
Variable manufacturing and delivery costs	(1,268)	(1,707)	(26)	(470)	(527)	(11)
Contribution	799	880	(9)	296	271	9
Fixed costs	(722)	(762)	(5)	(268)	(235)	14
Sundry costs and consolidation entries	(70)	(25)	180	(25)	(7)	257
Operating profit excluding special items	7	93	(92)	3	29	(90)
EBITDA excluding special items	128	206	(38)	47	64	(27)

Market conditions for graphic paper in Europe were challenging as demand shrunk by 20%. The European operations were able to reduce the impact of the demand reduction by increasing market share but were nevertheless forced to take 727,000 tons of production downtime during the year. Selling prices were resilient in the face of the declining demand as the region managed the effects of the lower demand. Packaging and speciality volumes were in line with the previous year as growth in the food packaging sectors was offset by reductions in the luxury goods markets.