sappi

Second quarter results for the period ended March 2019

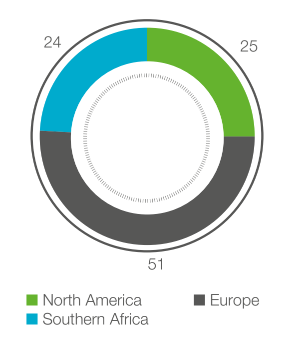
2nd quarter results

Sappi is a global diversified woodfibre company focused on providing dissolving wood pulp, packaging and speciality papers, printing and writing papers as well as biomaterials and biochemicals to our direct and indirect customer base across more than 150 countries.

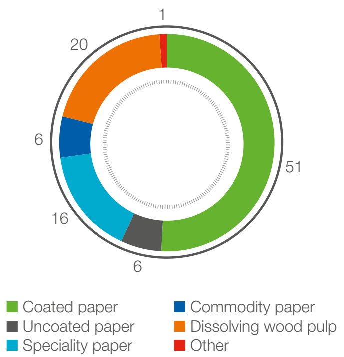
Our dissolving wood pulp products are used worldwide mainly by converters to create viscose fibre for fashionable clothing and textiles, as well as other consumer products; quality packaging and speciality papers are used in the manufacture of such products as soup sachets, luxury carry bags, cosmetic and confectionery packaging, boxes for agricultural products for export, tissue wadding for household tissue products and casting release papers used by suppliers to the fashion, textiles, automobile and household industries; our market-leading range of printing and writing papers are used by printers in the production of books, brochures, magazines, catalogues, direct mail and many other print applications; biomaterials include nanocellulose, fibre composites and lignosulphonate; biochemicals include second generation sugars.

The wood and pulp needed for our products are either produced within Sappi or bought from accredited suppliers. Sappi sells almost as much as it buys.

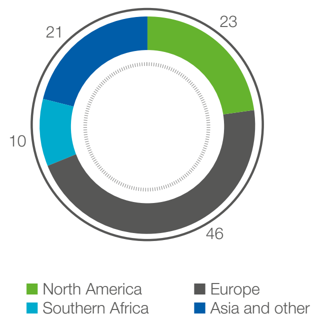
Sales by source* (%)



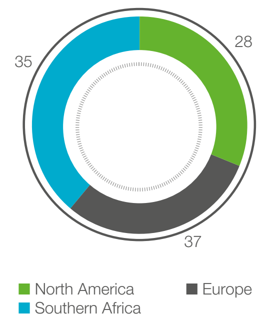
Sales by product* (%)



Sales by destination* (%)



Net operating assets** (%)



** For the period ended March 2019. ** As at March 2019.*

Highlights for the quarter

EBITDA excluding special items
US$187 million
(Q2 2018 US$211 million)

EPS excluding special items
13 US cents
(Q2 2018 17 US cents)

Profit for the period
US$72 million
(Q2 2018 US$102 million)

Net debt
US$1,680 million
(Q2 2018 US$1,632 million)

	Quarter ended			Half-year ended	
	Mar 2019	Mar 2018	Dec 2018	**Mar 2019**	Mar 2018
Key figures: (US$ million)					
Sales	**1,503**	1,496	1,418	**2,921**	2,826
Operating profit excluding special items[1]	**117**	142	128	**245**	247
Special items – loss (gain)[2]	**–**	(12)	5	**5**	(23)
EBITDA excluding special items[1]	**187**	211	197	**384**	383
Profit for the period	**72**	102	81	**153**	165
Basic earnings per share (US cents)	**13**	19	15	**28**	31
EPS excluding special items (US cents)[3]	**13**	17	16	**29**	31
Net debt[3]	**1,680**	1,632	1,557	**1,680**	1,632
Key ratios: (%)					
Operating profit excluding special items to sales	**7.8**	9.5	9.0	**8.4**	8.7
Operating profit excluding special items to capital employed (ROCE)[3]	**13.1**	16.8	14.7	**13.6**	14.8
EBITDA excluding special items to sales	**12.4**	14.1	13.9	**13.2**	13.6
Net debt to EBITDA excluding special items	**2.1**	2.2	2.0	**2.1**	2.2
Interest cover[3]	**10.5**	11.0	10.9	**10.5**	11.0
Net asset value per share (US cents)[3]	**366**	365	353	**366**	365

(1) *Refer to note 2 to the group results for the reconciliation of EBITDA excluding special items and operating profit excluding special items to segment operating profit, and profit for the period.*
(2) *Refer to note 2 to the group results for details on special items.*
(3) *Refer to supplemental information for the definition of the term.*

Commentary on the quarter

Graphic paper markets were much weaker than expected during the quarter, with demand in our major product categories down between 8% and 13% in Europe and North America. Consequently, we were compelled to take production downtime of 85,000 tons across our paper machines in these regions. Also, raw material costs, particularly pulp, continued to be elevated, packaging and specialities markets were inconsistent and the ramp-up of recently converted paper packaging machines was ongoing. Against this difficult backdrop, the group generated EBITDA excluding special items of US$187 million, 11% below that of the equivalent quarter last year. Profit for the period decreased from US$102 million to US$72 million due to the lower operating profit, higher depreciation charge and profit on the sale of property included in the prior year.

Dissolving wood pulp (DWP) sales volumes increased following the debottlenecking of the Saiccor and Ngodwana mills in the past year, and a strong operating performance from the DWP mills. Lower viscose staple fibre (VSF) prices, due to an oversupplied market, contributed towards Chinese DWP market prices declining throughout the quarter. The weaker Rand/US Dollar exchange rate and the quarter lag in contracted pricing benefited the South African DWP business, resulting in higher Rand prices for the quarter. Demand from our major customers remained healthy.

Packaging and specialities markets were mixed, with solid containerboard demand in addition to a recovery in the consumer packaging market offset by continued weakness in the self-adhesives and release paper segment. Packaging and specialities sales volumes for the group were 18% higher year-on-year.

Ongoing weak demand for graphics papers in European and export markets due to general economic uncertainty, the impact from higher selling prices and the related commercial downtime, lowered margins in the European business despite higher selling prices.

US coated paper market conditions weakened considerably during the quarter as a result of weaker end-use demand and a customer inventory correction following a series of selling price increases implemented in 2018. DWP sales volumes rose year-on-year, while average US Dollar net sales prices were flat. Somerset PM1 continued to ramp up paperboard production, and total packaging and specialities sales were 77% up on last year.

The South African business delivered another excellent performance, with increased DWP sales volumes and higher average net selling prices for all major product categories more than offsetting higher energy and fibre cost pressures.

Earnings per share excluding special items was 13 US cents, a decrease from the 17 US cents generated in the equivalent quarter last year. Special items were neutral for the quarter.

Cash flow and debt

Net cash utilised for the quarter was US$148 million primarily as a result of the 2018 dividend payment of US$92 million, an increase in working capital due to the timing of month end and self-funded capital expenditure relating mainly to the Saiccor expansion and the Lanaken conversion projects.

Cash taxes for the quarter were US$43 million, a decrease of US$7 million compared to the equivalent quarter last year.

Net debt of US$1,680 million rose US$48 million year-on-year as a result of the cash utilised in the quarter as mentioned above, offset by the benefits of a weaker Euro/US Dollar exchange rate on the translation of Euro denominated debt.

Liquidity comprised cash on hand of US$720 million and US$658 million available from the undrawn committed revolving credit facilities in South Africa and Europe. The cash on hand was inflated at quarter end by the proceeds of a new seven-year Euro 450 million bond issued during March to repay the Euro 450 million bond maturing in 2022 in full post-quarter end.

Operating review for the quarter

Europe

€ million	Quarter ended Mar 2019	Dec 2018	Sept 2018	Jun 2018	Mar 2018
Sales	**675**	642	671	636	616
Operating profit excluding special items	**24**	30	38	31	37
Operating profit excluding special items to sales (%)	***3.6***	*4.7*	*5.7*	*4.9*	*6.0*
EBITDA excluding special items	**50**	59	71	60	64
EBITDA excluding special items to sales (%)	***7.4***	*9.2*	*10.6*	*9.4*	*10.4*
RONOA pa (%)	***6.9***	*8.8*	*11.3*	*9.3*	*11.7*

The European business was affected by the ongoing weakness in graphic paper markets. The reduction in demand moved below the long-term trend because of a general economic slowdown in the region combined with the impact from a series of selling price increases implemented in 2018. Higher net selling prices were insufficient to offset weaker graphic paper sales volumes and higher variable costs.

Industry shipments of coated woodfree and coated mechanical paper declined 11% and 9% respectively during the quarter, with both domestic and export markets under pressure. Consequently, we took 46,000 tons of production downtime on our paper machines to manage inventory levels and match production to demand. Average net selling prices for the graphics grades were 9% higher year-on-year.

The packaging and specialities paper business increased volumes by 25% compared to the prior year primarily due to a full quarter of volumes from the Cham Paper acquisition which was concluded at the end of February 2018 and the ramp-up of Maastricht during the quarter. The economic situation also impacted certain products in this segment, resulting in lower sales. Demand for flexible packaging volumes recovered during the quarter, however, the self-adhesives market remains weak due to tepid demand in the automotive sector. Average net selling prices were 9% higher than the previous year.

Variable costs in Euro were 12% higher year-on-year, driven primarily by softwood and hardwood pulp costs that were 24% and 9% higher respectively. However, pulp, energy and chemical costs declined compared to the prior quarter. Fixed costs were 6% higher, mainly due to the inclusion of Cham Paper fixed costs for a full quarter.

Operating review for the quarter continued

North America

	Quarter ended				
US$ million	**Mar 2019**	Dec 2018	Sept 2018	Jun 2018	Mar 2018
Sales	**378**	351	388	339	363
Operating profit (loss) excluding special items	**10**	9	31	1	18
Operating profit (loss) excluding special items to sales (%)	***2.6***	*2.6*	*8.0*	*0.3*	*5.0*
EBITDA excluding special items	**31**	29	51	20	37
EBITDA excluding special items to sales (%)	***8.2***	*8.3*	*13.1*	*5.9*	*10.2*
RONOA pa (%)	***3.4***	*3.2*	*10.9*	*0.4*	*6.8*

Improved DWP and packaging sales volumes and higher graphic paper sales prices were insufficient to offset weak graphic paper demand and input cost pressures, resulting in an operating profit that declined year-on-year.

Coated paper demand in the US market weakened further during the quarter, with the latest industry statistics showing a 9.5% demand decline through the first two months of the quarter, a situation which was exacerbated for domestic producers by an increase in imports. Factors which contributed to the weak demand included a series of selling price increases implemented in 2018 which resulted in an inventory build by customers throughout the year and affected downstream demand. We took 39,000 tons of production downtime in the quarter to manage inventory levels and match production to demand.

DWP sales volumes increased year-on-year due to good customer demand, while net sales prices were constant.

The ramp-up of Somerset PM1 paperboard grades progressed, with commercial paperboard sales volumes 68% higher than the prior quarter. Much of this volume is lower margin food service board rather than the SBS board which will ultimately fill most of this machine capacity as qualification and customer acceptance processes are completed. These markets require complex and lengthy qualification processes, which impacted machine optimisation and efficiency and therefore profitability.

Variable costs, which were 12% higher year-on-year, were impacted negatively by high paper pulp costs and to a lesser extent wood, chemicals and energy. Paper pulp list prices declined during the quarter, alleviating some of the pressure on purchased paper pulp arising from the additional DWP production. Fixed costs remain well managed and were 2% higher.

Southern Africa

ZAR million	Quarter ended **Mar 2019**	Dec 2018	Sept 2018	Jun 2018	Mar 2018
Sales	**5,234**	4,981	5,103	4,383	4,548
Operating profit excluding special items	**1,121**	1,217	1,081	553	950
Operating profit excluding special items to sales (%)	***21.4***	*24.4*	*21.2*	*12.6*	*20.9*
EBITDA excluding special items	**1,374**	1,446	1,344	742	1,168
EBITDA excluding special items to sales (%)	***26.3***	*29.0*	*26.3*	*16.9*	*25.7*
RONOA pa (%)	***21.1***	*24.0*	*22.4*	*11.9*	*20.9*

Improved average net selling prices and DWP sales volumes contributed to a stronger operating performance for the Southern African business.

DWP sales volumes increased compared to both comparative quarters, while a weaker Rand/US Dollar exchange rate benefited Rand selling prices.

Packaging sales volumes were below those of last year following a seasonal shift in containerboard sales volumes to the prior quarter. Sales prices improved for all major packaging categories, and matched variable cost pressures. Newsprint and office paper sales volumes were flat year-on-year, however, sales price increases in this segment lagged variable cost rises, leading to reduced margins.

Fixed costs rose 5% year-on-year, while variable costs were 15% higher driven by energy, wood and pulp costs.

Directorate

The board is pleased to announce the appointment of Mr James Lopez as independent non-executive director with effect from 01 March 2019.

Outlook

DWP demand from our major customers remains healthy. The expanded production capacity, following the debottlenecking of Saiccor and Ngodwana in 2018, is fully sold. Our DWP contract sales prices lag Chinese market prices by a quarter and therefore the decline in market prices over the past few months along with planned maintenance downtime at all three of our DWP mills will impact margins and profitability in the third quarter.

Packaging and speciality markets, with the exception of release and self-adhesive papers, are growing. Raw material prices remain a concern for non-integrated mills, however, pulp and chemical costs have started to decline recently. The ramp-up and product mix optimisation process continues at Somerset and Maastricht as qualification and customer acceptance work is completed. Demand for South African packaging products is expected to be strong.

Graphic paper markets remain weak, and despite expected closures or conversions by competitors, it may take the remainder of the calendar year before sufficient capacity is removed to allow operating rates and margins to recover. Some relief may be expected from lower input costs going forward as paper pulp and some chemical prices have reduced in recent months. The conversion of Lanaken PM8 to coated woodfree from coated mechanical will be completed during the third quarter, with some negative impact on production and fixed costs due to machine downtime in the interim.

Capital expenditure for the remainder of 2019 is expected to be approximately US$370 million as we continue the transition towards growing and higher margin segments. Major projects include the 110kt expansion project at Saiccor and the conversion of Lanaken PM8 from coated mechanical to coated woodfree paper production as well as the recently completed pulp mill debottlenecking at Cloquet.

Given the current weak market conditions for graphic paper, DWP pricing pressure from oversupplied VSF markets and our more conservative outlook on the global economy, the second half and full year profitability are now expected to be below that of last year.

On behalf of the board

S R Binnie
Director

G T Pearce
Director

09 May 2019

Forward-looking statements

Certain statements in this release that are neither reported financial results nor other historical information, are forward-looking statements, including but not limited to statements that are predictions of or indicate future earnings, savings, synergies, events, trends, plans or objectives. The words "believe", "anticipate", "expect", "intend", "estimate", "plan", "assume", "positioned", "will", "may", "should", "risk" and other similar expressions, which are predictions of or indicate future events and future trends and which do not relate to historical matters, and may be used to identify forward-looking statements. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors which are in some cases beyond our control and may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements (and from past results, performance or achievements). Certain factors that may cause such differences include but are not limited to:

- *the highly cyclical nature of the pulp and paper industry (and the factors that contribute to such cyclicality, such as levels of demand, production capacity, production, input costs including raw material, energy and employee costs, and pricing);*
- *the impact on our business of a global economic downturn;*
- *unanticipated production disruptions (including as a result of planned or unexpected power outages);*
- *changes in environmental, tax and other laws and regulations;*
- *adverse changes in the markets for our products;*
- *the emergence of new technologies and changes in consumer trends including increased preferences for digital media;*
- *consequences of our leverage, including as a result of adverse changes in credit markets that affect our ability to raise capital when needed;*
- *adverse changes in the political situation and economy in the countries in which we operate or the effect of governmental efforts to address present or future economic or social problems;*
- *the impact of restructurings, investments, acquisitions, dispositions and other strategic initiatives (including related financing), any delays, unexpected costs or other problems experienced in connection with dispositions or with integrating acquisitions or implementing restructuring and other strategic initiatives and achieving expected savings and synergies; and*
- *currency fluctuations.*

We undertake no obligation to publicly update or revise any of these forward-looking statements, whether to reflect new information or future events or circumstances or otherwise.

Condensed group income statement

US$ million	Note	Quarter ended Mar 2019	Quarter ended Mar 2018	Reviewed Half-year ended Mar 2019	Reviewed Half-year ended Mar 2018
Sales		**1,503**	1,496	**2,921**	2,826
Cost of sales		**1,290**	1,244	**2,486**	2,365
Gross profit		**213**	252	**435**	461
Selling, general and administrative expenses		**87**	106	**187**	200
Other operating expenses		**10**	(7)	**10**	(6)
Share of profit from equity investments		**(1)**	(1)	**(2)**	(3)
Operating profit	3	**117**	154	**240**	270
Net finance costs		**20**	21	**37**	36
Net interest expense		**21**	23	**40**	39
Interest capitalised		**–**	(1)	**–**	(1)
Net foreign exchange gain		**(1)**	(1)	**(3)**	(2)
Profit before taxation		**97**	133	**203**	234
Taxation		**25**	31	**50**	69
Profit for the period		**72**	102	**153**	165
Basic earnings per share (US cents)	4	**13**	19	**28**	31
Weighted average number of shares in issue (millions)		**542.7**	538.7	**541.3**	537.2
Diluted earnings per share (US cents)	4	**13**	19	**28**	30
Weighted average number of shares on fully diluted basis (millions)		**549.3**	549.4	**548.8**	549.2

Condensed group statement of other comprehensive income

	Quarter ended		Reviewed Half-year ended	
US$ million	**Mar 2019**	Mar 2018	**Mar 2019**	Mar 2018
Profit for the period	**72**	102	**153**	165
Other comprehensive income, net of tax				
Items that will not be reclassified subsequently to profit or loss	**–**	–	**–**	(19)
Tax rate change[1]	**–**	–	**–**	(19)
Items that may be reclassified subsequently to profit or loss	**(3)**	43	**(25)**	149
Exchange differences on translation of foreign operations	**2**	44	**(17)**	141
Movements in hedging reserves	**(6)**	(3)	**(10)**	9
Tax effect of above items	**1**	2	**2**	(1)
Total comprehensive income for the period	**69**	145	**128**	295

[1] *For the half-year ended March 2018, there were tax rate changes in various countries resulting in a US$17 million taxation charge recorded through the income statement and US$19 million through other comprehensive income.*

Condensed group balance sheet

US$ million	Note	Reviewed Mar 2019	Sept 2018
ASSETS			
Non-current assets		**3,747**	3,766
Property, plant and equipment		**2,990**	3,010
Plantations	5	**466**	466
Deferred tax assets		**99**	106
Goodwill and intangible assets		**60**	63
Equity-accounted investees		**32**	33
Other non-current assets		**100**	88
Current assets		**2,278**	1,904
Inventories		**804**	741
Trade and other receivables		**737**	767
Derivative financial assets		**6**	21
Taxation receivable		**11**	12
Cash and cash equivalents		**720**	363
Total assets		**6,025**	5,670
EQUITY AND LIABILITIES			
Shareholders' equity			
Ordinary shareholders' interest		**1,987**	1,947
Non-current liabilities		**2,482**	2,550
Interest-bearing borrowings		**1,759**	1,818
Deferred tax liabilities		**337**	335
Other non-current liabilities		**386**	397
Current liabilities		**1,556**	1,173
Interest-bearing borrowings		**641**	97
Overdrafts		**–**	16
Trade and other payables		**870**	1,009
Provisions		**7**	6
Derivative financial liabilities		**6**	6
Taxation payable		**32**	39
Total equity and liabilities		**6,025**	5,670
Number of shares in issue at balance sheet date (millions)		**542.7**	539.3

Condensed group statement of cash flows

	Quarter ended		Reviewed Half-year ended	
US$ million	**Mar 2019**	Mar 2018	**Mar 2019**	Mar 2018
Profit for the period	**72**	102	**153**	165
Adjustment for:				
Depreciation, fellings and amortisation	**88**	88	**174**	168
Taxation	**25**	31	**50**	69
Net finance costs	**20**	21	**37**	36
Defined post-employment benefits paid	**(12)**	(12)	**(22)**	(22)
Plantation fair value adjustments	**(29)**	(25)	**(49)**	(57)
Asset impairments	**11**	–	**11**	–
Asset impairment reversals	**(8)**	–	**(8)**	–
Net restructuring provisions	**–**	(2)	**–**	(2)
(Profit) loss on disposal and written off assets	**3**	(9)	**3**	(9)
Other non-cash items[1]	**12**	–	**30**	8
Cash generated from operations	**182**	194	**379**	356
Movement in working capital	**(80)**	(35)	**(167)**	(118)
Net finance costs paid	**(20)**	(15)	**(25)**	(21)
Taxation (paid) refund	**(43)**	(50)	**(46)**	(44)
Dividend paid	**(92)**	(81)	**(92)**	(81)
Cash generated from operating activities	**(53)**	13	**49**	92
Cash utilised in investing activities	**(95)**	(238)	**(204)**	(331)
Capital expenditure	**(95)**	(119)	**(201)**	(207)
Proceeds on disposal of assets	**1**	10	**1**	10
Acquisition of subsidiary	**–**	(132)	**–**	(132)
Other non-current asset movements	**(1)**	3	**(4)**	(2)
Net cash (utilised) generated	**(148)**	(225)	**(155)**	(239)
Cash effects of financing activities	**531**	60	**533**	118
Proceeds from interest-bearing borrowings	**552**	64	**558**	122
Repayment of interest-bearing borrowings	**(21)**	(4)	**(25)**	(4)
Net movement in cash and cash equivalents	**383**	(165)	**378**	(121)
Cash and cash equivalents at beginning of period	**350**	618	**363**	550
Translation effects	**(13)**	6	**(21)**	30
Cash and cash equivalents at end of period	**720**	459	**720**	459

[1] *Other non-cash items for the half-year ended March 2019 primarily relate to non-cash movements in the defined benefit liabilities and plan assets of US$17 million (2018: US$8 million).*

Condensed group statement of changes in equity

US$ million	Reviewed Half-year ended Mar 2019	Mar 2018
Balance – beginning of period	**1,947**	1,747
Total comprehensive income for the period	**128**	295
Shareholders for dividend	**(92)**	(81)
Transfers from the share purchase trust	**–**	3
Transfers of vested share options	**–**	(1)
Share-based payment reserve	**4**	5
Balance – end of period	**1,987**	1,968
Comprising		
Ordinary share capital and premium	**838**	1,025
Non-distributable reserves	**133**	144
Foreign currency translation reserves	**(176)**	(162)
Hedging reserves	**(37)**	(27)
Retained earnings	**1,229**	988
Total equity	**1,987**	1,968

Notes to the condensed group results

1. Basis of preparation

The condensed consolidated interim financial statements for the quarter and half-year ended March 2019 are prepared in accordance with the International Financial Reporting Standards, IAS 34 *Interim Financial Reporting*, the SAICA Financial Reporting Guides as issued by the Accounting Practices Committee and Financial Pronouncements as issued by Financial Reporting Standards Council and the requirements of the Companies Act of South Africa. The accounting policies applied in the preparation of these interim financial statements are in terms of International Financial Reporting Standards as issued by the IASB and are consistent with those applied in the previous annual financial statements except those new standards adopted and set out below under “adoption of accounting standards in the current year”.

The preparation of these condensed consolidated interim financial statements was supervised by the Chief Financial Officer, G T Pearce, CA(SA) and were authorised for issue on 9 May 2019.

The condensed consolidated interim financial statements for the half-year ended March 2019 have been reviewed in accordance with the International Standard on Review Engagements 2410 by the group’s auditors, KPMG Inc. Their unmodified review report is available for inspection at the company’s registered office. The auditor’s report does not necessarily report on all of the information contained in this announcement/financial results. Shareholders are therefore advised that in order to obtain a full understanding of the nature of the auditor’s engagement they should obtain a copy of the auditor’s report together with the accompanying financial information from the issuer’s registered office. Any reference to future financial performance included in this announcement, has not been reviewed or reported on by the company’s auditors.

Adoption of accounting standards in the current year

The group has adopted the following standards and amendments to standards during the current year, all of which had no material impact on the group’s reported results or financial position:

IFRS 9 *Financial Instruments*

IFRS 9 sets out a new classification and measurement approach for financial assets that reflects the business model in which the assets are managed and their cash flow characteristics. The three principal classification categories for financial assets are: measured at amortised cost, fair value through profit or loss and fair value through other comprehensive income. The new classification did not have a significant impact compared to the previous accounting for financial assets under IAS 39. IFRS 9 replaced the “incurred loss” model in IAS 39 with a forward-looking “expected credit loss” (ECL) model. The group applied the practical expedient in IFRS 9 to calculate the ECL on trade receivables using a provision matrix. The application of the ECL model did not result in a material impact compared to the previous accounting under IAS 39. With respect to hedging, a new non-distributable equity reserve was created called “cost of hedging reserve”. This reserve is used to separate all time value of money and forward-point valuations on hedged instruments, as required per IFRS 9. This resulted in an increase to retained earnings and a decrease to this “cost of hedging reserve” of US$4 million on adoption of IFRS 9.

IFRS 15 *Revenue from Contracts with Customers*

Revenue is derived principally from the sale of goods to customers and is measured at the fair value of the amount received or receivable after the deduction of trade and settlement discounts, rebates and customer returns. For the majority of local and regional sales, transfer occurs at the point of offloading the shipment into the customer’s warehouse whereas for the majority of export sales, transfer occurs when the goods have been loaded onto the relevant carrier unless the contract of sale specifies different terms.

The adoption of IFRS 15 resulted in the group recognising revenue from delivery activities as a separate performance obligation when control of the goods pass to customers at the point when the goods have been loaded onto the relevant carrier for export sales. Given that the group is acting as an agent in these activities, revenue is recognised when the delivery is arranged which is considered to be at the point of loading of the goods resulting in no significant timing differences compared to revenue recognition under IAS 18. The related delivery costs have been set off against this revenue based on agent accounting principles whereas these were previously included in cost of sales. Refer to note 2 for the quantitative impact of this adjustment. The group elected to adopt IFRS 15 on a cumulative effect method.

Notes to the condensed group results continued

2. Segment information

Metric tons (000's)	Quarter ended Mar 2019	Quarter ended Mar 2018	Half-year ended Mar 2019	Half-year ended Mar 2018
Sales volume				
North America	**350**	347	**671**	690
Europe	**842**	847	**1,651**	1,669
Southern Africa – Pulp and paper	**418**	413	**814**	796
Forestry	**306**	254	**623**	502
Total	**1,916**	1,861	**3,759**	3,657
Which consists of:				
Dissolving wood pulp	**350**	302	**647**	589
Packaging and specialities papers	**273**	231	**525**	429
Printing and writing papers	**987**	1,074	**1,964**	2,137
Forestry	**306**	254	**623**	502

US$ million	Quarter ended Mar 2019	Quarter ended Mar 2018	Reviewed Half-year ended Mar 2019	Reviewed Half-year ended Mar 2018
Sales				
North America	**378**	363	**729**	705
Europe	**767**	756	**1,499**	1,429
Southern Africa – Pulp and paper	**355**	359	**684**	658
Forestry	**18**	18	**37**	34
Delivery costs revenue adjustment[2]	**(15)**	–	**(28)**	–
Total	**1,503**	1,496	**2,921**	2,826
Which consists of:				
Dissolving wood pulp	**308**	279	**571**	520
Packaging and specialities papers	**312**	254	**594**	450
Printing and writing papers	**880**	945	**1,747**	1,822
Forestry	**18**	18	**37**	34
Delivery costs revenue adjustment[2]	**(15)**	–	**(28)**	–

[2] *Relates to delivery costs netted off against revenue. Refer to note 1, IFRS 15 adoption.*

2. Segment information continued

US$ million	Quarter ended Mar 2019	Quarter ended Mar 2018	Reviewed Half-year ended Mar 2019	Reviewed Half-year ended Mar 2018
Operating profit (loss) excluding special items				
North America	**10**	18	**19**	17
Europe	**27**	45	**61**	82
Southern Africa	**80**	79	**165**	148
Unallocated and eliminations[1]	**–**	–	**–**	–
Total	**117**	142	**245**	247
Which consists of:				
Dissolving wood pulp	**77**	69	**154**	131
Packaging and specialities papers	**10**	25	**23**	41
Printing and writing papers	**30**	48	**68**	75
Unallocated and eliminations[1]	**–**	–	**–**	–
Special items – (gains) losses				
North America	**13**	–	**13**	2
Europe	**1**	(1)	**5**	1
Southern Africa	**(14)**	(13)	**(17)**	(29)
Unallocated and eliminations[1]	**–**	2	**4**	3
Total	**–**	(12)	**5**	(23)
Segment operating profit (loss)				
North America	**(3)**	18	**6**	15
Europe	**26**	46	**56**	81
Southern Africa	**94**	92	**182**	177
Unallocated and eliminations[1]	**–**	(2)	**(4)**	(3)
Total	**117**	154	**240**	270
EBITDA excluding special items				
North America	**31**	37	**60**	55
Europe	**57**	78	**124**	147
Southern Africa	**98**	97	**199**	181
Unallocated and eliminations[1]	**1**	(1)	**1**	–
Total	**187**	211	**384**	383
Which consists of:				
Dissolving wood pulp	**92**	83	**183**	158
Packaging and specialities papers	**29**	38	**59**	65
Printing and writing papers	**65**	91	**141**	160
Unallocated and eliminations[1]	**1**	(1)	**1**	–

[1] *Includes the group's treasury operations and our insurance captive.*

Notes to the condensed group results continued

2. Segment information continued

Reconciliation of EBITDA excluding special items and operating profit excluding special items to segment operating profit and profit for the period

Special items cover those items which management believe are material by nature or amount to the operating results and require separate disclosure.

	Quarter ended		Reviewed Half-year ended	
US$ million	**Mar 2019**	Mar 2018	**Mar 2019**	Mar 2018
EBITDA excluding special items	**187**	211	**384**	383
Depreciation and amortisation	**(70)**	(69)	**(139)**	(136)
Operating profit excluding special items	**117**	142	**245**	247
Special items – gains (losses)	**–**	12	**(5)**	23
Plantation price fair value adjustment	**10**	6	**13**	22
Acquisition costs	**–**	(2)	**–**	(2)
Net restructuring provisions	**–**	2	**–**	2
Profit (loss) on disposal and written off assets	**(3)**	9	**(3)**	9
Asset impairments	**(11)**	–	**(11)**	–
Asset impairment reversals	**8**	–	**8**	–
Black Economic Empowerment charge	**–**	(1)	**–**	(1)
Fire, flood, storm and other events	**(4)**	(2)	**(12)**	(7)
Segment operating profit	**117**	154	**240**	270
Net finance costs	**(20)**	(21)	**(37)**	(36)
Profit before taxation	**97**	133	**203**	234
Taxation	**(25)**	(31)	**(50)**	(69)
Profit for the period	**72**	102	**153**	165

2. Segment information continued

US$ million	Reviewed Half-year ended Mar 2019	Mar 2018
Segment assets		
North America	**1,184**	1,090
Europe	**1,586**	1,652
Southern Africa	**1,502**	1,545
Unallocated and eliminations[1]	**19**	4
Total	**4,291**	4,291
Reconciliation of segment assets to total assets		
Segment assets	**4,291**	4,291
Deferred tax assets	**99**	93
Cash and cash equivalents	**720**	459
Trade and other payables	**870**	908
Provisions	**7**	5
Derivative financial instruments	**6**	7
Taxation payable	**32**	45
Total assets	**6,025**	5,808

[1] *Includes the group's treasury operations and our insurance captive.*

3. Operating profit

US$ million	Quarter ended Mar 2019	Mar 2018	Reviewed Half-year ended Mar 2019	Mar 2018
Included in operating profit are the following items:				
Depreciation and amortisation	**70**	69	**139**	136
Fair value adjustment on plantations (included in cost of sales)				
Changes in volume				
Fellings	**18**	19	**35**	32
Growth	**(19)**	(19)	**(36)**	(35)
	(1)	–	**(1)**	(3)
Plantation price fair value adjustment	**(10)**	(6)	**(13)**	(22)
	(11)	(6)	**(14)**	(25)
Net restructuring provisions	**–**	(2)	**–**	(2)
(Profit) loss on disposal and written off assets	**3**	(9)	**3**	(9)
Asset impairment reversals	**(8)**	–	**(8)**	–
Asset impairments	**11**	–	**11**	–

Notes to the condensed group results continued

4. Earnings per share

US$ million	Quarter ended Mar 2019	Quarter ended Mar 2018	Reviewed Half-year ended Mar 2019	Reviewed Half-year ended Mar 2018
Basic earnings per share (US cents)	**13**	19	**28**	31
Headline earnings per share (US cents)	**14**	18	**29**	30
EPS excluding special items (US cents)	**13**	17	**29**	31
Weighted average number of shares in issue (millions)	**542.7**	538.7	**541.3**	537.2
Diluted earnings per share (US cents)	**13**	19	**28**	30
Diluted headline earnings per share (US cents)	**14**	17	**29**	29
Weighted average number of shares on fully diluted basis (millions)	**549.3**	549.4	**548.8**	549.2
Calculation of headline earnings				
Profit for the period	**72**	102	**153**	165
(Profit) loss on disposal and written off assets	**3**	(9)	**3**	(9)
Asset impairment reversals	**(8)**	–	**(8)**	–
Asset impairments	**11**	–	**11**	–
Tax effect of above items	**(2)**	3	**(2)**	3
Headline earnings	**76**	96	**157**	159
Calculation of earnings excluding special items				
Profit for the period	**72**	102	**153**	165
Special items after tax	**–**	(8)	**5**	(16)
Special items	**–**	(12)	**5**	(23)
Tax effect	**–**	4	**–**	7
Tax special items	**–**	–	**–**	19
Earnings excluding special items	**72**	94	**158**	168

5. Plantations

Plantations are stated at fair value less cost to sell at the harvesting stage. In arriving at plantation fair values, the key assumptions are estimated prices less cost of delivery, discount rates and volume and growth estimations.

Mature timber that is expected to be felled within 12 months from the end of the reporting period is valued using unadjusted current market prices. Mature timber that is to be felled in more than 12 months from the reporting date is valued using a 12 quarter rolling historical average price. Immature timber is valued using a discounted cash flow method taking into account the growth cycle of a plantation.

The fair value of plantations is a Level 3 measure in terms of the fair value measurement hierarchy as established by IFRS 13 *Fair Value Measurement*.

	Reviewed	
US$ million	**Mar 2019**	Sept 2018
Fair value of plantations at beginning of year	**466**	458
Gains arising from growth	**36**	69
In-field inventory	**(3)**	1
Gain arising from fair value price changes	**13**	27
Harvesting – agriculture produce (fellings)	**(35)**	(66)
Translation difference	**(11)**	(23)
Fair value of plantations at end of period	**466**	466

6. Financial instruments

The group's financial instruments that are measured at fair value on a recurring basis consist of derivative financial instruments, available-for-sale financial assets and a contingent consideration liability. These have been categorised in terms of the fair value measurement hierarchy as established by IFRS 13 *Fair Value Measurement* per the table below.

		Fair value[1]	
US$ million	Fair value hierarchy	**Reviewed Mar 2019**	Reviewed Sept 2018
Investment funds[2]	Level 1	**7**	7
Derivative financial assets	Level 2	**6**	21
Derivative financial liabilities	Level 2	**6**	6
Contingent consideration liability[3]	Level 3	**5**	7

[1] *The fair value of the financial instruments are equal to their carrying value.*
[2] *Included in other non-current assets.*
[3] *Included in other non-current liabilities and trade and other payables.*

Notes to the condensed group results continued

6. Financial instruments continued

There have been no transfers of financial assets or financial liabilities between the categories of the fair value hierarchy.

The fair value of all external over-the-counter derivatives is calculated based on the discount rate adjustment technique. The discount rate used is derived from observable rates of return for comparable assets or liabilities traded in the market. The credit risk of the external counterparty is incorporated into the calculation of fair values of financial assets and own credit risk is incorporated in the measurement of financial liabilities. The change in fair value is therefore impacted by the movement of the interest rate curves, by the volatility of the applied credit spreads, and by any changes to the credit profile of the involved parties.

The contingent consideration is based on a multiple of targeted future earnings, of which a weighted average outcome has been considered.

There are no financial assets and liabilities that have been remeasured to fair value on a non-recurring basis.

The carrying amounts of other financial instruments which include cash and cash equivalents, accounts receivable, certain investments, accounts payable, bank overdrafts and current interest-bearing borrowings approximate their fair values.

7. Capital commitments

	Reviewed	
	Mar 2019	Sept 2018
Contracted	**255**	293
Approved but not contracted	**328**	381
	583	674

8. Material balance sheet movements

Cash and interest-bearing borrowings

On 26 March the group raised an aggregate principal amount of €450 million (US$505 million) in new senior unsecured notes due 2026 at a coupon of 3.125% per annum. The proceeds from these notes were used to redeem the full amount of the group's €450 million senior (US$505 million) unsecured notes due 2022 on 10 April as the group exercised its option to early redeem these notes. The coupon on the notes redeemed was 3.375%. The senior unsecured notes due 2022 of €450 million (US$505 million) were reclassified to short term in the quarter in view of the impending repayment of the notes shortly after quarter-end.

Inventories and trade and other payables

The increase in inventories and decrease in trade and other payables is largely attributable to seasonal working capital movements.

9. Related parties

There has been no material change, by nature or amount, in transactions with related parties since the 2018 financial year-end except for The Boldt Company which is no longer considered a related party.

10. Accounting standards, interpretations and amendments to existing standards that are not yet effective

There has been no significant change to managements estimates in respect of new accounting standards, amendments and interpretations to existing standards that have been published which are not yet effective and which have not yet been adopted by the group. Management is in the process of completing their assessment of IFRS 16 *Leases*.

11. Events after the balance sheet date

On 10 April the group redeemed its senior unsecured notes of €450 million (US$505 million) due 2022 as it exercised its option to early redeem these notes.

Supplemental information (this information has not been audited or reviewed)

General definitions

Average – averages are calculated as the sum of the opening and closing balances for the relevant period divided by two

Broad-based Black Economic Empowerment (BBBEE) charge – represents the IFRS 2 non-cash charge associated with the BBBEE transaction implemented in fiscal 2010 in terms of BBBEE legislation in South Africa

Capital employed – shareholders' equity plus net debt

EBITDA excluding special items – earnings before interest (net finance costs), taxation, depreciation, amortisation and special items

EPS excluding special items – earnings per share excluding special items and certain once-off finance and tax items

Fellings – the amount charged against the income statement representing the standing value of the plantations harvested

Headline earnings – as defined in circular 4/2018, issued by the South African Institute of Chartered Accountants in April 2018, which separates from earnings all separately identifiable remeasurements. It is not necessarily a measure of sustainable earnings. It is a Listings Requirement of the JSE Limited to disclose headline earnings per share

Interest cover – last 12 months EBITDA excluding special items to net interest adjusted for refinancing costs

NBSK – Northern Bleached Softwood Kraft pulp. One of the main varieties of market pulp, produced from coniferous trees (ie spruce, pine) in Scandinavia, Canada and northern USA. The price of NBSK is a benchmark widely used in the pulp and paper industry for comparative purposes

Net assets – total assets less total liabilities

Net asset value per share – net assets divided by the number of shares in issue at balance sheet date

Net debt – current and non-current interest-bearing borrowings, bank overdrafts less cash and cash equivalents

Net debt to EBITDA excluding special items – net debt divided by the last 12 months EBITDA excluding special items

Net operating assets – total assets (excluding deferred tax assets and cash) less current liabilities (excluding interest-bearing borrowings and overdraft). Net operating assets equate to segment assets

Operating profit – A profit from business operations before deduction of net finance costs and taxes

Non-GAAP measures – the group believes that it is useful to report certain non-GAAP measures for the following reasons:

- these measures are used by the group for internal performance analysis;
- the presentation by the group's reported business segments of these measures facilitates comparability with other companies in our industry, although the group's measures may not be comparable with similarly titled profit measurements reported by other companies; and
- it is useful in connection with discussion with the investment analyst community and debt rating agencies

These non-GAAP measures should not be considered in isolation or construed as a substitute for GAAP measures in accordance with IFRS

ROCE – annualised return on average capital employed. Operating profit excluding special items divided by average capital employed

RONOA – return on average net operating assets. Operating profit excluding special items divided by average net operating assets

Special items – special items cover those items which management believe are material by nature or amount to the operating results and require separate disclosure. Such items would generally include profit or loss on disposal of property, investments and businesses, asset impairments, restructuring charges, non-recurring integration costs related to acquisitions, financial impacts of natural disasters, non-cash gains or losses on the price fair value adjustment of plantations and alternative fuel tax credits receivable in cash

The above financial measures are presented to assist our shareholders and the investment community in interpreting our financial results. These financial measures are regularly used and compared between companies in our industry.

Supplemental information (this information has not been audited or reviewed)

Summary Rand convenience translation

	Quarter ended		Half-year ended	
	Mar 2019	Mar 2018	**Mar 2019**	Mar 2018
Key figures: (ZAR million)				
Sales	**21,073**	17,889	**41,381**	36,095
Operating profit excluding special items[1]	**1,640**	1,698	**3,471**	3,155
Special items – (gains) losses[1]	**–**	(143)	**71**	(294)
EBITDA excluding special items[1]	**2,622**	2,523	**5,440**	4,892
Profit for the period	**1,009**	1,220	**2,168**	2,107
Basic earnings per share (SA cents)	**186**	226	**401**	392
Net debt[1]	**24,356**	19,320	**24,356**	19,320
Key ratios: (%)				
Operating profit excluding special items to sales	**7.8**	9.5	**8.4**	8.7
Operating profit excluding special items to capital employed (ROCE)[1]	**12.7**	16.6	**13.5**	15.0
EBITDA excluding special items to sales	**12.4**	14.1	**13.1**	13.6

[1] *Refer to supplemental information for the definition of the term.*

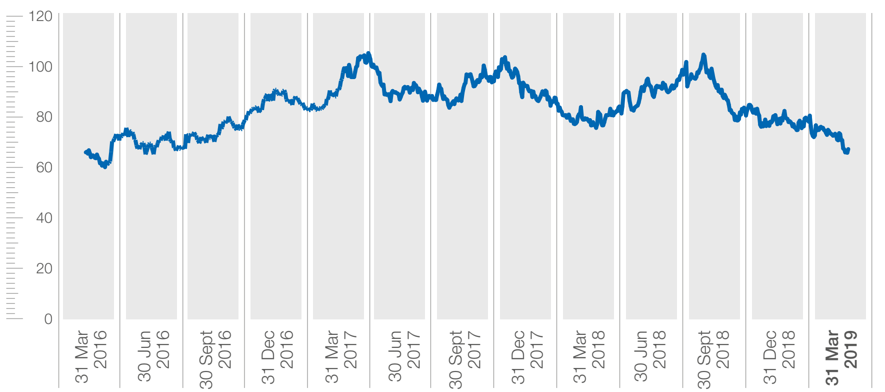
The above financial results have been translated into Rand from US Dollar as follows:
– assets and liabilities at rates of exchange ruling at period end; and
– income, expenditure and cash flow items at average exchange rates.

Supplemental information (this information has not been audited or reviewed)

Exchange rates

	Mar 2019	Dec 2018	Sept 2018	Jun 2018	Mar 2018
Exchange rates:					
Period end rate: US$1 = ZAR	**14.4975**	14.4361	14.1473	13.7275	11.8385
Average rate for the quarter: US$1 = ZAR	**14.0203**	14.3127	14.0615	12.6312	11.9577
Average rate for the year to date: US$1 = ZAR	**14.1668**	14.3127	13.0518	12.7255	12.7723
Period end rate: €1 = US$	**1.1218**	1.1438	1.1609	1.1685	1.2323
Average rate for the quarter: €1 = US$	**1.1360**	1.1409	1.1626	1.1920	1.2286
Average rate for the year to date: €1 = US$	**1.1385**	1.1409	1.1902	1.1995	1.2032

Sappi share price – March 2016 to March 2019
(ZAR)



sappi

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Sappi has a primary listing on the JSE Limited and a Level 1 ADR programme that trades in the over-the-counter market in the United States

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