Forestry & Paper

Sappi Ltd: Q2 21A Insights

Date: 06 May 2021

Key message*: Results broadly in line with our expectations and thesis intact. Packaging and Specialties performed well, supported by the DWP segment. The European Graphic Paper business continues to weigh on earnings.*

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- **Conference call today at 3pm:** *Conference call registration.*

- **Q2 21A snapshot:** EBITDA of USD 112mn was 4% lighter than our estimate, with EBITDA down 2% y/y but up 10% q/q. EPS came in at negative USD 0.01/share (CRe: USD 0/share).
- **Europe (25% of EBITDA) EBIT now in the red:** Sales were slightly weaker than what we expected. We attribute this to lower-than-expected Packaging and Specialty volumes. Encouragingly, the EBITDA margin surprised to the upside at 4.8%.
- **North America (32% of EBITDA) EBIT was back in the green:** However, the EBITDA margin was lower than our estimates driven by more optimistic CFS volume and pricing expectations.
- **Strong performance from South Africa, drove EBITDA up 29% q/q (43% of EBITDA):** Strong DWP and Packaging volumes helped uplift EBITDA for the quarter; however, this was not enough to offset ZAR strength, which adversely impacted the EBITDA margin (down 90 bps q/q).
- **Despite a strong recovery in DWP volumes, margin came under pressure due to a stronger ZAR (30% of EBITDA):** DWP sales were in line with our estimates; but potentially could have been 23kt higher if Ngodwana did not curtail production due to oxygen supply issues (flagged previously).
- **Packaging & Specialties (48% of EBITDA) had a strong quarter, with EBITDA up 6% y/y (51% q/q):** The EBITDA margin expanded by 290bps q/q (but down 200bps y/y) on the back of a strong volume performance in North America (+56% y/y and +18% q/q), supported by SA (+28% y/y), while Europe (+2%) missed our estimates by 11%.
- **Graphic Paper (22% of EBITDA) had another tough quarter, driven by weakness in Europe:** North American volumes were strong (but still at 85% of pre-COVID levels), while Europe declined by c.19%. The achilleas heel for this segment remains the lack of pricing power in Europe, coupled with SAP's net short pulp position in Europe (c.800ktpa).
- **Gearing increased in Q2 but key metrics to improve from Q3:** Net debt increased by 10% y/y and 1% q/q to USD 2.07bn. Net debt/EBITDA increased to 6.5x vs. our estimate of 6.4x. SAP has agreed revised leverage covenants (net debt/EBITDA) with it's banking group: December 2021: 5.50x; March 2022: 5.25x; June 2022: 4.75x; September and December 2022: 4.50x and March 2023: 4.25x. Based on our current estimates, SAP has more than enough headroom. We currently estimate FY 21E net debt/EBITDA of 3.0x.
- **FY 21E CapEx guidance remains on track for USD400mn:** This implies USD 230mn in H2 21E. Saiccor mill expansion project is expected to see production on track for Q4 21E. SAP have not communicated further guidance on cost savings since 2019.
- **Outlook guidance in line with our expectations:** SAP is guiding for Q3 21e EBITDA to be higher q/q (CRe: USD 187mn); however, with European earnings to be lower on the back of higher pulp prices (CRe: EUR 12mn, -48%q/q).

Disclaimer: