Forestry & Paper

Sappi Ltd: Upgrade to Overweight

***Key message**: DWP price recovery underway, Packaging and Specialties volume ramp-up and improving Graphic Paper fundamentals.*

- **Sappi share price outperformance driven by a recovery in the global textile fibre supply chain:** YTD, Sappi (+29%) has outperformed key graphic paper peers (Stora Enso: -3%; UPM: -2% and Verso: -2%).
- **Further re-rating under way:** We have maintained that in order for a material re-rating to take place, the DWP price would need to rebound. This coupled with a >200kt (50% North America; 35% Europe and 15% in SA) uplift in Packaging and Specialties volumes and improving Graphic Paper dynamics drives the upgrades to our EPS outlook and accordingly our target price.
- **FY EBITDA uplift from DWP price recovery could add up to USD 300mn EBITDA:** However, Sappi will not capture the full uplift due to planned maintenance and the Saiccor expansion. Looking forward, we believe a sustained DWP price recovery is underway on the back of robust VSF supply/demand dynamics (operating rates are currently c.83% with only 9 days of days of supply).
- **Project Vulindlela at Saiccor likely to provide significant cost savings:** Last cost savings guidance provided was ZAR 300/t in the FY 19A AIR. Following upgrades to the project, we estimate cost savings of at least ZAR 1,000/t. Further savings could increase our SA FY 22E EBITDA margin by 200-400bps.
- **Internal net debt target should be lowered, in our view:** In FY 21E, we expect net debt/EBITDA to decline to 3.7x (FY 20A: 5.7x), but with net debt increasing by 5% to USD 2.051mn. Encouragingly, we expect net debt/EBITDA to be below 3x in Q1 22e. Based on previous debt covenants, we would expect the revised covenant to require net debt/EBITDA to be below 4.25x. We expect SAP to reach its internal net debt/EBITDA target of <2x by FY 23E.
- **Q1 21E results tomorrow, key numbers to look out for:** EBITDA USD 78m (-44% y/y and -5% q/q) and EPS of -USD 0.04/share. We expect net debt to increase to USD 2.050mn with net debt/EBITDA of 6.5x.
- **AGM tomorrow, ordinary resolution # 5 likely to be approved:** We believe the convertible bond issue is likely to be approved to ensure sufficient liquidity in the ST. With the share price currently >25% than the strike price, it is likely that debt holders will convert to equity; however, with timing uncertain.
- **Upgrade to OVERWEIGHT:** In the next 12-18months, we expect Sappi to trade above its historical average forward P/E (10x) and EV/EBITDA (5.5x). We value SAP using a SotP EV/EBITDA and set a 1-yr TP of ZAR 54.22/share, implying 26% upside.

Financial summary

USDmn (to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Sales	5 806	5 746	4 609	5 290	5 588	5 639
EBITDA ex. special items	762	687	378	560	718	732
EBITDA margin (%)	*13.1%*	*12.0%*	*8.2%*	*10.6%*	*12.9%*	*13.0%*
EPS ex. special items	60	44	-5	23	52	59
FCF (USDm)	69	150	66	25	466	468
FCF/share	0.13	0.28	0.12	0.04	0.78	0.78
Net debt	1 568	1 501	1 957	2 051	1 638	1 214
Net debt/EBITDA (x)	2.1	2.2	5.2	3.7	2.3	1.7
ROCE (%)	14.6%	11.0%	1.6%	6.5%	11.3%	12.2%

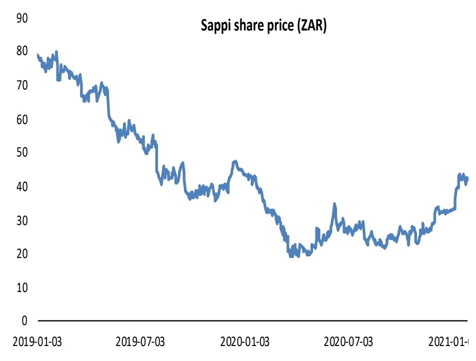
Source: Company data, Chronux Research estimates

Date: 02 February 2021

Analyst
Sean Ungerer
+27 82 319 3373
sean.ungerer@chronux.co.za

Rating:	Overweight
Price (02/02/2021):	R43.11
Target Price:	R54.22
Total return:	26%
Market cap	R24.3bn
Shares in issue	546.1mn

Q1 21e results on tomorrow: 8am, with a conference call at 4pm (*Conference call registration*).



Source: Bloomberg, Chronux Research

Figure 1 Financial summary

Segmental P/L (USDmn to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Sales	**5 806**	**5 746**	**4 609**	**5 290**	**5 588**	**5 639**
North America	1 432	1 466	1 385	1 664	1 768	1 754
Europe	2 970	2 918	2 314	2 403	2 477	2 457
South Africa Pulp and paper	1 328	1 342	920	1 162	1 271	1 356
South Africa Forestry	76	80	61	61	71	71
Adjustments	-	-60	-71	-	-	-
EBITDA excl. special items	**762**	**687**	**378**	**560**	**718**	**732**
North America	126	110	79	154	169	136
Europe	299	232	143	165	218	228
South Africa	337	339	151	241	331	368
Unallocated & eliminations	-	6	5	-	-	-
Depreciation & amortisation	**277**	**289**	**319**	**317**	**304**	**294**
North America	77	83	106	98	96	92
Europe	136	128	135	137	122	119
South Africa	67	72	76	82	86	83
Unallocated & eliminations	-3	6	2	-	-	-
Op. profit excl. special	**485**	**398**	**59**	**243**	**414**	**438**
North America	49	27	-27	56	72	45
Europe	163	104	8	27	96	109
South Africa	270	267	75	159	246	285
Unallocated & eliminations	3	-	3	-	-	-
Net finance costs	**-68**	**-85**	**-88**	**-90**	**-88**	**-80**
Profit before taxation	426	294	-124	153	326	358
Taxation	-98	-87	19	-13	-11	-4
Profit for the period	**328**	**207**	**(105)**	**140**	**315**	**355**
EPS ex. special items	**60**	**44**	**-5**	**23**	**52**	**59**

Group Balance Sheet (USDmn to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Non-current assets	**3 766**	**3 789**	**3 891**	**3 876**	**3 754**	**3 642**
Property, plant and equipment	3 010	3 061	3 103	3 088	2 966	2 854
Plantations	466	451	419	419	419	419
Deferred tax assets	106	106	59	59	59	59
Right of use assets	-	-	101	101	101	101
Goodwill and intangible assets	63	54	113	113	113	113
Equity-accounted investees	33	31	11	11	11	11
Other non-current assets	88	86	85	85	85	85
Current assets	**1 904**	**1 834**	**1 558**	**1 956**	**2 352**	**2 791**
Inventories	741	709	673	805	797	801
Trade and other receivables	767	718	584	760	751	761
Derivative financial instruments	21	3	3	3	3	3
Taxation receivable	12	11	19	19	19	19
Cash and cash equivalents	363	393	279	369	782	1 207
Total assets	**5 670**	**5 623**	**5 455**	**5 838**	**6 111**	**6 439**
Shareholders' equity	**1 947**	**1 948**	**1 632**	**1 707**	**2 021**	**2 376**
Non-current liabilities	**2 550**	**2 461**	**2 700**	**2 852**	**2 820**	**2 788**
Interest- bearing borrowings	1 818	1 713	1 861	2 045	2 045	2 045
Lease liabilities	-	-	81	81	81	81
Deferred tax liabilities	335	328	304	304	304	304
Defined benefit and other liabilities	397	418	445	413	381	349
Derivative financial liabilties	-	2	9	9	9	9
Current liabilities	**1 173**	**1 214**	**1 123**	**1 279**	**1 270**	**1 274**
Interest-bearing borrowings	97	181	270	270	270	270
Overdraft	16	-	-	-	-	-
Lease liabilities	-	-	24	24	24	24
Trade and other payables	1 009	969	797	953	944	948
Derivative financial instruments	6	7	19	19	19	19
Taxation payable	39	51	2	2	2	2
Provisions	6	6	11	11	11	11
Total equity and liabilities	**5 670**	**5 623**	**5 455**	**5 838**	**6 111**	**6 439**

Group Cash flow statement (USDmn to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Profit (loss) for the period	323	211	-135	140	315	355
Adjusted for:						
Depreciation, fellings and amortisation	348	356	384	385	372	362
Taxation	98	87	9	13	11	4
Net finance costs	68	85	88	90	88	80
Defined post-employment benefits paid	-45	-41	-40	-32	-32	-32
Plantation fair value adjustments	-96	-92	-92	-	-	-
Asset impairments (impairment reversals)	-3	10	15	-	-	-
Restructuring provisions raised	1	-	34	-	-	-
Profit/(loss) on disposal of investment	-8	1	-	-	-	-
Profit/(loss) on disposal of non-current assets held for sale	4	10	-	-	-	-
Other non-cash items	19	46	42	-	-	-
Cash generated from operations	**709**	**673**	**323**	**596**	**754**	**768**
Movement in working capital	-79	-15	65	-152	8	-10
Net finance costs paid	-66	-42	-102	-90	-88	-80
Taxation paid	-73	-51	-26	-13	-11	-4
Dividends paid	-81	-92	-	-	-	-
Cash generated from operating activities	**410**	**473**	**260**	**341**	**664**	**674**
Cash (utilised) generated from investing activities	**(664)**	**(472)**	**(517)**	**(370)**	**(250)**	**(250)**
Capital expenditure	-541	-471	-351	-370	-250	-250
Net proceeds on disposal of assets	11	3	1	-	-	-
Acquisition	-132	-	-160	-	-	-
Other movements	-2	-4	-7	-	-	-
Cash effects of financing activities	**68**	**56**	**138**	**119**	**-**	**-**
Proceeds from interest-bearing borrowings	137	616	1 065	119	-	-
Repayment of interest-bearing borrowings	-69	-560	-905	-	-	-
Lease payments	-	-	-22	-	-	-
Net movement in cash and cash equivalents	**(186)**	**57**	**(119)**	**90**	**414**	**424**
Cash and cash equivalents at beginning of period	550	363	393	279	369	782
Translation effects	-1	-27	5	-	-	-
Cash and cash equivalents at end of period	**363**	**393**	**279**	**369**	**782**	**1 207**

Source: Chronux Research, Company data

Dissolving wood pulp (DWP)

Saiccor expansion, project Vulindlela (ZAR 2.7bn and some)

In FY 19A, Sappi began the Saiccor Mill expansion, increasing DWP capacity from 800tpa to 910ktpa. Besides increasing capacity, the project includes a change in technology that will also improve energy and chemical recovery and improve water use efficiency, thus lowering variable costs of the Saiccor mill.

Last formal guidance was provided in the FY 19A AIR, estimating a saving of ZAR 300/t (USD 20/t). Sappi was targeting project completion by Q4 20A. However, due to the Covid-19 lockdown in South Africa, Sappi declared force majeure. During the period that construction was halted, Sappi revised the project, with a focus in lowering future variable costs further (no guidance provided). With the closure of the Lignotech joint venture, Saiccor's higher cost calcium line will now be converted to a magnesium process, with additional savings in energy costs and chemical recovery. No revised guidance has been provided, except "This will lead to a significant reduction in the fossil fuel energy requirements and increase our renewable energy usage".

Saiccor upgrade to boost SA margins from FY 22E

At the end of FY 20A, Saiccor capacity accounted for c.45% of SA capacity for external sales. We believe the Saiccor upgrade is likely to provide significant cost advantages to the SA business. Below, we highlight the sensitivity to our SA EBITDA margin outlook and impact on Group EPS under various cost savings assumptions: In our base case, we pencil in a saving of ZAR 1,000/t or USD 66/t.

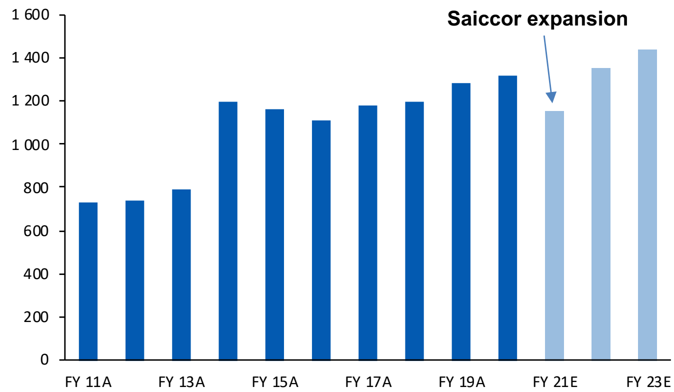
Figure 2 Cost savings sensitivity from Saiccor expansion on FY 22E EBITDA and EPS

Cost savings (ZAR/t)	EBITDA margin (%)	EPS (USD/share)
300	19.6%	0.43
500	20.4%	0.45
1 000	**22.3%**	**0.49**
1 500	24.2%	0.53
2 000	26.0%	0.58

Source: Chronux Research estimates

DWP volumes to be constrained in the ST

Figure 3 Group DWP sales outlook (ktpa)



- DWP volumes to be constrained in the ST:
  - Ngodwana maintenance shut in Q1 21e
  - Volumes on Saiccor calcium line constrained due to closure of Lignotech JV. c.55kt impact.
- We pencil in sales from Saiccor expansion in Q1 22e vs. SAP's guidance of Q4 21e.
- With the current DWP/HW spread at c.USD 352/t, we expect Cloquet to have fully swung back to DWP by the end of Q2 20e.

Source: Chronux Research, Company data

DWP price rally on a FY basis would add c.USD 300mn EBITDA based on spot prices

All else equal, the DWP price increase of USD 288/t since August last year would increase Sappi's FY EBITDA by USD 300-320m.

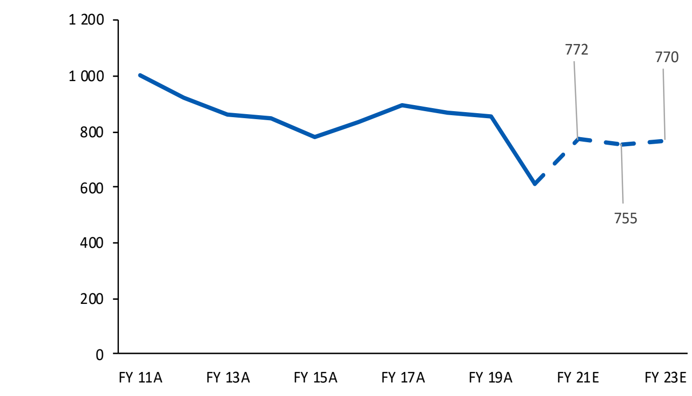
Figure 4 Sappi major sensitivities impacting EBITDA (USDm)

Sensitivities	Change	Europe (EURm)	North America (USDm)	SA (ZARm)	Translation (USDm)	Group (USDm)
Net selling prices	1%	22	16	184	-	51
Dissolving pulp prices	USD 10	-	2	158	-	11
Variable costs	1%	12	8	103	-	27
Sales volume	1%	8	6	68	-	19
Fixed costs	1%	6	5	54	-	15
Paper pulp price	USD 10	5	1	7	-	6
Oil price	USD 1	2	-	3	-	3
ZAR/US$ (Weakening)	10 cents	-	-	54	(1)	2
Euro/US$ (Weakening)	10 cents	(2)	(4)	-	(15)	(21)

Source: Chronux Research, Company data

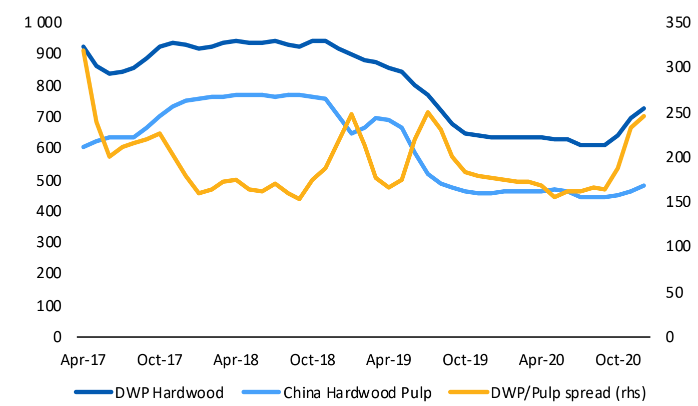
However, in the ST, Sappi will not fully capture the upside from the recent DWP price rally

Figure 5 DWP price outlook for Sappi's FY (USD/t)



Source: Chronux Research estimates, Company data

Figure 6 DWP/HW Pulp spread (USD/t)



Source: CCF, Chronux Research, FOEX

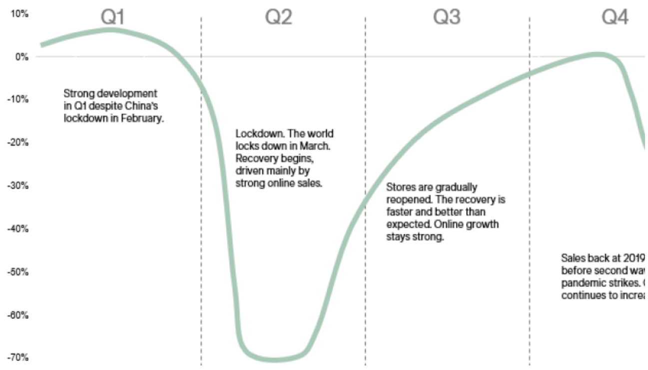
DWP price recovery underway, with VSF likely to provide more upside

DWP prices have rallied 34% since reaching lows of c.USD 600/t in August last year. The DWP market remains complex, with the price recovery underpinned by various drivers. We expect further DWP price momentum on the back of encouraging VSF fundaments supported by global growth this year (the IMF expects global GDP to increase by 5.5% in CY 21e vs. a decline of 3.5% in CY 20A: -3.5%). We caution however, that with HW pulp prices in China up 22% since August last year, the spot DWP/HW spread is currently USD 352, sufficiently above the USD 250/t threshold to incentivise swing capacity.

Key drivers behind the DWP price recovery to date include:

- **Permanent and temporary capacity curtailment:** More than 10% of global capacity was idled in 2020.
- **Textiles fibre recovery:** Cotton and VSF prices have increased by 31% and 52%, respectively since August last year. This has been underpinned by retail and apparel sales rebounding strongly in H2 20A last year in China, Europe and the US. We also caution around the US ban on XPCC cotton imports. We note that XPCC produces c.85% of cotton in the Xinjiang region (>20% of global supplies). This is likely to provide a strong underpin for VSF prices going forwards. We caution however, the impact of further lockdowns and any delays in rolling out vaccines. We highlight an extract from H&M's recent FY 20A results: "The second wave of the pandemic has resulted in extensive restrictions and temporary store closures. At the most, 1,800 stores were closed in the current quarter. Net sales in the period 1 December 2020 to 27 January 2021 decreased by 23 percent in local currencies compared with the same period last year. Currently 1,800 stores, representing 36 percent of the total amount of stores, are still temporarily closed. A total of 51 of the group's 52 online markets are open"

Figure 7 H&M group sales development in local FX



Source: Chronux Research, Company data

Figure 8 H&M Q4 20A sales in top 10 markets

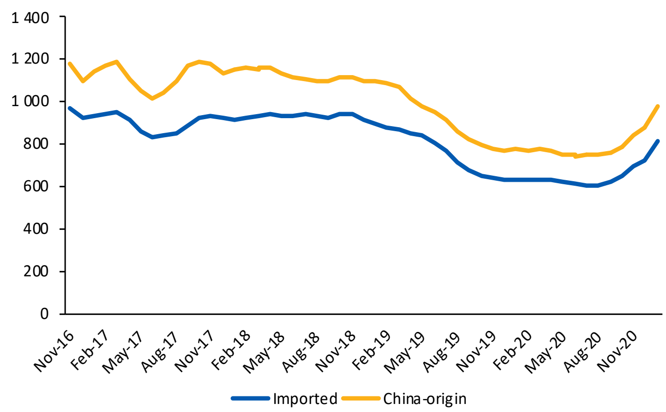
	Q4 - 2020	Q4 - 2019	Change in %		30 Nov - 20	Q4 - 2020
	SEK m net sales	SEK m net sales	SEK	Local currency	Number of stores	New stores (net)
Germany	8,721	9,138	-5	-3	457	-2
USA	6,030	7,876	-23	-17	582	-4
UK	3,155	3,963	-20	-16	289	-5
China	2,917	3,153	-7	-3	505	-8
France	2,198	3,172	-31	-28	228	1
Sweden	2,128	2,288	-7	-7	168	-3
Russia	1,831	1,817	1	27	155	5
Italy	1,743	2,353	-26	-24	174	-3
Netherlands	1,601	1,851	-14	-12	135	-3
Switzerland	1,552	1,574	-1	-1	98	-1
Others	20,673	24,509	-16	-10	2,227	-2
Total	52,549	61,694	-15	-10	5,018	-25

Source: Chronux Research, Company data

- **Tailwinds from a weaker USD:** The USD has weakened by 9% vs. the RMB since May 2020.
- **Shipping rates:** Globally, there is a shortage of containers, delays are being experienced and consequently shipping rates are on the rise, providing support for further commodity price inflation.

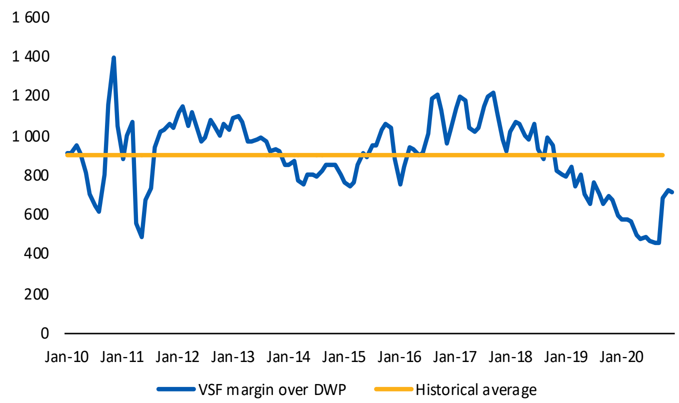
Health of the Chinese VSF industry (and DWP) has improved, with further upside likely

Figure 9 Hardwood DWP prices (USD/t)



Source: CCF, Chronux Research

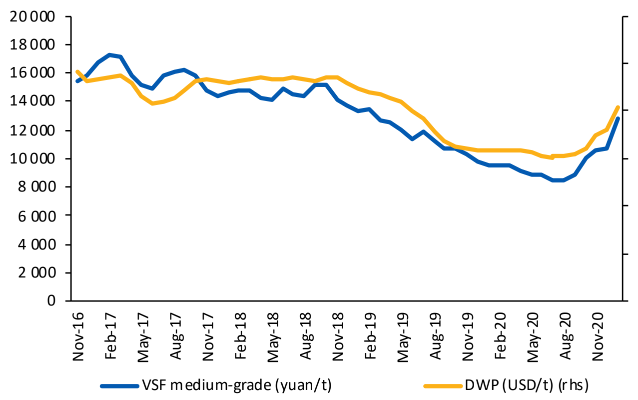
Figure 10 VSF/DWP spread (USD/t)



Source: CCF, Chronux Research

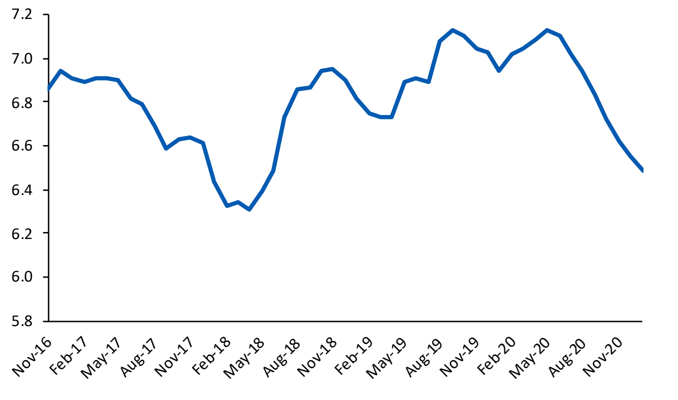
China VSF prices in local currency have increased by 52% since reaching a low of RMB 8,410/t in August. Bolstered by a weaker USD, USD prices are now up 63% over the same period. DWP prices have also played catch-up. Imported hardwood DWP is up 34% over the same period, while domestic prices are up 22% (30% in USD).

Figure 11 VSF price vs. DWP price



Source: CCF, Chronux Research

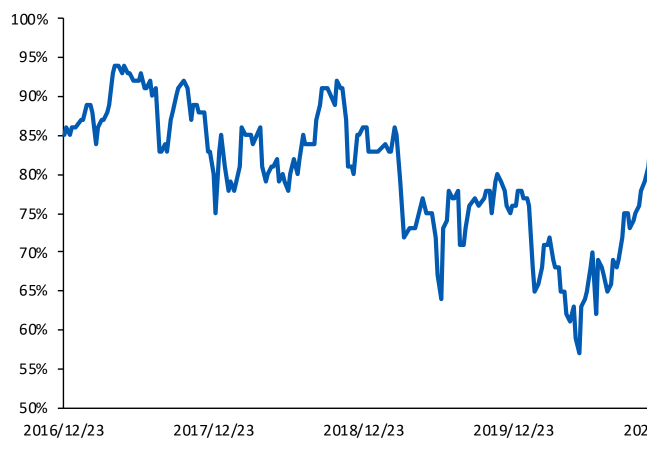
Figure 12 USD/RMB FX



Source: CCF, Chronux Research

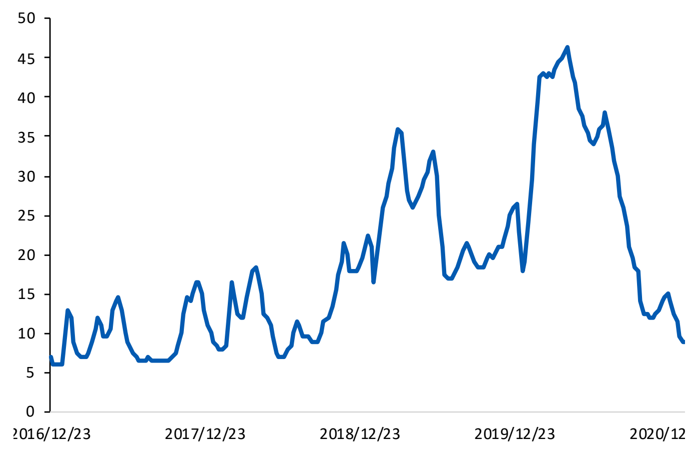
Recovery in VSF prices has been supported by higher operating rates and a tighter supply chain driven by strong order books. Chinese VSF operating rates have improved from a low of 57% in May 2020 to c.83% currently.

Figure 13 China VSF operating rate (%)



Source: CCF, Chronux Research

Figure 14 China VSF inventory days (#)



Source: CCF, Chronux Research

Restocking along the entire global textile supply chain has helped bring down VSF inventory days to only 9 days of supply.

Capital allocation – gearing has been Sappi's Achilles heel

Gearing outlook

Balance sheet stretched between FY 17-Q2 20A, Sappi was forced to favour liquidity over profitability

Net debt/EBITDA increased from 3.0x in FY 14A and declined to 1.7x in FY 17A, comfortably below Sappi's internal target of below 2.0x. Between FY 17A and Q2 20A, net debt/EBITDA ticked up to 3.3x on the back of USD 300m of M&A during the period.

Covenants proactively managed

Encouragingly, Sappi has been proactive in ensuring debt covenants were not breached. Sappi successfully negotiated the suspension of the measurement of their revolving credit facility (RCF) linked financial covenants through to September 2021 (with the first measurement due in December 2021).

Gearing to reduce but net debt to increase in FY 21E

In FY 21E, we expect net debt/EBITDA to decline to 3.7x (FY 20A: 5.7x), but with net debt increasing by 5% to USD 2.051mn. Encouragingly, we expect net debt/EBITDA to be below 3x in Q1 22e. Based on previous debt covenants, we would expect the revised covenant to require net debt/EBITDA to be below 4.25x. We expect SAP to reach its internal net debt/EBITDA target of <2x by FY 23E.

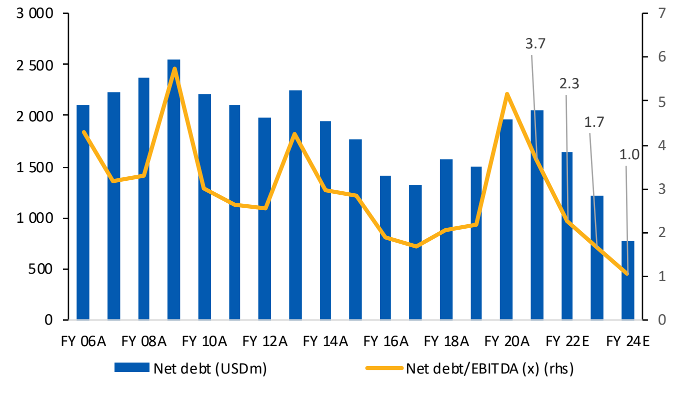
Refinancing risk is low and Sappi has shown its ability to obtain low cost funding

There are no significant maturities due before FY 23E, with most net debt maturing post FY24E. During FY 19A, Sappi refinanced their 2022 Euro bonds with a new seven-year Euro bond at a rate of 3.125%, Sappi's lowest ever rate.

Internal net debt target should be lowered, in our view

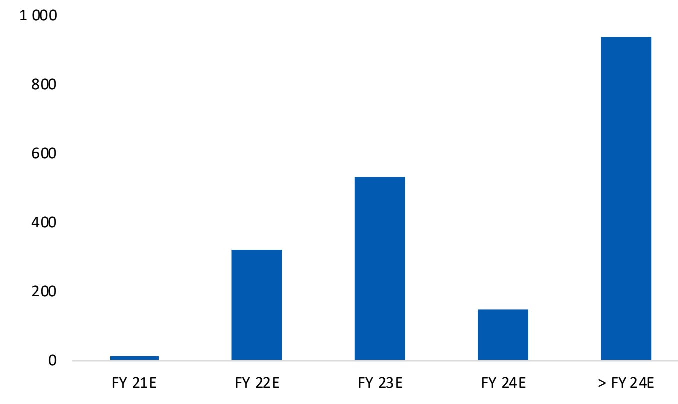
We maintain that Sappi should manage its balance sheet more prudently. We would think a target of below 1.5x would be more suitable for a commodity company such as Sappi.

Figure 15 Sappi net debt & net debt/EBITDA outlook



Source: Chronux Research, Company data

Figure 16 Sappi net debt maturity outlook (USDm)



Source: Chronux Research, Company data

Post FY 20A year-end, Sappi announced a ZAR1.8bn convertible bond issue

The convertible bond was issued on 25 November 2020 in order to fund the completion of the Saiccor Mill expansion project. A convertible was the most attractive option in light of the bond market last year and to avoid a rights issue.

We note that this issuance requires at least 75% shareholder approval at the AGM tomorrow. We believe it is likely that it will be approved on the basis of ensuring Sappi has sufficient liquidity and avoiding the repayment of expensive debt. Below, we highlight the extract for approval of ordinary resolution number 5:

> "**ZAR1,800,000,000 convertible bonds due 26 November 2025** issued by Sappi Southern Africa Limited on 25 November 2020 (convertible bonds), be and is hereby authorised to issue ordinary shares in the company to those holders of the convertible bonds who have exercised their rights to convert the convertible bonds into ordinary shares in the company and that the board be authorised to take all the steps and actions that may be required to issue those ordinary shares to those holders in accordance with the terms and conditions. The number of ordinary shares to be issued to a holder of a convertible bond who has exercised any right to convert convertible bonds into ordinary shares will be determined in accordance with the terms and conditions; and unless adjusted in terms of the terms and conditions, the principal amount of the convertible bonds will be convertible into ordinary shares in the company at an **initial conversion price of approximately ZAR33.1636** (thirty three Rand and sixteen cents) per ordinary share, subject to the terms and conditions, provided that the number of ordinary shares that may be issued in terms of this resolution is limited to a **maximum of 66,000,000,000 (sixty six million) ordinary shares**."

Incorporating the convertible bond into our model

We have assumed net inflow of cash of ZAR 1.8bn, while increasing net debt by c. ZAR 1.48bn with an equity option valued at c. ZAR 320m. With the share price currently >25% than the strike price, and based on our favourable outlook for earnings, it is likely that all debt holders will convert to equity. Timing of the conversions is uncertain as the holders are likely to have different approaches. On this basis and subject to shareholder approval, **we have not incorporated** an increase in the number of shares outstanding. However, below, we show the impact on our EPS outlook assuming c.54m shares are issued in either of the years FY 21-23E:

Figure 17 EPS dilution assuming 100% conversion

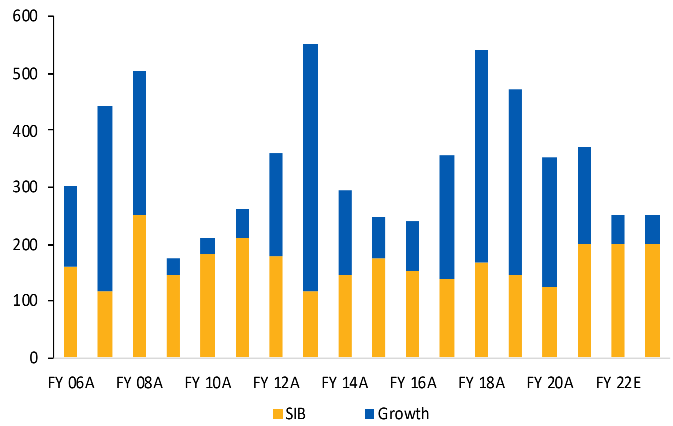
EPS	FY 21E	FY 22E	FY 23E
Base case	0.26	0.58	0.65
Shares issued	0.23	0.52	0.59
Difference	-0.03	-0.06	-0.06
%	-11.5%	-10.3%	-9.2%

Source: Chronux Research estimates

FY 21E CapEx to remain elevated on back of the Saiccor expansion

FY 21e CapEx is guided to be c.USD 370mn. This includes c.USD 100mn related to the decision to delay the Saiccor expansion project and the postponement of major shuts at Saiccor and Ngodwana which reduced FY 20A CapEx.

Figure 18 Sappi CapEx outlook (USDm)

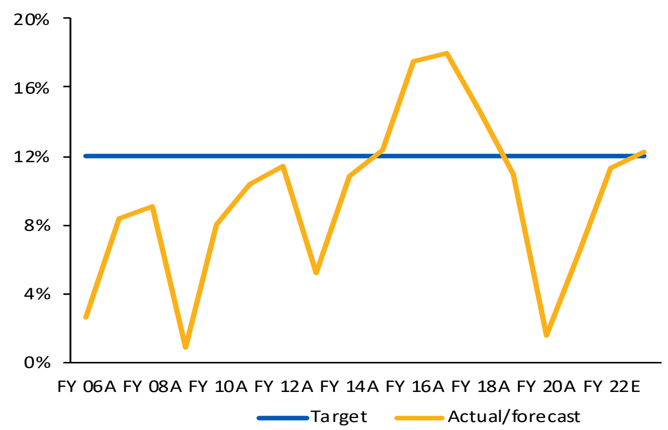


Source: Chronux Research, Company data

- In light of Sappi's gearing, we assume that CapEx will normalise to c. USD 250mn from FY 22E.
- CapEx from FY 22E focused on maintenance.
- We note an extract from Sappi's 2020 AIR: "current market conditions, with low DP prices, viscose customers under significant pressure and excess DP and viscose capacity make a further significant expansion difficult to justify in the medium term".
- Based on current market dynamics, we do not expect Sappi to make any further DWP expansion plan announcements until at least FY 23/24E.

From SAP's "2020Vision" to "Thrive 2025", more focus needs to be on ROCE, in our view

Figure 19 Sappi ROCE outlook (%)



Source: Chronux Research, Company data

- More focus needed on ROCE. Balance sheet flexibility should allow this.
- ROCE target and emphasis on ROCE was missing from "Thrive 2025" in the 2020 AIR.
- Sappi's target through the cycle is 12%.
- In the past 15 years, ROCE has been above the 12% target in 4 of the years (FY 15-18A).
- Looking forward, we expect ROCE to exceed 12% in FY 23E.

Valuation - higher profits, lower gearing and more upside risks

We have maintained that in order for a material re-rating to take place, the DWP price would need to rebound. This coupled with a >200kt (50% North America; 35% Europe and 15% in SA) uplift in Packaging and Specialties volumes and improving Graphic Paper dynamics drives the upgrades to our EPS outlook and accordingly our target price. **Below, we highlight how textile fibre share prices have run ytd and outperformed Sappi's key Graphic Paper peers.**

Figure 50 SAP key peers share price performance (%)

Peers	CY 19A	CY 20A	CY 21A YTD
Grasim	-11%	25%	14%
Mondi	10%	5%	5%
Lenzing	0%	0%	19%
UPM	40%	-1%	-2%
Sappi	-45%	-25%	29%
Stora Enso	27%	21%	-3%
Verso	-21.6%	-33.3%	-2.2%

Source: Bloomberg, Chronux Research

Below, we highlight the EBITDA/t in USD across Sappi's key reporting segments and products. We note that SA has traded at an average premium between FY 17-20A of 139% and 160% over North America and Europe, respectively. Additionally, North America has traded at an average premium of 8% over Europe during the same period.

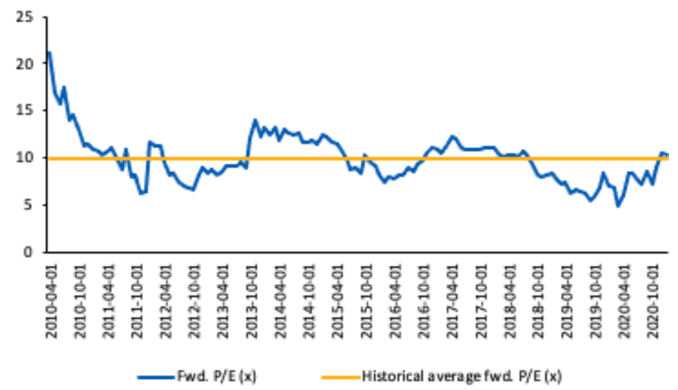
Figure 21 EBITDA analysis

EBITDA analysis	FY 17A	FY 18A	FY 19A	FY 20A
EBITDA//t (USD)	**124**	**120**	**110**	**67**
North America	93	92	80	52
Europe	78	89	72	53
South Africa	247	208	207	107
DWP	326	255	237	48
Packaging and Specialties	137	137	112	148
Graphics	66	77	65	42
EBITDA margin (%)	***15%***	***13%***	***12%***	***8%***
North America	9%	9%	8%	6%
Europe	10%	10%	8%	6%
South Africa	29%	24%	24%	15%
DWP	36%	29%	28%	8%
Packaging and Specialties	13%	13%	10%	14%
Graphics	8%	9%	7%	5%
EBITDA contribution (%)				
North America	*16%*	*17%*	*16%*	*21%*
Europe	*33%*	*39%*	*34%*	*38%*
South Africa	*50%*	*44%*	*49%*	*40%*
DWP	49%	40%	44%	17%
Packaging and Specialties	15%	18%	18%	47%
Graphics	36%	42%	37%	35%

Source: Chronux Research, Company data

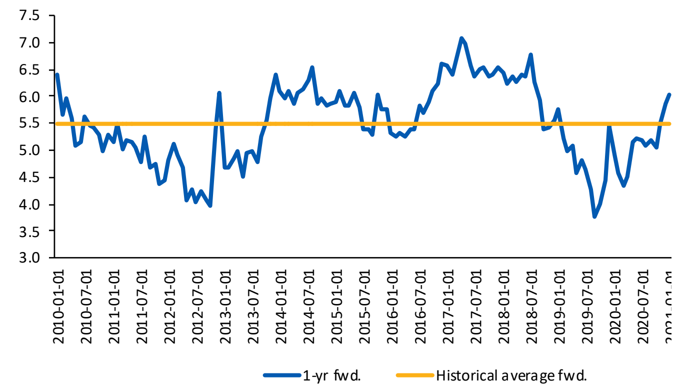
We think Sappi will trade above its historical forward P/E (10x) and EV/EBITDA (5.5x) in the next 12-18m

Figure 22 Sappi historical forward P/E (x)



Source: Chronux Research, Company data

Figure 23 Sappi historical forward EVEBITDA (x)



Source: CCF, Chronux Research

Upgrade to OVERWEIGHT

We continue to value Sappi using a SotP EV/EBITDA. On this basis, we set a 1-yr TP of ZAR 54.22/share, implying 26% upside. We accordingly upgrade to OVERWEIGHT.

Figure 64 Sappi SotP EV/EBITDA (x) using spot FX

Details (USDm)	Y1 rolled EBITDA	EV/EBITDA (x)	EV by region (USDm)	% of total EV
Europe	181	5.5	994	25%
North America	159	6.0	955	24%
South Africa	284	7.0	1 986	50%
Group	**624**	**6.3**	**3 935**	**100%**
Last reported net debt			-1 957	
Equity value			1 978	
WANOS (m)			546.1	
TP (USD/share)			3.62	
Spot USD/ZAR			14.97	
TP (ZAR/share)			**54.22**	
Current share price			43.11	
Expected 1-yr return			**26%**	

Source: Chronux Research, Company data

Figure 75 Global Forestry & Paper ranking table

Company	EV/EBITDA (x)		P/E (x)	
	Y1	Y2	Y1	Y2
Amcor	11.4	11.0	15.0	14.3
Altri	10.9		28.1	
Arctic Paper	3.2		4.7	
Avery Dennison	13.0	12.2	20.1	18.5
BillerudKorsnäs	9.6	8.6	21.8	17.4
Borregaard	13.5	11.7	25.8	21.1
Clearwater Paper	6.4		11.9	
Domtar	5.7	5.2	13.6	11.0
DS Smith	7.8	7.3	12.6	11.3
Duratex	10.9		24.3	
Ence	9.7	7.4	88.8	20.5
Grasim	54.8	23.0	15.4	13.1
Holmen	18.0	17.1	31.4	29.3
Huhtamaki	10.4	10.0	18.5	17.1
International Paper	8.0	7.7	13.1	12.3
Klabin	9.8	9.2	16.1	19.6
Lenzing	10.7	7.5	30.6	17.5
Mayr-Melnhof	7.9		15.4	
Mercer International	6.6	4.8	29.5	7.8
Metsa Board	10.0	10.3	16.9	16.5
Mondi	**8.5**	**7.9**	**14.8**	**13.0**
Navigator	7.8		13.7	
OJI	8.3	7.9	11.9	10.8
Packaging Corporation of America	10.6	10.2	19.2	18.1
Rayonier	7.6			
Sappi	**5.6**	**4.8**	**10.0**	**6.4**
SCA	20.8	19.4	35.6	32.4
Smurfit Kappa Group	8.5	7.8	15.8	14.1
Stora Enso	9.6	8.7	18.3	15.5
Suzano	8.6	8.6	9.4	13.3
UPM	10.7	9.8	19.5	17.8
WestRock	6.7	6.3	11.4	9.7
Weyerhaeuser	13.8	14.5	25.0	26.6

Source: Bloomberg, Chronux Research

Segmental outlook by region

Figure 26 Segmental outlook

Europe segmental outlook EURmn (to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Sales	2 494	2 587	2 067	1 972	2 019	2 003
Operating profit excluding special items	137	93	7	22	78	89
Operating profit excluding special items to sales (%)	*5.5%*	*3.6%*	*0.3%*	*1.1%*	*3.9%*	*4.4%*
EBITDA excluding special items	254	206	128	135	178	186
EBITDA excluding special items to sales (%)	*10.2%*	*8.0%*	*6.2%*	*6.8%*	*8.8%*	*9.3%*
Depreciation & amortisation	117	113	121	113	100	97
EUR/USD average	**1.16**	**1.13**	**1.12**	**1.22**	**1.23**	**1.23**
Sale volumes (kt)	**3 366**	**3 241**	**2 698**	**2 722**	**2 672**	**2 619**
Coated paper	3 028	2 764	2 220	2 189	2 124	2 060
Packaging and specialties	338	477	478	532	548	559
Average European selling price (EUR/t)	**741**	**798**	**766**	**725**	**756**	**765**
Graphic paper	713	745	698	661	691	693
Packaging and specialties	1 072	1 072	1 113	988	1 007	1 028

North America segmental outlook USDmn (to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Sales	1 432	1 466	1 385	1 664	1 768	1 754
Operating costs	-1 383	-1 439	-1 412	-1 608	-1 696	-1 709
Operating profit excluding special items	49	27	-27	56	72	45
Operating profit excluding special items to sales (%)	*3.4%*	*1.8%*	*-1.9%*	*3.4%*	*4.1%*	*2.6%*
EBITDA excluding special items	126	110	79	154	169	136
EBITDA excluding special items to sales (%)	*8.8%*	*7.5%*	*5.7%*	*9.3%*	*9.5%*	*7.8%*
Depreciation & amortisation	77	83	106	98	96	92
Sales volumes (kt)	**1 371**	**1 379**	**1 516**	**1 644**	**1 706**	**1 681**
CFS	960	844	697	794	844	819
Specialty (Westbrook)	16	20	13	14	20	20
Market pulp (US ops)	-	35	70	60	-	-
Matane pulp	-	-	121	89	89	90
DWP	255	290	253	264	333	333
Packaging and specialties	60	190	317	425	420	420
Average price realised (USD/t)	**1 044**	**1 063**	**914**	**1 012**	**1 036**	**1 043**
Graphic paper	990	1 036	978	985	985	985
Packaging and specialties	1 140	1 186	1 127	1 177	1 189	1 189
DWP	871	853	610	772	755	770

South Africa segmental outlook ZARmn (to September)	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Sales	18 325	20 402	15 918	17 799	20 458	22 747
Operating profit excluding special items	3 524	3 832	1 217	2 433	3 952	4 774
Operating profit excluding special items to sales (%)	*19.2%*	*18.8%*	*7.6%*	*13.7%*	*19.3%*	*21.0%*
EBITDA excluding special items	4 398	4 864	2 450	3 684	5 329	6 170
EBITDA excluding special items to sales (%)	*24.0%*	*23.8%*	*15.4%*	*20.7%*	*26.0%*	*27.1%*
Depreciation & amortisation	874	1 032	1 233	1 251	1 377	1 397
USD/ZAR average	**13.07**	**14.35**	**16.22**	**15.34**	**16.10**	**16.77**
Sale volumes excl. Forestry (kt)	**1 620**	**1 639**	**1 406**	**1 476**	**1 637**	**1 728**
Graphic Paper and Packaging and specialties	670	650	545	583	621	621
DWP	950	999	861	893	1 016	1 107
Forestry	1 234	1 363	1 168	1 168	1 168	1 168
Average price realised (USD/t)						
Graphic Paper and Packaging and specialties	687	765	711	697	697	697
DWP	871	853	610	772	755	770
Forestry	62	59	52	52	61	61

Source: Chronux Research, Company data

Disclaimer: