

SAPPI LTD
Form 20-F
December 15, 2006

As filed with the Securities and Exchange Commission on December 15, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended October 1, 2006

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from [] to []

Commission file number 1-14872

☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report []

SAPPI LIMITED

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant's name into English)

Republic of South Africa

(Jurisdiction of incorporation or organisation)

48 Ameshoff Street
Braamfontein
Johannesburg 2001
Republic of South Africa
(Telephone: +27-11-407-8111)

(Address and telephone number of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Edgar Filing: SAPPI LTD - Form 20-F

**American Depositary Shares, evidenced by
American Depositary Receipts, each representing
1 Ordinary Share**

(Title of each class)

**New York Stock Exchange
Ordinary Shares, par value R1.00 per Share***

(Name of each exchange on which registered)

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

239,071,892 Ordinary Shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES x **NO o**

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

YES o **NO x**

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x **NO o**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x **Accelerated filer o** **Non-accelerated filer o**

Indicate by check mark which financial statements item the registrant has elected to follow.

ITEM 17 o **ITEM 18 x**

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o **NO x**

* Not for trading but only in connection with the registration of the American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

TABLE OF CONTENTS

	Page
<u>Our Use of Terms and Conventions in this Annual Report</u>	iii
<u>Explanatory Note relating to International Financial Reporting Standards</u>	iv
<u>Accounting Periods and Principles</u>	iv
<u>Currency of Presentation and Exchange Rates</u>	iv
<u>Forward-Looking Statements</u>	v
	<u>PART I</u>
<u>Item 1. Identity of Directors, Senior Management and Advisers</u>	1
<u>Item 2. Offer Statistics and Expected Timetable</u>	1
<u>Item 3. Key Information</u>	1
<u>Item 4. Information on the Company</u>	8
<u>Item 5. Operating and Financial Review and Prospects</u>	40
<u>Item 6. Directors, Senior Management and Employees</u>	91
<u>Item 7. Major Shareholders and Related Party Transactions</u>	101
<u>Item 8. Financial Information</u>	102
<u>Item 9. The Offer and Listing</u>	105
<u>Item 10. Additional Information</u>	107
<u>Item 11. Quantitative and Qualitative Disclosures About Market Risk</u>	125
<u>Item 12. Description of Securities Other than Equity Securities</u>	125
	<u>PART II</u>
<u>Item 13. Defaults, Dividend Arrearages and Delinquencies</u>	126
<u>Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	126
<u>Item 15. Controls and Procedures</u>	126
<u>Item 16A. Audit Committee Financial Expert</u>	128
<u>Item 16B. Code of Ethics</u>	128
<u>Item 16C. Principal Accountant Fees and Services</u>	129
<u>Item 16D. Exemptions from the Listing Standards for Audit Committees</u>	129
<u>Item 16E. Purchases of Equity Securities</u>	130
	<u>PART III</u>
<u>Item 17. Financial Statements</u>	130
<u>Item 18. Financial Statements</u>	130
<u>Item 19. Exhibits</u>	131

OUR USE OF TERMS AND CONVENTIONS IN THIS ANNUAL REPORT

Unless otherwise specified or the context requires otherwise in this Annual Report on Form 20-F (Annual Report):

- references to Sappi , Sappi Group , Group , we , us and our are to Sappi Limited together with its subsidiaries;
- references to IFRS are to the International Financial Reporting Standards;
- references to southern Africa are to the Republic of South Africa, the Kingdom of Swaziland, the Kingdom of Lesotho, the Republic of Namibia and the Republic of Botswana;
- references to North America are to the United States, Canada and the Caribbean;
- references to Latin America are to the countries located on the continent of South America and Mexico;
- references to Rand , ZAR and R are to South African Rand and references to SA cents are to South African cents, the currency of South Africa;
- references to US dollar(s) , dollar(s) , US\$, \$ and US cents are to United States dollars and cents, the currency of the United States;
- references to euro , EUR and are to the currency of those countries in the European Union that form part of the common currency of the euro.
- references to Guilders and NLG are to Dutch Guilders, the former currency of the Netherlands;
- references to Deutsche marks and DEM are to German Deutsche marks, the former currency of Germany;
- references to UK pounds sterling and GBP are to United Kingdom pounds sterling, the currency of the United Kingdom;
- references to m² are to square metres and references to hectares or ha are to a land area of 10,000 square metres or approximately 2.47 acres;
- references to tonnes are to metric tonnes (approximately 2,204.6 pounds or 1.1 short tonnes);
- references to market share are based upon sales volumes in a specified geographic region during the fiscal year ended October 1, 2006;
- references to "NBSK" are to northern bleached softwood kraft pulp frequently used as a pricing benchmark for pulp;
- references to "groundwood" or to mechanical are to pulp manufactured using a mechanical process, or where applicable to paper, made using a high proportion of such pulp; and
- references to "woodfree paper" are to paper made from chemical pulp, which is pulp made from wood fibre that has been produced in a chemical process.

Except as otherwise indicated, in this Annual Report the amounts of capacity or production capacity of our facilities or machines are based upon our best estimates of production capacity at the date of filing of this Annual Report. Actual production by machines may differ from production capacity as a result of products produced, variations in product mix and other factors.

Certain market share information and other statements presented herein regarding our position relative to our competitors with respect to the manufacture or distribution of particular products are not based on published statistical data or information obtained from independent third parties, but reflect our best estimates. We have based these estimates upon information obtained from our customers, trade and business organisations and associations and other contacts in our industries.

Unless otherwise provided in this Annual Report, trademarks identified by ® are registered trademarks of Sappi Limited or our subsidiaries.

**EXPLANATORY NOTE
RELATING TO THE FIRST TIME ADOPTION OF
INTERNATIONAL FINANCIAL REPORTING STANDARDS.**

The consolidated financial statements of the Sappi Group as of and for the years ended September 2006 and 2005, including the applicable notes thereto, contained in Item 18 Financial Statements of this Annual Report on Form 20-F and the consolidated financial information of the Sappi Group as of and for the years ended September 2006 and 2005 contained herein have been aligned with International Financial Reporting Standards (IFRS). The consolidated financial statements and related financial information of the Sappi Group as of and for each of the years ended September 2004, 2003 and 2002, cannot be provided on an IFRS aligned basis without unreasonable effort or expense. The Sappi Group has not amended, and does not intend to amend, its previously filed financial statements for the years affected by the change in accounting policy that ended prior to the year ended September 2005. For this reason, our Annual Reports on Form 20-F for those prior years, the consolidated financial statements and applicable notes thereto, auditors reports and related financial information contained in such reports should not be compared to this Annual Report on Form 20-F. For a description of the change in accounting policy and resulting adjustments, see Item 5 Operating and Financial Review and Prospects, and note 2 to our Group annual financial statements, included herein.

ACCOUNTING PERIODS AND PRINCIPLES

Unless otherwise specified, all references in this Annual Report to a fiscal year and year ended of Sappi Limited refer to a twelve-month financial period. All references in this Annual Report to fiscal 2006 and fiscal 2005, or the year ended September 2006 and 2005 refer to Sappi Limited s twelve-month financial periods ended on October 1, 2006 and October 2, 2005 respectively; references in this Annual Report to fiscal 2007 refer to the period beginning October 2, 2006 and ending September 30, 2007. Our Group annual financial statements included elsewhere in this Annual Report have been prepared in conformity with IFRS, which differ in certain respects from United States generally accepted accounting principles (United States GAAP or US GAAP); see note 35 to our Group annual financial statements included elsewhere in this Annual Report. On May 13, 2002, we acquired the coated fine paper business of Potlatch Corporation. Our Group financial data for the year ended September 2002 includes the results for the acquired coated fine paper business since its acquisition.

CURRENCY OF PRESENTATION AND EXCHANGE RATES

We publish our Group annual financial statements and all financial data presented in this Annual Report in US dollars on a nominal (non-inflation adjusted) basis. For information regarding the conversion to US dollars in fiscal 2006 and 2005, see note 2 to our Group annual financial statements included elsewhere in this Annual Report.

FORWARD-LOOKING STATEMENTS

In order to utilise the Safe Harbor provisions of the United States Private Securities Litigation Reform Act of 1995 (the Reform Act), we are providing the following cautionary statement. Except for historical information contained herein, statements contained in this Annual Report may constitute forward-looking statements within the meaning of the Reform Act. The words believe, anticipate, expect, intend, estimate, assume, positioned, will, may, should, risk and other similar expressions, which are predictions of or indicate future events and future trends, which do not relate to historical matters identify forward-looking statements. In addition, this document includes forward-looking statements relating to our potential exposure to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity price risk. 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; pulp and paper production, production capacity, input costs (including raw materials, energy and employee costs) and pricing levels in North America, Europe, Asia and southern Africa; any major disruption in production at our key facilities; changes in environmental, tax and other laws and regulations; adverse changes in the markets for our products; any delays, unexpected costs or other problems experienced with any business acquired or to be acquired and achieving expected savings and synergies; consequences of our leverage; 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; and the impact of future investments, acquisitions and dispositions (including the financing of investments and acquisitions) and any delays, unexpected costs or other problems experienced in connection with dispositions.

These factors are fully discussed in this Annual Report. For further discussion on these factors, see Item 3 Key Information Selected Financial Data, Item 3 Key Information Risk Factors, Item 4 Information on the Company, Item 5 Operating and Financial Review and Prospects Financial Condition and Results of Operations, Item 10 Additional Information Exchange Controls and note 31 to our Group annual financial statements included elsewhere in this Annual Report. You are cautioned not to place undue reliance on these forward-looking statements. These forward-looking statements are made as of the date of the filing of this Annual Report and are not intended to give any assurance as to future results. 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.

PART I**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**Selected Financial Data**

The selected financial data set forth below has been derived from our Group annual financial statements and are qualified by reference to, and should be read in conjunction with, our Group annual financial statements and the notes thereto, which are included elsewhere in this Annual Report, and Item 5 Operating and Financial Review and Prospects.

We prepare our Group annual financial statements according to International Financial Reporting Standards. There are differences between these principles and those applied in the United States. You can read about the principal differences in note 35 to our Group annual financial statements included elsewhere in this Annual Report.

	Year Ended September	
	2006	2005
	(US\$ million, except per share data)	
Consolidated Income Statement Data:		
International Financial Reporting Standards:		
Sales(1)	4,941	5,018
Operating profit (loss)	125	(109)
Net (loss)	(4)	(184)
Basic (loss) per share (US cents)	(2)	(81)
Diluted (loss) per share (US cents)	(2)	(81)
Dividends per share (US cents)(3)	30	30

	Year Ended September				
	2006	2005	2004	2003	2002
	(US\$ million, except per share data)				
United States GAAP:					
Sales(1)	4,941	5,018	4,728	4,299	3,729
Operating profit (loss)(2)	21	(235)	120	272	402
Extraordinary items					6
Net (loss) profit(2)	(116)	(345)	46	148	237
Basic (loss) earnings per share (US cents)(2)	(52)	(154)	20	65	102
Diluted (loss) earnings per share (US cents)(2)	(52)	(154)	20	64	102
Dividends per share (US cents)(3)	30	30	30	29	28

	Year Ended September	
	2006	2005
	(US\$ million)	
Consolidated Balance Sheet Data:		
International Financial Reporting Standards:		
Total assets	5,517	5,889
Operating assets(4)	5,219	5,452
Total long-term borrowings	1,634	1,600
Shareholders' equity	1,386	1,589

	Year Ended September				
	2006	2005	2004	2003	2002
	(US\$ million)				
United States GAAP:					
Total assets	5,370	5,808	6,419	6,090	4,931
Operating assets(4)	5,066	5,369	5,889	5,465	4,672
Total long-term borrowings	1,734	1,643	1,904	1,869	1,559
Shareholders' equity(2)	1,356	1,591	1,979	1,908	1,581

Other Information:

	Year Ended September	
	2006	2005
	(US\$ million, except number of shares data)	
International Financial Reporting Standards:		
EBITDA(5)	591	381
Weighted average number of ordinary shares in issue (in million)	226.2	225.8

	Year Ended September				
	2006	2005	2004	2003	2002
	(US\$ million, except number of shares data)				
United States GAAP:					
EBITDA(2)(5)	466	226	570	656	745
Weighted average number of ordinary shares in issue (in million)	225.3	224.7	225.0	227.6	228.8

(1) Sales are defined in note 2 to our Group annual financial statements included elsewhere in this Annual Report.

(2) In 2005, stock compensation of US\$12 million was included in the US GAAP equity reconciliation and has been removed. An amount of US\$13 million was charged to the 2005 profit and loss accounts in respect of the adoption of FAS 123R. This comprises a US\$10 million charge due to the adoption of IFRS 2 and an additional US\$3 million being the extra charge as a result of the earlier effective date of FAS 123R compared to IFRS 2. The effect is a change of US GAAP basic and diluted earnings per share from US 148 cents to US 154 cents per share. For a more detailed explanation see note 35 to our Group annual financial statements included elsewhere in this Annual Report.

(3) The dividends per share were, in each case, declared after the end of the year indicated. For further information on our dividend policy, see Item 8 Financial Information-Dividend Policy.

(4) Operating assets are defined in note 3 to our Group annual financial statements included elsewhere in this Annual Report.

(5) In connection with the U.S. Securities Exchange Commission (SEC) rules relating to Conditions for Use of Non-GAAP Financial Measures , we have reconciled EBITDA to net profit rather than

2

operating profit and recalculated EBITDA. As a result our definition has been amended to retain non-trading profit/loss and minority interest as part of EBITDA. EBITDA represents earnings before interest (net finance costs), taxation, depreciation and amortisation (including fellingings). Net finance costs includes: gross interest paid; interest received; interest capitalised; net foreign exchange gains; and net fair value adjustments on interest rate financial instruments. See the Group income statement to our Group annual financial statements included elsewhere in this Annual Report for an explanation of the computation of net finance costs. We use EBITDA as an internal measure of performance to benchmark and compare performance, both between our own operations and as against other companies. EBITDA is a measure used by the group, together with measures of performance under IFRS and US GAAP, to compare the relative performance of operations in planning, budgeting and reviewing the performances of various businesses. We believe EBITDA is a useful and commonly used measure of financial performance in addition to net profit, operating profit and other profitability measures under IFRS or US GAAP because it facilitates operating performance comparisons from period to period and company to company. By eliminating potential differences in results of operations between periods or companies caused by factors such as depreciation and amortization methods, historic cost and age of assets, financing and capital structures and taxation positions or regimes we believe EBITDA can provide a useful additional basis for comparing the current performance of the underlying operations being evaluated. For these reasons, we believe EBITDA and similar measures are regularly used by the investment community as a means of comparison of companies in our industry. Different companies and analysts may calculate EBITDA differently, so making comparisons among companies on this basis should be done very carefully. EBITDA is not a measure of performance under IFRS or US GAAP and should not be considered in isolation or construed as a substitute for operating profit or net profit as an indicator of the company's operations in accordance with IFRS or US GAAP.

The following table reconciles net (loss) profit to EBITDA.

	Year Ended September	
	2006	2005
	(US\$ in million)	
International Financial Reporting Standards:		
Net (loss)	(4)	(184)
Add back:		
Depreciation and amortisation (fellings)	466	490
Net finance costs	130	80
Taxation	(1)	(5)
EBITDA	591	381

	Year Ended September				
	2006	2005	2004	2003	2002
	(US\$ in million)				
United States GAAP:					
Net (loss) profit	(116)	(345)	46	148	237
Add back:					
Depreciation and amortisation (fellings)	446	470	450	385	349
Net finance costs	106	55	93	90	74
Taxation	30	46	(19)	33	85
EBITDA	466	226	570	656	745

Risk Factors

In addition to other information contained in this Annual Report, you should carefully consider the following factors before deciding to invest in our ordinary shares and American Depositary Shares (ADSs). There may be additional risks that we do not currently know of or that we currently deem immaterial based on the information available to us. Our business, financial condition or results of operations could be materially adversely affected by any of these risks, resulting in a decline in the trading price of our ordinary shares and ADSs.

Risks Related to Our Industry.

We operate in a cyclical industry, which has in the past resulted in substantial fluctuations in our results.

The markets for our pulp and paper products are significantly affected by changes in industry capacity and output levels and by cyclical changes in the world economy. As a result of periodic supply/demand imbalances in the pulp and paper industry, these markets historically have been highly cyclical, with volatile pulp and paper prices. The timing and magnitude of price increases or decreases in the pulp and paper market have generally varied by region and by type of pulp and paper.

The selling prices of the majority of the products manufactured and purchase prices of many of our raw materials used generally fluctuate in line with commodity cycles; however, in fiscal 2006, we may not be able to increase selling prices sufficiently or in time to offset the effects of increased costs, which has an adverse impact on our profitability. Other than maintaining a high level of pulp integration, the hedging techniques applied on our raw materials and products are on a small scale and short term in nature. Movements in prices of pulp and paper products are difficult to predict. Also, there may be periods during which demand for our products is insufficient to enable us to operate our production facilities in an economical manner. A sustained period of weak demand or excess supply would be likely to adversely affect pulp and paper prices which could have a material adverse effect on our operating rates and financial results.

Despite a relatively high level of pulp integration on a Group-wide basis, a significant increase in the prices for pulp or pulpwood could adversely affect our non-integrated and partially integrated operations if they are unable to raise paper prices sufficiently to offset the effects of increased costs.

The majority of our fine paper sales consist of sales to merchants. The pricing of products for merchant sales can generally be changed upon between 30 to 90 days advance notice to the merchant. Sales to converters may be subject to longer notice periods for price changes. Such notice periods generally would not exceed 6 to 12 months. In southern Africa, we have entered into longer-term fixed-price agreements of between 6 to 12 months duration for primarily packaging paper and newsprint sales with domestic customers. Such agreements accounted for less than 5% of consolidated sales during fiscal 2006.

Most of our chemical cellulose sales contracts are multi-year contracts. The pricing is generally based on a formula linked to the NBSK price and reset on a quarterly basis.

For further information, see Item 4 Information on the Company Business Overview The Pulp and Paper Industry .

The markets for pulp and paper products are highly competitive, and many of our competitors have advantages that may adversely affect our ability to compete with them, particularly in North America.

We compete against a large number of pulp and paper producers located around the world. A recent trend towards consolidation in the pulp and paper industry has created larger, more focused pulp and paper companies. Some of these companies benefit from greater financial resources or operate mills that are lower cost producers of pulp and paper products than our mills. We cannot assure you that each of our

mills will be competitive. Furthermore, we cannot assure you that we will be able to take advantage of consolidation opportunities which may arise, or that any failure to exploit opportunities for growth would not make us less competitive. Increased competition, including import duties decrease in accordance with the terms of free trade agreements, could cause us to lose market share, increase expenditures or reduce pricing, any of which could have a material adverse effect on the results of our operations. In addition, competition may result in our being unable to increase selling prices of our products sufficiently or in time to offset the effects of increased costs without losing market share, as occurred in Europe in fiscal 2006, which has an adverse impact on profitability.

Our North American business has experienced significant losses in recent years partly due to competition, and it may face additional competitive challenges in returning to profitability. There was a significant amount of coated fine paper capacity added in China in 2005. Some of this capacity may be exported to the US, depressing domestic operating rates and potentially also depressing prices. While we believe our North American business is competitive compared to our US competitors, the assets of our North American business are small in comparison to new world-scale coated fine paper machines. The cost position of our machines in relation to imports from both Asia and Europe may be less competitive due to a variety of factors including currency, fuel costs, shipping charges, duties, and market pulp prices. A significant strengthening of the US dollar in comparison to the euro could attract a significant amount of imports from Europe.

The cost of complying with environmental regulation may be significant to our business.

Our operations are subject to a wide range of environmental requirements in the various jurisdictions in which we operate. We expect to continue to incur significant expenditures and may face operational constraints to maintain compliance with applicable environmental laws, to upgrade equipment at our mills and to meet new regulatory requirements, including those in the United States, South Africa and Europe. Expenditures to comply with future environmental laws and regulations could have a material adverse effect on our business and financial condition.

For further information, see Item 4 Information on the Company Business Overview Environmental and Safety Matters Environmental Matters and Item 5 Operating and Financial Review and Prospects Environmental Matters .

The availability and cost of Insurance cover can vary considerably from year to year as a result of events beyond our control, and this can result in our paying higher premiums and periodically being unable to maintain the levels or types of insurance carried.

The insurance industry remains cyclical and catastrophic events can change the state of the insurance market, leading to sudden and unexpected increases in premiums and deductibles and unavailability of coverage due to reasons totally unconnected with our business.

Although we have successfully placed the renewal of our 2006/2007 insurance cover at rates lower than 2005/2006 and self-insured deductibles for any one property damage occurrence have remained at \$25 million, with an unchanged aggregate limit of \$40 million, we are unable to predict whether past or future events will result in less favourable terms. For property damage and business interruption, there generally does not seem to be cost effective cover available to full value, however the directors believe that the loss limit cover of \$1 billion should be adequate for what they have determined as the reasonably foreseeable loss for any single claim.

While we believe our insurance provides adequate coverage for reasonably foreseeable losses, we continue working on improved enterprise risk management to lower the risk of incurring losses from uncontrolled incidents. We are unable to assure you that actual losses will not exceed our coverage or that such excess will not be material.

New technologies or changes in consumer preferences may affect our ability to compete successfully.

We believe that new technologies or novel processes may emerge and that existing technologies may be further developed in the fields in which we operate. These technologies or processes could have an impact on production methods or on product quality in these fields. Unexpected rapid changes in employed technologies or the development of novel processes that affect our operations and product range could render the technologies we utilise or the products we produce obsolete or less competitive in the future. Difficulties in assessing new technologies may impede us from implementing them and competitive pressures may force us to implement these new technologies at a substantial cost. Any such development could materially and adversely impact our revenues or net profits or both.

Consumer preferences may change as a result of the availability of alternative products or of services such as electronic media or the internet, which could impact consumption of our products.

Risks Related to Our Business

Our indebtedness may impair our financial and operating flexibility.

At September 2006, our total interest-bearing borrowings were \$2,328 million. While reduction of borrowings is a priority, opportunities to grow within our businesses will continue to be evaluated, and the financing of any future acquisition or capital investment may include the incurrence of additional indebtedness.

We are subject to South African exchange controls, which partially inhibit the free flow of funds from South Africa and can restrict activities of subsidiaries of the Sappi Group. These exchange controls have affected the geographic distribution of our debt. As a result, acquisitions in the United States and Europe were financed with indebtedness incurred by companies in those regions. The level of our debt has important consequences. For example, our ability to obtain additional financing may be limited, which could limit, among other things, our ability to exploit growth opportunities; a substantial portion of our cash flow from operations may be required to make debt service payments; we are exposed to increases in interest rates because a portion of our debt bears interest at variable rates; we may be more leveraged than certain of our competitors; we may be more vulnerable to economic downturns and adverse changes in our business; and our ability to withstand competitive pressure may be more limited.

In addition, certain of our financing arrangements contain covenants and conditions that restrict the activities of certain Group companies.

Exchange control restrictions may restrict the transfer of funds directly or indirectly between our subsidiaries or between the parent company and our subsidiaries. We may also incur tax costs in connection with these transfers of funds. As a consequence, the ability of Sappi Limited or any of our subsidiaries to make scheduled payments on its debt will depend on its financial and operating performance, which will depend on various factors beyond our control, such as prevailing economic and competitive conditions. If Sappi Limited or any of our subsidiaries is unable to achieve operating results or otherwise obtain access to funds sufficient to enable it to meet its debt service obligations, it could face substantial liquidity problems. As a result, it might need to delay investments or dispose of material assets or operations. The timing of and the proceeds to be realised from any such disposition would depend upon circumstances at the time.

Labour agreements are under negotiation at several of our mills.

The Cloquet and Muskegon Mills United Steelworkers union contracts that expired in April 2006 and August 2005 respectively are under negotiation. Collective labour agreements have been renegotiated for all sites in Europe during fiscal 2006, with minor disruption to operations at only one site. At our southern African mills wage negotiations occur annually and in 2006 negotiations were completed in August 2006.

While we hope to reach agreements on new contracts at all affected sites, in the event that agreements cannot be reached and a prolonged work stoppage that results in a curtailment of output ensues at any or all such sites, our business could be adversely affected.

Fluctuations in the value of currencies, particularly the Rand and the euro, in relation to the US dollar have in the past had and could in the future have a significant impact on our earnings in these currencies.

Exchange rates fluctuations have in the past, and may in the future, affect the competitiveness of our products in relation to the products of pulp and paper companies based in other countries.

Fluctuations in the exchange rate between currencies, particularly the Rand and euro, in relation to the US dollar have in the past significantly affected and could in the future significantly affect our earnings.

Since the adoption of the euro by the European Union on January 1, 1999 (when the euro was trading at approximately \$1.18 per euro), it has fluctuated against the US dollar to approximately \$1.27, \$1.20 and \$1.23 per euro at the end of fiscal 2006, 2005 and 2004, respectively. It reached a low of approximately \$0.83 per euro on October 25, 2000 and, on December 6, 2006, was trading at approximately \$1.33 per euro.

In recent years, the value of the Rand against the US dollar has fluctuated considerably. It has moved against the US dollar to approximately R7.77, R6.37 and R6.43 per US dollar at the end of fiscal 2006, 2005 and 2004, respectively. The Rand reached a low of approximately R13.90 per US dollar on December 21, 2001. Since then, it has appreciated and on December 6, 2006 was trading at approximately R7.08 per US dollar.

For further information, see notes 21 and 31 to our Group annual financial statements included elsewhere in this Annual Report and Item 5 Operating and Financial Review and Prospects Operating Results currency fluctuations .

There are risks relating to the many countries in which we operate that could impact our earnings or affect your investment in our Company.

We own manufacturing operations in five countries in Europe, four states in the United States, South Africa, Swaziland and have an investment in a joint venture in China. These risks arise from being subject to various economic, fiscal, monetary, regulatory operational and political factors that affect companies generally and which may change as economic, social or political circumstances change. See Item 5 Operating and Financial Review and Prospects South African Economic and Political Environment and Item 5 Operating and Financial Review and Prospects South African Exchange Controls .

Our geographic diversity may help to mitigate these risks. In fiscal 2006, 44% of our sales originated from Europe, 29% from North America and 27% from southern Africa. 42% of our operating assets were located in Europe, 26% in North America and 32% in southern Africa. In the fiscal year 2006 our operations outside southern Africa had an operating loss of US\$49 million and our operations in southern Africa had an operating profit of US\$174 million.

We face certain risks in dealing with HIV/AIDS which may have an adverse effect on our southern African operations.

There is a serious problem with HIV/AIDS infection among our southern African workforce, as there is in southern Africa generally. Although the HIV/AIDS infection rate of our southern African workforce is significantly lower than the national average, it is expected to increase over the next decade. While we have several programmes designed to mitigate the impact of the disease on our business, the costs and lost worker s time associated with HIV/AIDS may adversely affect our southern African operations.

Several customers account for a significant amount of our revenues.

We sell a significant portion of our products to several major customers, including PaperlinX, Unisource Worldwide Inc., xpedx and Antalis. Any adverse development affecting our principal customers or our relationships with our principal customers could have an adverse effect on our business and results of operations. See Item 4 Business Overview Marketing and Distribution Sappi Fine Paper Customers and Item 4 Business Overview Marketing and Distribution Sappi Forest Products Customers .

Because of the nature of our business and workforce, we are facing challenges in the retention and succession planning of management that could adversely affect our business.

We are facing an aging demographic work profile among our management due to the mature nature of our industry and the rural and often remote location of our mills, together with generally long tenure of employees at the mills. As a result we are likely to experience groups of employees leaving the company within a relatively short space of time of one another and may have difficulty attracting qualified replacements. The potential risks we face are a loss of institutional memory, skills, experience and management capabilities. Although we have put in place a number of initiatives to mitigate this risk, including implementing programs to promote phased retirement and transfer of knowledge, creating flexibility in career and job design and focussing greater effort on succession planning and talent review and effective skills training and leadership development we may be unable to attract and retain sufficient qualified replacements when and where necessary to avoid an adverse impact on our business.

Risks Related to Our Shares

Your ability to sell a substantial number of ordinary shares may be restricted by the limited liquidity of shares traded on the JSE Limited.

The principal trading market for the ordinary shares of Sappi Limited is the JSE Limited (JSE) (formerly the JSE Securities Exchange South Africa). Historically, trading volumes and liquidity of shares listed on the JSE have been low in comparison with other major international markets. In fiscal 2006, 251 million ordinary shares of Sappi Limited were traded on the JSE and 58 million ADSs were traded on the New York Stock Exchange. See Significant shareholders may be able to influence the affairs of our Company , Item 7 Major Shareholders and Related Party Transactions Major Shareholders , Item 9 The Offer and Listing Offer and Listing Details and Item 9 The Offer and Listing Markets .

Significant shareholders may be able to influence the affairs of our Company.

Although our investigation of beneficial ownership of our shares identified only two beneficial owners of more than 5% of our ordinary shares, holding approximately 19.9%, as shown in our shareholders register at September 30, 2006, the five largest shareholders of record, four of which are nominees that hold shares for a multitude of beneficial owners, owned approximately 93% of our ordinary shares. See Item 7 Major Shareholders and Related Party Transactions Major Shareholders .

ITEM 4. INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF THE COMPANY

Sappi Limited is a public company incorporated in the Republic of South Africa. Its principal executive offices are located at 48 Ameshoff Street, Braamfontein, Johannesburg, 2001, Republic of South Africa and its telephone number is +27-11-407-8111.

Sappi Limited was founded and incorporated in 1936 in South Africa and is a corporation organised under the Companies Act 61 of 1973 of the Republic of South Africa.

Until 1990, we primarily expanded our operations within southern Africa. Since 1990, we have grown through acquisitions outside of southern Africa. In the mid 1990's we acquired S.D. Warren Company, a market leader in the United States in coated fine paper and a major producer of other speciality paper products. It now conducts business as Sappi Fine Paper North America. In the late 1990's we acquired KNP Leykam, a leading European producer of coated fine paper. KNP Leykam now conducts business as Sappi Fine Paper Europe. On May 13, 2002, we acquired Potlatch Corporation's coated fine paper business and have integrated it in Sappi Fine Paper North America.

In December 2004 we acquired 34% of Jiangxi Chenming Paper Company, a joint venture which commissioned in mid-2005 a coated mechanical paper machine, mechanical pulp mill and de-inked pulp mill in China.

In August 2006, we announced the expansion of the existing capacity at Sappi Saiccor in South Africa, where Chemical Cellulose products are produced. The current capacity of the mill is approximately 600,000 metric tonnes per annum. The expansion will increase capacity by a net 225,000 metric tonnes per annum. The estimated cost of the project is \$460 million. Funding for the project is to be sourced mainly from existing financing facilities in South Africa.

In April 2006, Sappi announced a black economic empowerment transaction involving the sale of identified forestry land to a South African empowerment partner. Certain conditions to the formal conclusion of the transaction have not yet been met, and therefore, no transactions under the arrangement have been effected.

For information on our principal investments and capital expenditures, see the description of our business in [Business Overview](#) and [Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources](#).

We currently have our primary listing on the JSE Limited (Johannesburg Stock Exchange) and have secondary listings on the New York and London Stock Exchanges.

BUSINESS OVERVIEW

Business Strategy

Our objective for the coming years is to build on our position as a global leader in the coated fine paper market, which was from the beginning of the 1990's one of the fastest growing market sectors in the paper industry, and to explore opportunities across the broad spectrum of coated paper to utilise our experience in paper coating as well as the chemical cellulose market and to support this with a high level of economic pulp integration. These represent our core products and sectors in the paper and forest products industry. We will continue to invest in our southern African businesses which have important market shares. The key elements of our business strategy are and have been as follows:

Strengthen our leadership position in our core businesses through organic growth and selective acquisitions.

We believe that opportunities for further consolidation remain in our sector. We intend to be at the forefront of this consolidation, aiming to strengthen our position in Europe, North America, and eventually Asia. We intend to focus on investment and acquisition opportunities that fit our strategies, that offer a potential return that exceeds our expected cost of capital and that in the medium term are more advantageous than buying back our shares.

Maintain a global presence.

One of Sappi's key strengths is our geographically diverse business base. We have a significant presence in each of Europe, North America and Africa, and a modest presence in Asia. The presence in Europe and North America has been built up over the past ten years, largely through strategic acquisitions. We will continue to pursue a strategy of geographic diversification supported by leading market positions.

Maintain a high level of economic pulp integration.

We intend to maintain a high level of economic pulp integration, which helps reduce the impact of pulp price volatility on our earnings.

Maintain cost efficient asset base and invest to increase efficiency/productivity.

We believe our asset base has some of the lowest cost and most efficient assets in the coated fine paper sector in the world. We maintain a rigorous focus on costs, and actively manage our asset base, including divesting or closing non-performing assets. We have closed 14 paper machines since 1995, including the recent closure of the Nash Mill.

We maintain an investment policy that is focused on high return projects. A significant portion of our investments are designed to increase production capacity, reduce costs and improve product quality.

Drive growth through market focus and innovation.

The Sappi Group operations represent the originators of many of the major innovations in the industry in the last century. We continue to maintain a focus on innovation through our research and development centres in Europe, North America and South Africa and have established multi-regional, multi-discipline teams to ensure that we transfer knowledge throughout the Group and implement best practice and that our research and development efforts are market oriented. We intend to allocate additional resources to marketing, innovation and technology. This includes the creation of multi-regional marketing teams and their links with the relevant technology teams.

Through our partnership with a leading global software provider, we are focused on developing unique information technology solutions that satisfy our customers' requirements and production capabilities, resulting in improved service delivery and operational efficiency.

The Pulp and Paper Industry

The paper industry is generally divided into the printing and writing paper segment, consisting of newsprint, groundwood paper and fine paper, and the packaging segment, consisting of containerboard, boxboard and sackkraft.

Long-term, paper and board consumption has grown in line with overall economic growth, but consumption patterns are also influenced by short-term economic developments. Pricing largely is influenced by the supply/demand balance for individual products, which is partially dependent on capacity and inventory levels in the industry. The ability to adapt capacity changes in response to shorter-term fluctuations in demand is limited, as large amounts of capital are required for the construction or upgrade of production facilities and as lead times are long between the planning and completion of new facilities. Industry-wide over-investment in new production capacity has in the past led to situations of significant oversupply, which has caused product prices to decrease. This has been exacerbated by inventory speculation, as purchasers have sought to benefit from the price trend. As a result, financial performance has deteriorated during periods of significant oversupply to again improve when demand has increased to levels that support the implementation of price increases.

In recent years the industry has experienced significant strategic changes. The high costs associated with building new paper mills and establishing and growing market share has led to companies focusing on acquisition, rather than construction, of new capacity. In China, however, rapid economic growth and government incentives spurred massive investment in the pulp and paper industry. Over the last 5 years, paper and board capacity increased 73%. This development has led to a reduction in events of significant dislocations in the supply/demand balance typically associated with the entry of new production capacity into established markets. With increased capacity in 2006 China is no longer a net importer of coated fine paper. Another result of this trend has been a greater concentration of production capacity among fewer producers. Many leading industry producers now focus on fewer core grades and have divested non-core assets that are not part of the industry or which have been considered not consistent with long-term strategies. The regional and global market shares of leading producers have increased significantly over the past decade.

The following table shows a breakdown and description of the major product categories Sappi participates in, the products in these categories and the typical uses for such products. We have produced and sold each of these products in each of our last three fiscal years.

Major Product Categories	Description and Typical Uses
<i>Fine Paper:</i>	
Coated paper	Higher level of smoothness than uncoated paper achieved by applying a coating (typically clay based) on the surface of the paper. As a result, higher reprographic quality and printability is achieved. Uses include brochures, catalogues, corporate communications materials, direct mail promotions, educational textbooks, luxury advertising, magazine covers and upscale magazines.
Uncoated paper	Uses include business forms, business stationery, general printing paper, tissue and photocopy paper.
Speciality paper	Can be either coated or uncoated. Uses include bags, labels, packaging and release paper for casting textured finishes (e.g., artificial leather).
<i>Packaging products:</i>	
Packaging paper	Heavy and lightweight grades of paper and board primarily used for primary and secondary packaging of fast moving consumer goods, agricultural and industrial products. Products include containerboard (corrugated shipping containers), sack kraft (multi-walled shipping sacks) and machine glazed kraft (grocers bags). Can be coated to enhance barrier and aesthetics properties.
<i>Groundwood products:</i>	
Newsprint	Manufactured from groundwood and bleached chemical pulp. Uses include advertising inserts and newspapers. Demand is highly dependent on newspaper circulation and retail advertising.
Coated groundwood paper	A coated groundwood fibre based paper, primarily used for magazines, catalogues and advertising material. Manufactured from mechanical pulp.

Pulp:

Paper pulp

Main raw material used in production of printing, writing and packaging paper. Pulp is the generic term that describes the cellulose fibre derived from wood. These cellulose fibres may be separated by mechanical, thermo-mechanical or chemical processes. The chemical processes involve removing the glues (lignins) which bind the wood fibres to leave cellulose fibres. Paper made from chemical pulp is generally termed woodfree. Uses include paper, paperboard and tissue.

Chemical cellulose

Manufactured by similar processes to paper pulp, but purified further to leave virtually pure cellulose fibres. Chemical cellulose is used in the manufacture of a variety of cellulose textile and non-woven fibre products, including viscose staple fibre (rayon), solvent spun fibre (lyocell) and filament. It is also used in various other cellulose-based applications in the food, cigarette, chemical and pharmaceutical industries. These include the manufacture of acetate tow microcrystalline cellulose, cellophane, ethers and moulding powders. The various grades of chemical cellulose are manufactured in accordance with the specific requirements of customers in different market segments. The purity of the chemical cellulose is one of the key determinants of its suitability for particular applications with the purer grades of chemical cellulose generally supplied into the speciality segments.

Timber products:

Sawn timber for construction and furniture manufacturing purposes.

The following table sets forth selected pulp and paper prices in certain markets for the periods presented.

	Year Ended September					
	2006	2005	2004			
	Low	High	Low	High	Low	High
Coated Fine Paper						
100 gsm delivered Germany (euro per metric tonne)(1)	790	825	845	845	840	855
60 lb. delivered US (US\$per short tonne)(2)	900	960	870	920	760	840
Uncoated Fine Paper						
50 lb. delivered US (US\$per short tonne)(3)	700	850	700	770	575	750
Paper Pulp						
NBSK (US\$per metric tonne)(4)	595	715	585	655	540	660
Chemical cellulose						
92 alpha (US\$per metric tonne)(5)	650	775	600	780	600	780

(1) 100 gsm sheets, RISI.

(2) 60 lb. Coated Web, RISI.

(3) 50 lb. Offset, RISI.

(4) Northern Bleached Softwood Kraft Pulp CIF Northern Europe, RISI.

(5) Selected indicative prices, Sappi.

Fine Papers

Our fine paper activities are divided into coated and uncoated fine paper and speciality paper grades.

Coated Fine Paper. Major end uses of coated fine paper include high-end magazines, catalogues, brochures, annual reports and commercial printing. Coated fine paper is made from chemical pulp and is coated on one or both sides for use where high reprographic quality is required. The majority of coated fine paper production is coated on two sides, permitting quality printing on both sides of the paper. Paper that is coated on one side is used in special applications such as consumer product and mailing label applications.

Our 2006 North American coated fine paper sales volume was 26% in sheet form and 74% in reel form. The sheet volume is largely influenced by brochure and general commercial printing activities and printers using mainly sheetfed offset lithographic printing processes, which are not particularly seasonal, and corporate annual reports, which result in heaviest demand during the first calendar quarter. Reels volume is heavily influenced by catalogue and text book activity, which results in heaviest demand during the third calendar quarter, and publication printer activity, which is not particularly seasonal. These printers principally use heatset web offset printing processes.

Our 2006 European business sales volumes of coated fine paper were 72% in sheet form and 28% in reels form. Due to the diversity in languages in the European market, the print editions of brochure and general commercial printing activities are considerably smaller than in the US market. This translates into a significantly higher volume in sheets. The seasonal patterns of both sheets and reels are mostly influenced by the catalogue business. This segment has its highest seasonal activity in the spring, when the fashion catalogues come out, and the autumn, when the Christmas catalogues and holiday brochures are printed. Commercial print and publishing business provide a more steady demand in this market.

See Item 5 Operating and Financial Review and Prospects Markets .

Uncoated Paper. Uncoated fine paper represents the largest industry fine paper grade in terms of both global capacity and consumption. Uncoated fine paper is used for bond/writing and offset printing papers, photocopy papers, writing tablets (e.g., legal pads), speciality lightweight printing paper (e.g., bibles) and thin paper.

The market for uncoated paper products generally follows cyclical trends, which do not necessarily coincide with cycles for coated paper but are impacted by capacity changes in uncoated fine paper output levels.

Speciality Paper. The high value-added speciality paper markets in which Sappi Fine Paper operates generally follow trends in the respective end use sectors in addition to changes in production capacity, output levels and cyclical changes in the world economy. Largely due to the highly specialised nature of speciality paper, price fluctuations have historically tended to lag and be less precipitous than price changes in the uncoated fine paper market.

Packaging Products

Our range of forest products comprises a variety of packaging papers produced in southern Africa at the Tugela, Cape Kraft and Ngodwana mills. We are one of the two major suppliers of packaging papers in South Africa.

Packaging Paper. As with fine paper, the market for packaging papers is affected by cyclical changes in the world economy, local economic growth, retail sales and by changes in production capacity and output levels. The southern African containerboard market has been positively affected by strong gross domestic product growth and corresponding growth in retail sales during fiscal 2006. Demand for sack kraft is largely driven by the demand for cement, potatoes, sugar and milling products. Sappi's sack kraft

market share was negatively affected by lower priced imported products and production constraints in 2005, a trend that continued through 2006 despite positive demand growth in the local market.

Over the past year, the kraft linerboard (KLB) price recovered. During September 2006 US East price for 42lb KLB traded at US\$ 515 per short ton, US\$120 higher than September 2005, which traded at US\$395. In the South African domestic market, we have entered into medium-term contractual commitments with converters of containers, sacks and bags. These commitments include certain volume targets and, in some cases, as is customary in the market, fixed prices for periods of 12 months.

Groundwood Products

Newsprint. The Ngodwana mill produces newsprint. The worldwide market for newsprint is a low growth sector in the paper industry and was adversely affected during the early 1990s by substantial increased capacity and stagnating demand from, and cost-cutting measures imposed by, major newsprint end-users. Since 1999 consumption of newsprint in the United States has declined every year and as of calendar year 2005 was 21% lower than in 1999. Consumption in South Africa has however grown on the back of new titles and greater penetration of freesheets.

Coated Groundwood. Coated groundwood paper, primarily used for magazines, catalogues and advertising materials, has been one of the fastest growing paper grades in the paper industry in recent years. The segment is also one of the most consolidated segments of the paper industry. Demand for coated magazine paper is influenced by magazine circulation and demand for advertising, and by the price difference relative to coated fine paper and to uncoated groundwood paper as substitution between these grades is possible, depending on quality requirements and price levels. Western European producers are the leading producers of coated groundwood globally. Rapid capacity expansion by leading producers in the early 1990s led to volatile pricing and the development of a significant export business from Europe, primarily to North America and Asia. Pricing development has been more stable in the past three years.

Pulp

We produce chemical cellulose, as well as a wide range of paper pulp grades, including groundwood pulp used in newsprint, unbleached kraft pulp, bleached kraft pulp and bleached sulphite pulp.

Paper Pulp. The market pulp industry is highly competitive and is sensitive to changes in industry capacity, producer inventories, demand for paper and cyclical changes in the world economy. The market price per metric tonne of northern bleached softwood kraft (NBSK) pulp, a pulp principally used for the manufacture of fine paper, is a benchmark widely used in the industry for comparative purposes.

In line with the global economy, pulp demand was low throughout 2002 and 2003 and price fluctuations were driven primarily by supply management and the consequent impact on inventories. Accordingly, NBSK prices fluctuated considerably with a difference of \$180 per metric tonne between a high of \$560 and a low of \$380 during fiscal 2002 and 2003. Higher demand during the first six months in fiscal 2004 caused pulp prices to trade at a higher base, with prices reaching a high of \$655 and a low of \$585. Lagging paper market demand in especially Asia and Europe caused pulp demand to decline during the latter part of 2004 and the beginning 2005. The pulp market however improved towards the end of 2005 and remained firm during 2006. As a result NBSK prices averaged \$695 during 2006, a \$50 premium compared to 2005, pulp prices continued to increase during 2006, trading at \$770 in October 2006.

Market unbleached kraft pulp (UKP) is used in the production of packaging papers, including kraft linerboard and sack kraft and for certain niche products such as oil and air filters. The market price of UKP generally follows the price trends of other paper pulp grades.

Chemical cellulose. The viscose staple fibre (VSF) industry which manufactures textile and non-woven fibres is the largest market segment for chemical cellulose. Prices of VSF grade chemical cellulose

generally follow those of the European NBSK. Over the past decade, the price of VSF grade chemical cellulose has ranged from a high of over \$1,000 per metric tonne in the fourth quarter of 1995, to a low of \$470 per metric tonne in the second quarter of 2002. During the past year, prices of VSF grade chemical cellulose were weaker at the beginning of the fiscal year but subsequently strengthened during the year, reaching a high in the fourth fiscal quarter of 2006 of \$775 per metric tonne. This level is expected to continue in the short term. Prices of the higher purity chemical cellulose used in applications other than for VSF products tend to be more stable and are largely unrelated to the price of NBSK. The manufacture of cellulose acetate flake (used in the manufacture of acetate tow for cigarette filter tips) is the second largest application for chemical cellulose after viscose staple fibre. The market price for chemical cellulose used for cellulose acetate flake production has increased to levels above \$900 per metric tonne and is set by competitive forces within this specific market.

Timber Products

Our timber products operations are concentrated in South Africa and consist of sawn timber for the building industry and components for the furniture and packaging industry.

Business Review

We are a leading global producer of coated fine paper and chemical cellulose.

We are a geographically diverse global paper company with significant manufacturing operations on three continents and sales in over 100 countries. During fiscal 2006, we had sales of \$4,941 million, operating profit of \$125 million and net loss of \$4 million. We currently have a paper production capacity of approximately 5.1 million metric tonnes per annum, chemical cellulose production capacity of 600,000 metric tonnes per annum and paper pulp production capacity of 2.9 million metric tonnes per annum.

Our operations are currently structured around two business units (segments):

- Sappi Fine Paper, which has fine paper and related paper pulp businesses in North America, Europe, South Africa and a 34% share in a Chinese joint venture; and
- Sappi Forest Products, which produces commodity paper products (newsprint and packaging papers), pulp (including chemical cellulose and hardwood and softwood pulp) and forest and timber products (including pulpwood, sawlogs and sawn timber) for southern Africa and export markets. Sappi Forest Products is based in South Africa.

We also operate a trading network for the international marketing and distribution of our products outside our core operating regions of North America, Europe and southern Africa. Our trading operation, which we refer to as Sappi Trading, co-ordinates our shipping and other logistical functions for exports from southern Africa, Europe and North America. All sales and costs associated with Sappi Trading are allocated to the two business units.

The markets for our pulp and paper products are significantly affected by changes in industry capacity and output levels and by cyclical changes in the world economy. For further information,

see Information on the Company Business Overview The Pulp and Paper Industry and Item 5 Operating and Financial Review and Prospects .

The chart below represents the operational rather than the legal or ownership structure of Sappi as of November 2006. Units shown are not necessarily legal entities.

The following table sets forth certain information with respect to our operations for, or as at the end of, the year ended September 2006.

	Sappi Fine Paper North America	Europe	South Africa	Sappi Forest Products	Corporate And Other	Total
	(US\$million, metric tonnes in thousands)					
Sales volume (metric tonnes)	1,426	2,450	328	2,995		7,199
Sales	1,439	2,194	325	983		4,941
Operating profit	(16)	(27)	(6)	175	(1)	125
Operating assets(1)	1,334	2,196	196	1,407	86	5,219

(1) Operating assets as defined in note 3 to our Group annual financial statements included elsewhere in this Annual Report.

SAPPI FINE PAPER

Overview

Sappi Fine Paper is the largest business sector of Sappi and contributed approximately 58% of our sales volumes in fiscal 2006. It has the capacity to produce 4.2 million metric tonnes of paper per annum at its 14 paper and related paper pulp mills located on three continents. Sappi Fine Paper manages its business in three principal regions: Sappi Fine Paper North America, Sappi Fine Paper Europe and Sappi Fine Paper South Africa.

The following chart sets forth certain information with respect to the mills and principal products of Sappi Fine Paper as of November 2006.

The following table sets forth approximate annual production capacity with respect to Sappi Fine Paper's products.

	Annual Production Capacity			
	North America	Europe	South Africa	Total
Production capacity (000s metric tonnes):				
Fine paper				
Coated(1)	1,260	2,605	80	3,945
Uncoated(2)		35	270	305
Total(3)	1,260	2,640	350	4,250
Paper pulp	900	680	160	1,740
Percentage paper pulp integration(4)	115 %	46 %	59 %(5)	65 %

(1) Includes coated fine paper, coated groundwood paper and speciality papers.

(2) Includes 30,000 metric tonnes of tissue manufactured at the Stanger mill in South Africa and 14,000 metric tonnes of kraft manufactured at the Enstra and Adamas mills in South Africa.

(3) Excludes Chinese joint venture tons.

(4) Includes pulp used internally and pulp sold.

(5) Sappi Forest Products provides most of the additional pulp requirements of our South African fine paper operations.

Facilities and Operations

Sappi Fine Paper North America

Sappi Fine Paper North America is a leading producer and supplier of coated fine paper in the United States. Sappi Fine Paper North America also produces a variety of other fine paper, including coated speciality paper.

Sappi Fine Paper North America is headquartered in Boston, Massachusetts, and operates four paper mills in the United States in Somerset, Maine; Muskegon, Michigan; Westbrook, Maine; and Cloquet, Minnesota. These four mills have a total annual production capacity of approximately 1.3 million metric tonnes of paper and a capacity of approximately 0.9 million metric tonnes of paper pulp, which represents approximately 115% of Sappi Fine Paper North America's pulp requirements. This significantly reduces Sappi Fine Paper North America's exposure to fluctuations in the price of market pulp that are not driven by fluctuations in wood or other major raw material prices. In July 2005, we announced the closure of the Number 4 paper machine and the mothballing of the pulp mill at Muskegon, which had an annual production capacity of 105,000 metric tonnes of paper and 110,000 metric tonnes of pulp, respectively.

Coated paper accounted for approximately 76% of Sappi Fine Paper North America's sales in fiscal 2006. Speciality paper and pulp accounted for the remaining 24%.

The following table sets forth sales by product for our North American operations, including contribution from the closed Muskegon assets in fiscal 2005.

	Year Ended September	
	2006	2005(1)
Sales (US\$ million)		
Coated fine paper	1,094	1,148
Speciality paper and other(2)	345	310
Total	1,439	1,458

(1) Includes sales for the Number 4 paper machine at Muskegon mill during fiscal 2005, which contributed \$83 million of sales (68,300 metric tonnes).

(2) Other consists primarily of market pulp.

For the year ended September 2006, Sappi Fine Paper North America sold approximately 1,426,000 metric tonnes of paper and pulp products. The following table sets forth, as of September 2006, the production capacity, number of paper machines, products, pulp integration and capital expenditures at each of our continuing mills in North America.

	Mill Locations			
	Somerset	Muskegon	Westbrook	Cloquet
Production capacity (000s metric tonnes)				
Paper	760	170	30	300
Market pulp	110			230
Number of paper machines	3	1	1	2
Products:				
Paper	Coated Fine Paper	Coated Fine Paper	Casting release paper	Coated fine paper
Market pulp	Bleached kraft pulp			Bleached kraft pulp
Percentage pulp integration(1)	101	%	None	227
Capital expenditures (October 2004- September 2006) (US\$million)	45	14	8	39

(1) Includes pulp sold to third parties.

Cloquet. The Cloquet mill has two paper machines and an offline coater, producing premium coated paper. The newest machine and coater were installed in 1988 and 1989, respectively. The pulp mill started up by the previous owner in 2000 at a total cost of \$525 million is the newest pulp mill in the United States. The Cloquet paper machines have an annual production capacity of 300,000 metric tonnes of coated paper, and the state-of-the-art pulp mill has an annual production capacity of 410,000 metric tonnes.

Somerset. The Somerset mill is a low-cost producer and has an annual production capacity of approximately 760,000 metric tonnes of paper and approximately 490,000 metric tonnes of pulp. The pulp mill was built in 1976, and Somerset became an integrated facility with the completion of Paper Machine 1 (PM1) in 1982. Each of the three paper machines at the Somerset facility employs Sappi Fine Paper North America's patented on-line coating and finishing technology. This technology combines the three steps (paper making, coating and finishing) in the manufacture of coated paper into one continuous process. It is well suited for the lightweight coated papers produced at Somerset, because it allows the production of high gloss, consistent quality products at high speeds.

Muskegon. The Muskegon mill consists of one continuing paper machine with an annual winder capacity of approximately 170,000 metric tonnes of text and cover weight coated paper using Sappi Fine

Paper North America's on-line finishing technology. On July 28, 2005, we announced the closure of the Number 4 paper machine and the mothballing of the pulp mill at Muskegon, which had an annual production capacity of 105,000 metric tonnes of paper and 110,000 metric tons of pulp, respectively.

Westbrook. Westbrook is Sappi Fine Paper North America's original mill, with origins dating back to 1854. After the closure of one of its paper machines, the mill is primarily a speciality paper production facility with an annual capacity of 34,000 metric tonnes of coated fine and casting release paper. Its paper machine primarily produces base paper, which is coated off-line. Westbrook also has six speciality coaters, including four employing Sappi Fine Paper North America's patented Ultracast® process. This process uses an electron beam to cure coating against a finely engraved steel roll, resulting in a virtually exact replication of the roll pattern. Sappi Fine Paper North America also has a research and development facility at Westbrook.

Sappi Fine Paper North America also operates a coated paper sheeting and distribution facility in Allentown, Pennsylvania, which was completed in 1994 and has an annual sheeting capacity of approximately 100,000 metric tonnes. The Allentown facility produces sheet paper primarily from the Cloquet mill.

Sappi Fine Paper Europe

Sappi Fine Paper is a leading producer of coated fine paper in Europe and a producer of commercial printing paper, coated groundwood paper and speciality paper used in packaging, labelling and laminating. Sappi Fine Paper Europe's operations consist of seven mills with an aggregate annual production capacity of approximately 2.6 million metric tonnes of paper and 680,000 metric tonnes of related paper pulp. Sappi Fine Paper Europe's headquarters are located in Brussels, Belgium.

The following table sets forth sales by product for our Sappi Fine Paper Europe operations, including contribution from the Nash mill until May 2006.

	Year Ended September	
	2006	2005
Sales (US\$ million):(1)		
Coated fine paper(2)	1,917	1,934
Uncoated fine paper	38	35
Speciality coated paper and other	239	270
Total	2,194	2,239

(1) Includes sales for the Nash mill, which contributed \$23 million of sales (16,442 metric tonnes) in fiscal 2006 and \$42 million of sales (31,651 metric tonnes) in fiscal 2005.

(2) Includes coated mechanical paper produced at Lanaken mill.

For the year ended September 2006, Sappi Fine Paper Europe sold approximately 2,450,000 metric tonnes of paper and pulp products. The following table sets forth the annual production capacity, number of paper machines, products, pulp integration and capital expenditures at each of Sappi Fine Paper Europe's mills in Europe.

	Mill Location													
	Germany Alfeld		Ehingen		Austria Gratkorn		Netherlands Maastricht		Nijmegen		Belgium Lanaken		United Kingdom Blackburn	
Paper capacity (000s metric tonnes)	360		250		860		320		240		490		120	
Number of paper machines	5		1		2		2		1		2		1	
Products	Coated and Uncoated fine paper, coated specialities paper		Coated fine paper and uncoated fine paper		Coated fine paper and uncoated fine paper		Coated fine paper and coated speciality paper		Coated fine paper		Coated groundwood paper and coated fine paper		Coated fine paper	
Percentage pulp integration(1)	60		%		79		%		58		%		None	
Capital expenditures (October 2004 to September 2006) (US\$ million)	19		94		67		22		7		24		3	

(1) Includes pulp sold to third parties.

Alfeld. The Alfeld mill is located to the south of Hannover, Germany, and its origins date back to 1706. It has a paper production capacity of approximately 360,000 metric tonnes and a pulp production capacity of approximately 120,000 metric tonnes per annum. It produces coated fine and speciality paper products, which are mainly coated and have a variety of finishes. In 1995 a major rebuild of Alfeld's Paper Machine 3 (PM3) was completed, enhancing the production of low substance flexible packaging papers. Alfeld's PM3 employs a fully integrated concept of in-line coating and calendaring. The Alfeld mill produces totally chlorine-free (TCF) bleached sulphite pulp for its own use. In early 2002, a rebuild of Alfeld's Paper Machine 2 (PM2) was completed. Alfeld spent approximately 50 million on the rebuild of PM2.

Ehingen. The Ehingen mill is located to the southeast of Stuttgart, Germany and was acquired by Hannover Papier, predecessor entity to Sappi Alfeld, in 1987. A paper machine with a capacity of 180,000 metric tonnes per annum of coated fine paper was commissioned in July 1991, expanding Ehingen from a market pulp mill into an integrated pulp and paper mill. During 1994 the construction of a high-rack warehouse was completed. As a result of upgrades during 1994 and 1996, Ehingen's total paper capacity was increased to 235,000 metric tonnes per annum. During August and September 2006 the paper machine was rebuilt and started up together with a new coater allowing a significant quality upgrade from single coated to triple coated fine paper with capacity of approximately 250,000 metric tons per annum. The pulp mill's capacity is currently 135,000 metric tonnes per annum of TCF bleached sulphite pulp. The pulp is produced mainly for internal use, but is also sold to third party customers.

Gratkorn. Paper has been produced at the Gratkorn, Austria site for more than four centuries. In course of a major expansion and renovation project the Gratkorn mill has been transformed from a five-machine mill into a two-machine mill. As a result of this project, Gratkorn now has an annual capacity

of 860,000 metric tonnes of triple-coated fine paper on just two paper machines and 250,000 metric tonnes of TCF chemical pulp. The machines at Gratkorn are among the largest and most efficient paper machines in the world. After extension of Gratkorn's sheeting plant it also has an annual sheet finishing capacity of 800,000 metric tonnes.

Maastricht. The Maastricht, Netherlands, mill has the capacity to produce over 320,000 metric tonnes per annum of coated fine paper and board and one-side coated paper used primarily for printing labels. Paper was first produced in Maastricht in 1852. Paper Machine 6 (PM6), which was installed at Maastricht in 1962, was first rebuilt in 1977. In 1996, PM6 underwent an extensive NLG224 million (€102 million) rebuild. Maastricht specialises in high basis-weight triple-coated fine paper and board for graphics applications. PM6's production complements that of the Gratkorn mill, which produces lower weight coated fine paper. Paper Machine 5 (PM5) at Maastricht was constructed in 1952. It underwent a rebuild in 1995, when it was reconfigured at a total cost, including the related upgrade of PM5's entire line, of \$13 million and a further upgrading in 2001. Following the reconfiguration, PM5 is utilised as a dedicated one-side coated speciality paper machine.

Nijmegen. The Nijmegen, Netherlands mill began operations in 1955 and operates one paper machine. The mill specialises in the production of reels of coated fine paper for web offset printing. It also produces special coated fine paper for use in digital printing. The Nijmegen mill was upgraded in 2001. The upgrade increased its capacity by 40,000 metric tonnes per annum. With an annual production capacity of 240,000 metric tonnes, the Nijmegen mill is one of Europe's largest suppliers of coated fine web offset paper. Rotary, or web, offset paper is used for commercial printing and publishing.

Lanaken. The Lanaken, Belgium mill began commercial operations in 1966. It produces coated groundwood paper and lower weight wood-containing coated paper for offset printing. Coated groundwood paper for web offset presses is used primarily in the production of advertising materials and magazines. Lanaken's two paper machines have a total annual capacity of 490,000 metric tonnes. One machine principally produces coated groundwood paper. It was completely overhauled in 1992, and an additional off-line coater was installed to provide triple coating capability. The other paper machine produces lower-weight wood-containing paper. Its capacity was increased to 285,000 metric tonnes per annum as a result of an optimisation process during the mid-1990s. Lanaken produces chemo-thermo-mechanical pulp (CTMP) in an integrated plant which has been extended to an annual capacity of 165,000 metric tonnes in 2003. This enables the mill to supply approximately 52% of its fibre requirements for paper production.

Blackburn. The Blackburn, England mill was established in 1875, and has been a major producer of cast coated paper. The Blackburn mill was rebuilt completely in 1996. In May 2000, we sold our Astralux brand of cast coated papers produced at the mill to the Favini Group in Italy. The production of cast coated papers at the Blackburn mill ceased at the end of May 2000. The Blackburn mill will continue to focus on its main business, the production of coated fine paper in reels.

Nash. The Nash mill in Hemel Hempstead, England operated as a paper mill since the 1800s and manufactured a variety of different grades of paper and board. The mill's principal products were its branded and watermarked business papers, sold under the Croxley brand name, and its wide range of white and coloured boards, sold under the Vanguard brand name. The mill had the capacity to produce 30,000 metric tonnes of paper and board per annum. During May 2006 production at Nash mill was terminated and the production of several special grades has been transferred to facilities in Sappi Southern Africa.

Sappi Fine Paper South Africa

Sappi Fine Paper, through Sappi Fine Paper South Africa, produces and markets a wide range of coated, uncoated and speciality papers as well as crêped tissue and fibreboard in South Africa. Sappi Fine Paper South Africa is headquartered in Johannesburg. In the uncoated fine paper sector, Sappi Fine Paper operates one integrated pulp and uncoated paper mill, Enstra (located near Johannesburg). Stanger (located north of Durban) uses bagasse (the fibrous residue of sugar cane) to produce coated fine paper and tissue. A smaller paper mill, Adamas (located in Port Elizabeth) utilises pulp from our pulp mills and waste paper to produce speciality paper and some kraft products. Adamas now also produces branded printing paper and board, previously produced at the Nash mill in the United Kingdom. Sappi Fine Paper South Africa is the only producer of coated fine paper in South Africa.

The following table sets forth sales by product for our Sappi Fine Paper South Africa operations.

	Year Ended September	
	2006	2005
Sales (US\$million):		
Coated fine paper	61	67
Uncoated fine paper	191	188
Speciality paper and other	73	68
Total	325	323

The following table sets forth the annual paper production capacity, number of machines, products, pulp integration and capital expenditures at each of the mills of Sappi Fine Paper South Africa.

	Mill Locations			
	Enstra	Stanger	Adamas	
Paper capacity (000s metric tonnes)	200	110	40	
Number of paper machines	3	2	2	
Products	Uncoated fine Paper	Coated fine Paper, coated label paper and tissue	Prestige stationary, branded printing paper and board, envelope paper and corrugated medium	
Percentage pulp integration	63	%	77	%
Capital expenditures (October 2004-September 2006) (US\$million)	16	17	8	

Enstra. The Enstra mill is the largest mill of Sappi Fine Paper South Africa, with a capacity of approximately 200,000 metric tonnes of elemental chlorine-free uncoated fine paper products per annum. In 1996, the Enstra mill completed a \$96 million capital expenditure programme. This programme increased capacity by 50,000 metric tonnes per annum and has resulted in improved production efficiency and product quality. The product range at the Enstra mill caters to the business forms, scholastic, office, envelope and general printing industries. The mill has a capacity of 105,000 metric tonnes per annum of bleached hardwood pulp. The mill uses an oxygen bleaching process, which is a process that was developed at the mill in the 1970s and has since become the industry standard.

Stanger. The Stanger mill commenced operations in 1976. It is unique in South Africa in that it uses bagasse as its basic raw material to produce high quality matte and gloss coated art papers and tissue. Art paper is used for high quality books and magazines, brochures, annual reports and labels. A \$26 million upgrade of the mill's paper machine was completed in August 2001, increasing the coated paper capacity to 80,000 metric tonnes per annum. The mill also produces 30,000 metric tonnes of tissue per annum and has

a capacity of 60,000 metric tonnes of bleached bagasse pulp per annum. A \$11 million upgrade on the bleach plant in 2006 converted the mill to an elemental chlorine free bleaching process.

Adamas. The Adamas mill is a small speciality mill. It produces high quality, uncoated prestige papers and boards in a variety of colours and embossing patterns. It also produces branded printing paper and board, previously produced at the Sappi Nash mill in the United Kingdom. The Adamas mill also produces packaging and industrial grades from waste paper. The mill has a capacity of 40,000 metric tonnes of paper per annum. This mill purchases wastepaper and bleached pulp from other mills in the Sappi Group.

Marketing and Distribution

Overview

The further integration of our international marketing and distribution efforts is one of our main strategic objectives. In order to attain this objective, we have adopted a system whereby the marketing and distribution of our fine paper products is performed by our operating business in the respective region, supplemented by a trading network outside these core regions.

Our trading network, Sappi Trading, co-ordinates the international marketing and distribution of our fine paper products outside our core regions. Sappi Trading operates in Hong Kong (China), Sydney (Australia), Sao Paulo (Brazil), Shanghai (China), Konstanz (Germany), Nairobi (Kenya), Mexico City (Mexico), Singapore, Johannesburg and Durban (South Africa), Zurich (Switzerland), Taipei (Taiwan), New York (United States). It manages a network of agents around the world handling exports to over 100 countries. Sappi Trading also manages the export logistics of the southern African and United States operations.

We sell the vast majority of our coated and uncoated fine paper through merchants. We also sell paper directly to converters. We generally deliver products sold to converters from the mill or via a distribution warehouse. Electronic business-to-business interaction has become more important to us, and we will continue to focus on increasing service and efficiency through business-to-business interaction. The systems and structures have been put in place to actively continue these efforts.

Merchants are authorised to distribute Sappi Fine Paper's products by geographic area and to carry competitors' product lines to cover all segments of the market. Merchants perform numerous functions, including holding inventory, sales promotion and marketing, taking credit risk on sales and delivery, and distribution of the products. Merchants buy paper from Sappi Fine Paper and resell it, placing a mark-up on their purchase price. A merchant may either deliver to the customer from its own stock or arrange for delivery directly from the mill or one of Sappi Fine Paper distribution warehouses.

Sappi Fine Paper North America

Sappi Fine Paper North America's coated paper sales structure is organised in 6 regions with sales representatives located in all major market areas, and 6 technical representatives located in different regions in North America supporting the sales effort.

Approximately 6% of Sappi Fine Paper North America's coated fine paper sales for fiscal 2006 were outside North America. Sappi Fine Paper North America's sales outside North America are handled in southern Africa by Sappi Fine Paper South Africa, in Europe by Sappi Fine Paper Europe and by Sappi Trading outside those regions.

In 2006, the Sappi Fine Paper North America sales force sold coated graphic paper to approximately 350 merchant distribution locations. By selling exclusively through merchant channels, Sappi Fine Paper North America believes it has created a loyal group of merchant customers. Rather than competing with

merchant distributors, the Sappi Fine Paper North America sales force focuses on generating demand with key printers, publishers and end users, which are then serviced by the merchant distributors.

In the United States, we market speciality paper through a dedicated speciality paper sales team directly to customers. Sappi Fine Paper North America also sells paper directly to large users of coated technical products utilising a dedicated sales team. The special end-use requirements often require a paper made to fit the customer's specific application.

Sappi Fine Paper Europe

As part of the formation of Sappi Fine Paper in April 1998, the sales and marketing operations of Sappi Fine Paper Europe were reorganised into graphic paper, comprising printing and writing paper, and speciality paper, comprising paper for labelling, packaging and other speciality uses.

The sales division of the graphic paper unit is responsible for all sales of coated fine and groundwood papers in Europe. This includes European sales on behalf of Sappi Fine Paper North America and Sappi Fine Paper South Africa. It is also responsible for export sales to markets outside Europe. Sappi Fine Paper Europe's graphic products are distributed primarily by merchants. The export sales office manages exports to markets outside Europe through Sappi Trading, Sappi Fine Paper North America and Sappi Fine Paper South Africa.

Sappi Fine Paper Europe's centralised logistics department was formed in early 1998. It is responsible for the development and optimisation of the logistics of the graphic and speciality papers business units and the re-engineering of the supply chain.

Sappi Fine Paper South Africa

Sappi Fine Paper South Africa has a marketing and sales and technical support team based in four major centres in South Africa and one in the United Kingdom (Nash). Approximately 22% of the sales of Sappi Fine Paper South Africa in fiscal 2006 were outside of southern Africa to markets in Europe, Africa, Asia and North and Latin America. The products of Sappi Fine Paper South Africa are distributed in southern Africa primarily through merchants. In addition, some large volume orders are sold directly to printers and converters.

Customers

Sappi Fine Paper sells its products to a large number of customers, many of whom have long-standing relationships with us. These customers include merchants, converters and other direct consumers.

The most significant merchant customers, based on sales during fiscal 2006, include:

North America: xpedx (a division of International Paper Company), Unisource Worldwide, Inc. (a majority interest of which is owned by Bain Capital Corporation), Lindenmeyr Paper Company (owned by Central National Gottesman Inc.) and a select number of regionally strong merchants;

Europe: **PaperlinX, Antalis (owned by Sequana Capital), IGEPA group and Papyrus.**

Southern Africa: **Antalis SA (Pty) Limited, Peters Papers and Finwood Papers (a division of Buhrmann Paper Merchant Division).**

Only one of these merchant distributors, PaperlinX, represented more than 10% of our total sales during fiscal 2006.

Sappi Fine Paper's converter customers include both multinational and regional converters. The most significant converter customers, based on sales during fiscal 2006, include: VanLeer, Fasson, Jackstadt, VAW Flexible Packaging, Alcan, UCB Transpac, Lawson Mardon Packaging and Perstop. These

customers use our products in the production of pressure sensitive and other types of labels as well as flexible packaging. Nampak, the CTP Group of companies, Paarl Media Lithotech, Merpak and Freedom Stationery and Silvery are also significant converter customers. These companies use our products in the production of packaging products. No converter customer, however, represented more than 10% of our total sales during fiscal 2006.

Merchant sales constitute the majority of our fine paper sales. Pricing of fine paper products is generally subject to change upon notice of 30 days with longer notice periods (typically 3 to 6 months) for some large end-use customers. Sales to converters may be subject to longer notice periods, which would generally not exceed 12 months. We have long-standing relationships with most of our customers, with volume and pricing generally agreed on a quarterly basis.

Competition

Overview

Although the markets for pulp and paper have regional characteristics, they are highly competitive international markets involving a large number of producers located around the world.

Pulp and paper are subject to relatively low tariff protection in major markets, with existing tariff protections being further reduced under the World Trade Organization (*WTO*). In South Africa, for example, no tariffs are imposed on imports of pulp and newsprint as well as most uncoated and coated woodfree products, with the exception of A4 office paper.

Competition in markets for our products is primarily based on price, quality, service, breadth of product line, product innovation and sales and distribution support. The speciality paper market puts greater emphasis on product innovation and quality as well as technical considerations. The packaging paper and newsprint markets place more emphasis on price.

In Europe and North America production capacity closures of more than one million metric tonnes of coated fine paper and 800,000 metric tonnes of mechanical coated paper has been announced during 2005 and 2006 by the industry of which 15% was by Sappi. Of these announcements, approximately 900,000 metric tonnes of coated fine paper and 520,000 metric tonnes of mechanical coated paper closures were realised at the end of fiscal 2006.

North America

The major domestic coated fine paper producers which compete with Sappi Fine Paper in North America are NewPage (formerly part of MeadWestvaco and now owned by Cerberus), Stora Enso and Verso Paper (formerly part of International Paper Company and now owned by an affiliate of Apollo Management L.P.). In addition, approximately 31% of US consumption is supplied by foreign producers, primarily Asian and European.

Europe

The market leaders in coated fine paper production in Europe are Sappi, M-real, Stora Enso, Burgo-Marchi Group, UPM-Kymmene and CVC Partners (Lecta).

Southern Africa

Mondi Paper Company Limited is a significant competitor of Sappi Fine Paper in southern Africa in the uncoated fine paper sector. Coated fine paper imports, primarily from Europe and Asia, have gained an increased share of the southern African fine paper market, after the lifting of sanctions and boycotts against South Africa in the early 1990s and as a result of declining import duties, which were removed in 2006. A substantial part of the imports originate from Sappi Fine Paper's European mills.

SAPPI FOREST PRODUCTS

Overview

Sappi Forest Products, headquartered in Johannesburg, South Africa, is an integrated pulp, packaging paper and timber products producer. Sappi Forest Products operates five pulp and paper mills and one sawmill and is managed in three operating divisions: Sappi Saiccor, Sappi Kraft and Sappi Forests.

Sappi Forest Products is a major pulp and paper producer in Africa with a production capacity of 830,000 metric tonnes of paper, 600,000 metric tonnes of chemical cellulose and 1,090,000 metric tonnes of paper pulp per annum. It is also a major timber grower and manages approximately 546,000 hectares of forestland, of which, approximately 398,000 hectares is planted with primarily pine and eucalyptus. Approximately 70% of our southern African pulpwood and sawlog requirements are from our own plantations.

The following chart sets forth certain information with respect to the mills and principal products of Sappi Forest Products as of November 2006.

The following table sets forth sales by product for Sappi Forest Products operations:

	Year Ended September	
	2006	2005
Sales (US\$million):		
Commodity paper products(1)	410	430
Chemical cellulose	384	360
Paper pulp(2)	102	118
Timber and timber products	87	90
Total	983	998

(1) Includes newsprint and packaging products.

(2) Excludes sales related to paper pulp produced by Sappi Fine Paper facilities.

Sappi Forest Products sold approximately 2,995,000 metric tonnes of paper, pulp and forest products during the year ended September 2006.

The following table sets forth annual production capacity with respect to Sappi Forest Products products:

Production capacity (000s metric tonnes):		
Paper products		
Packaging paper	690	
Newsprint	140	
Total	830	
Pulp		
Chemical cellulose	600	
Paper pulp(1)	1,090	
Total	1,690	
Timber products	41	(2)
Percentage paper pulp integration	142	%(3)

(1) Excludes production capacity related to paper pulp produced by Sappi Fine Paper facilities.

(2) Represents 78,000 cubic metres.

(3) Excludes pulp produced by Sappi Saiccor. Our southern African operations are net sellers of pulp.

Facilities and Operations

Sappi Saiccor

Sappi Saiccor was established in 1951 and acquired by us in 1988. It is a low-cost producer and the world's largest single producer of chemical cellulose. In 1995, we completed an approximately \$221 million expansion project to increase capacity by one third to approximately 600,000 metric tonnes per annum. Capital expenditures during the period from October 2004 to September 2006 were approximately \$86 million. During 2006 most of the equipment for the modernisation project to de-bottleneck production at Sappi Saiccor was commissioned, at an approximate cost of \$40 million.

In August 2006 Sappi announced a \$460 million expansion project to increase Sappi Saiccor's chemical cellulose capacity by a net 225,000 metric tonnes per annum. Construction commenced in the same month with commissioning scheduled for the first half of 2008. Capital expenditure for the project during fiscal 2006 amounted to approximately \$32 million.

Virtually all of Sappi Saiccor's chemical cellulose production is exported from South Africa and marketed and distributed internationally by Sappi Trading. The pulp we principally produce is the type used in the manufacture of a variety of cellulose products, including viscose staple fibres (rayon) and solvent spun fibres (lyocell). Both viscose and lyocell fibres are used in the manufacture of fashion and decorating textiles which have a soft, natural feel and excellent breathing properties. Given their particularly high absorbency properties, these fibres are also used in non-woven applications in the healthcare, industrial and disposable product markets. Chemical cellulose is also used in the manufacture of acetate flake, which is used in products such as filter tow for cigarette filters, and high quality yarns and fabrics. It is also used to manufacture microcrystalline cellulose, which is used as a rheological modifier in the food industry, a tableting agent in the pharmaceutical industry, and in various ethers for the chemical industry. It is also used to manufacture cellophane film for use in a variety of packaging applications.

The mill's timber consumption is comprised primarily of eucalyptus hardwoods. These fast growing trees are grown in relatively close proximity to the mill, which contributes to Sappi Saiccor's position as a low cost producer of chemical cellulose.

Sappi Kraft

Based upon volume sold in fiscal 2006, Sappi Kraft supplies approximately 55% of South Africa's packaging paper requirements, other than cartonboard, from its Ngodwana, Tugela and Cape Kraft mills.

The following chart sets forth the annual paper production capacity, number of machines, products, pulp integration and capital expenditures at each of Sappi Kraft's mills in South Africa.

	Mill Locations in South Africa		
	Ngodwana	Tugela	Cape Kraft
Paper capacity (000s metric tonnes)	380	390	60
Number of paper machines	2	4	1
Products	Newsprint, kraft linerboard, white top linerboard, plasterboard and bleached and unbleached market pulp	Kraft linerboard, corrugating medium, sackkraft and machine glazed kraft	Linerboard, corrugating medium and coated products
Percentage pulp integration(1)	134%	100%	None(2)
Capital expenditures (October 2004-September 2006) (US\$million)	48	28	4

(1) Excludes pulp produced from recycled paper by the respective plants at the mills.

(2) Cape Kraft's raw material requirements are met from waste fibre supplied by Sappi Waste Paper.

Ngodwana. Ngodwana was expanded between 1981 and 1985 from an unbleached kraft mill with a capacity of 100,000 metric tonnes per annum to a modernised mill with a capacity of approximately 240,000 metric tonnes of linerboard and 140,000 metric tonnes of newsprint per annum. The linerboard machine also produces White Top Liner (included in total linerboard capacity). The mill produces nearly 410,000 metric tonnes of bleached and unbleached pulp and 100,000 metric tonnes of groundwood pulp annually.

The mill markets paper and excess pulp locally and in the export market. The mill is a large consumer of waste paper, which is used in the production of packaging paper. In 1995 the mill commissioned the world's first ozone bleaching plant, thus eliminating the use of elemental chlorine and significantly reducing mill effluent.

Tugela. Tugela is Sappi Kraft's largest integrated unbleached kraft mill, with a capacity of approximately 390,000 metric tonnes of packaging paper per annum. The mill supplies kraft linerboard and corrugating medium and most of South Africa's requirements for sackkraft, used in the production of multiwall sacks. Machine glazed packaging papers are also produced at the mill. The Kraft Linerboard machine was upgraded in 1996 at a cost of approximately \$81 million and the Sack Kraft machine and components of the pulp plant were upgraded in 2003/4 at a cost of approximately \$50 million. It is the only mill in South Africa to offer high performance containerboard packaging and extensible Sack Kraft.

Cape Kraft. The Cape Kraft mill was built during 1980, commissioned in 1981 and upgraded in 1995. The mill presently has a capacity of 60,000 metric tonnes of linerboard and corrugating medium per annum, which it sells principally to the corrugating industry in the Western Cape. The mill uses approximately 67,000 metric tonnes per annum of waste paper to produce 60,000 metric tonnes per annum of paper. The fact that the mill's product is produced from 100% recycled paper can provide a competitive edge in our markets, which are becoming increasingly environmentally aware.

Usutu Pulp. Usutu Pulp began production in 1961 and was upgraded during 1995 and 1996 at a cost of approximately \$69 million. During the period from October 2002 to September 2006, an additional \$23 million was invested. The mill has a capacity of 230,000 metric tonnes of unbleached kraft pulp and supplies approximately 6% of the world market for unbleached market kraft pulp (based upon tonnes sold in 2006). The mill is situated in Swaziland and is surrounded by 70,000 hectares of forestlands, which it leases from the Swazi nation under a long-term lease extendable to 2089. The location of these forestlands, combined with the very compact areas the trees are planted on, provides for low wood delivery costs. See Supply Requirements Southern Africa Wood for more information.

Sappi Kraft also manages Sappi Waste Paper. Sappi Waste Paper collected approximately 166,000 metric tonnes of waste paper in fiscal 2006. Most of the waste paper collected was supplied to our mills. Waste represents approximately 30% of the fibre requirements of our packaging grades.

Sappi Forests

Sappi Forests, together with Usutu Forests, supplies or procures all of Sappi Forest Products' and Sappi Fine Paper South Africa's domestic pulpwood requirements of approximately 6 million metric tonnes per annum. 88% of the pulpwood comes from owned or contracted sources. Together they manage or control, through contracts, about 546,000 hectares of land situated in: Mpumalanga (46%), KwaZulu-Natal (41%) and Swaziland (13%). Securing raw material for the future is a vital element in the long-term planning of Sappi Forest Products' business. Sappi Forests has an extensive research operation which concentrates on programmes to improve the yield per hectare of forestland used. Significant progress has been made in developing faster-growing trees with enhanced fibre yields. Sophisticated nurseries have been developed to accommodate the seedling requirements of Sappi Forest Products' operations. Approximately 50 million seedlings are grown annually at Sappi Forests' and Usutu Forests nurseries.

Sappi Forests and Usutu Forests have invested approximately \$89 million in maintaining, acquiring and expanding plantations and other capital expenditure projects in the period from October 2004 to September 2006.

The sawmill division operates one mill with a total production capacity of 78,000 cubic metres per annum of structural timber for the building industry and components for the furniture and packaging industry.

Marketing and Distribution

Overview

Each of Sappi Forest Products' divisions with major South African markets has its own marketing and sales team. Sappi Trading manages the exports of the Sappi Forest Products' divisions, in particular the marketing and distribution of the market pulp produced at Saiccor and Usutu.

Customers

Sappi Forest Products sells its products to a large number of customers, including merchants, converters, printers and other direct customers, many of whom have long-standing relations with us.

The most significant converter customers, based on sales in fiscal 2006, include: The CTP Group and Media 24, which uses Sappi Forest Products' newsprint; Nampak Limited; Mondipak; APL (Pty) Ltd and Houers Co-operative. A significant number of the viscose staple fibre manufacturers around the world purchase chemical cellulose from Sappi Forest Products, including large groups such as the Aditya Birla Group and the Lenzing Group. Most of our chemical cellulose sales contracts are multi-year contracts with pricing generally based on a formula linked to the NBSK price and reset on a quarterly basis.

Approximately 53% of the total sales of Sappi Forest Products during fiscal 2006 consisted of export sales.

Competition

Mondi Paper Company Limited is a significant competitor in most of the markets in which Sappi Forest Products operates in southern Africa. In recent years the regional recycled containerboard capacity has increased by approximately 60,000 metric tonnes. Due to exchange rate fluctuations a number of offshore containerboard suppliers have also entered the southern African packaging markets. In respect of chemical cellulose, competitors include Borregaard ChemCell Atisholz, Tembec Inc., Western Pulp Inc., Buckeye Technologies Inc. and Rayonier Inc.

SUPPLY REQUIREMENTS

Overview

The principal supply requirements for the manufacture of our products are wood, pulp, energy and chemicals. Large amounts of water are also required for the manufacture of pulp and paper products. See "Environmental and Safety Matters" "Environmental Matters" "South Africa". We believe that we have adequate sources of these and other raw materials and supplies necessary for the manufacture of pulp and paper for the foreseeable future.

North America

Wood

In connection with the 1998 sale of our US timberlands to Plum Creek Timber Company L.P., Sappi Fine Paper North America and Plum Creek are parties to a fibre supply agreement with an initial term expiring in December 2023 and with three five-year renewal options. Under the supply agreement, Sappi Fine Paper North America is required to purchase from Plum Creek and Plum Creek is required to sell to Sappi Fine Paper North America a guaranteed annual minimum of 318,000 metric tonnes of hardwood pulpwood, or approximately 10% of Sappi Fine Paper North America's annual requirements, at prices calculated based on a formula tied to market prices. Sappi Fine Paper North America has the option to purchase additional quantities of hardwood pulpwood harvested from these timberlands at prices generally higher than the ones paid for the guaranteed quantities. The remainder of Sappi Fine Paper North America's wood requirements is met through market purchases.

Pulp

Sappi Fine Paper North America's mills, taken together, are fully integrated on an economic basis with respect to hardwood pulp usage. Mills that are not fully integrated make market purchases, and mills that produce more pulp than they utilise make market sales.

Sappi Fine Paper North America currently offers recycled products in most coated grade lines. It uses reprocessed fibres recovered from its existing operations and purchases de-inked post consumer waste pulp to meet market requirements for recycled products.

Sappi Fine Paper North America manufactures, in aggregate, pulp and fibre equivalent to approximately 115% of its own pulp and fibre requirements. This vertical integration reduces its exposure to fluctuations in the market price for pulp.

Energy Requirements

Sappi Fine Paper North America's energy requirements are satisfied through wood and by-products derived from the pulping process, coal, oil, purchased electricity, purchased steam, natural gas and other sources.

A substantial majority of Sappi Fine Paper North America's electricity requirements are satisfied through its own electricity generation or co-generation agreements. In July 2002, Sappi Fine Paper North America entered a series of contracts with Central Maine Power (CMP) and a third party energy provider. The contracts provide that Somerset sell all of its excess generated power to CMP and purchase all of its power needs beyond its generation capacity from the third party provider, each at market rates. The agreements expire in 2012. Sappi Fine Paper North America also sells excess electricity it co-generates at the Westbrook mill.

The Cloquet mill, is supplied partly with internally generated electricity. The Cloquet mill includes a hydroelectric facility that is licensed by the Federal Energy Regulatory Commission. In addition to generating a portion of its own power, the Cloquet mill has entered into a take-or-pay agreement which terminates in 2008, to purchase a portion of its power from Minnesota Power.

Chemicals

Major chemicals used by Sappi Fine Paper North America include clays, carbonates, latices and plastic pigments, titanium dioxide, caustic soda, other pulping and bleaching chemicals and chemicals for the specialty business. Sappi Fine Paper North America purchases these chemicals from a variety of suppliers. There are generally adequate sources of supply, and in no case is Sappi Fine Paper North America dependent upon a sole source of supply. However, chemical supplies have tightened due to the rationalization of capacity over the last several years. Most of these chemicals are subject to price fluctuations based upon a number of factors, including energy and crude oil prices and transportation costs, and commodity demand vs. supply imbalances.

Europe

Wood

Sappi Fine Paper Europe purchases approximately 2,500,000 cubic metres of pulpwood per annum for its pulp mills. The wood is purchased both on contract and in the open market. Wood supply contracts are fixed for one year in terms of volumes. Price agreements range from three months for wood chips to one year for logwood.

The wood logs and wood chips used in the Gratkorn TCF pulp mill are purchased through the Papierholz Austria GmbH joint venture arrangement amongst Sappi, the Norske Skog Bruck mill and the Frantschach Group. We hold a 42.5% ownership interest in Papierholz.

The wood chips used in the Lanaken CTMP plant are purchased through Sapin S.A. (Sapin), a 50%-50% joint venture company operated together with Norske Skog. Sapin was initially formed on November 25, 1986, pursuant to a joint venture agreement between Sappi Lanaken and Parenco. Under the agreement, as amended in September 2003, the parties agree to utilise Sapin exclusively to furnish the entire wood requirements of the joint venture partners' affiliated mills.

Pulp

Sappi Fine Paper Europe produces approximately 45% of its pulp requirements. The remainder is supplied through open market purchases and, to a lesser extent, supply agreements.

Energy Requirements

Sappi Fine Paper Europe's energy requirements are generally met by internally generated sources and purchases of electricity, gas and, to a lesser extent, oil. In Germany, Sappi Fine Paper Europe internally generates approximately 65% of the electricity used at its mills. Approximately 45% of the energy requirements for the Gratkorn mill are internally generated. The remaining requirements are met by purchasing electricity, oil, coal and gas in accordance with various supply agreements.

Substantially all of the electricity requirements of the Maastricht mill are satisfied by a 60 megawatt combined heat/power plant operated through a joint venture with Essent. All surplus electrical energy is supplied to the public electricity grid. We hold an ownership interest of 50% in the VOF Warmte/Kracht Maastricht Mill, the joint venture, which was formed in 1992, and are obligated to purchase all of the steam and electricity requirements of the Maastricht mill from the joint venture facility under a long-term supply agreement. Essent purchases the surplus electrical energy of the VOF. The Maastricht mill also purchases natural gas pursuant to a contract with a natural gas supplier.

Nijmegen mill's electricity requirements are largely satisfied by its co-generation power plant. The Nijmegen mill additionally purchases natural gas from Gasunie, a local supplier.

Lanaken mill's energy requirements are generally met by purchases of natural gas and electricity. Certain of the energy requirements of the Lanaken mill are furnished by a combined heat and power unit constructed and operated pursuant to the Albertcentrale N.V. joint venture arrangement between Sappi, the Belgian power company Electrabel and Rabo Energy. Sappi holds a 49% ownership interest in the Albertcentrale facility and is obligated to purchase 85% of the plant's energy requirements from the joint venture facility under a long-term supply agreement. The facility commenced operations in April 1997.

Chemicals

Major chemicals used by Sappi Fine Paper Europe include clays, carbonates, latexes and starches and chemicals for the specialty business. Sappi Fine Paper Europe purchases most of these chemicals from a portfolio of suppliers, and in only one case is Sappi Fine Paper Europe dependent on a sole source of supply. There are generally adequate sources of supply in the market. Most of these chemicals are subject to price fluctuations based upon a number of factors, including energy and crude oil prices and transportation costs, and commodity demand vs. supply imbalances.

Southern Africa

Wood

Edgar Filing: SAPPI LTD - Form 20-F

Sappi Forest Products manages approximately 546,000 hectares of forestland in southern Africa, of which approximately 398,000 hectares are forested, which produces approximately 83% of the timber

33

required for its operations. Sappi Forests owns approximately 372,000 hectares and manages the majority of the remainder. Usutu Pulp owns 54,000 hectares of pine on 70,000 hectares of land that is leased from the Swazi nation on a long-term lease, which we have the option to extend until 2089. Sappi Forests presently has supply contracts for the timber from approximately 95,000 hectares of plantations planted by small growers with our technical and financial support. The remaining timber requirements are met through a number of significant medium-term contracts and open market purchases.

Pulp

Sappi Forest Products and Sappi Fine Paper South Africa in aggregate manufacture all of the pulp required in their respective papermaking operations, except minimal quantities of specialised pulps, and together are a net seller of bleached and unbleached paper pulp. This vertical integration substantially reduces our exposure to fluctuations in the market price for pulp.

Energy Requirements

Our energy requirements in southern Africa are met principally by purchases of coal and electricity supplemented by purchases of fuel oil and gas. Much of the energy demand is met by internally generated biomass and spent liquors from the pulping process. Electricity is supplied by Eskom, the state-owned electricity company, or generated internally. The electricity generated by our plants in southern Africa is equivalent to approximately 43% of our total electricity requirements. Coal, both for steam raising and gas production, and oil are purchased on contract.

Chemicals

Major chemicals used by Sappi Forest Products and Sappi Fine Paper South Africa include caustic soda, calcium carbonates, latexes and starches and sulphur and sulphuric acid. Sappi Forest Products and Sappi Fine Paper South Africa purchase these chemicals from a variety of South African and overseas suppliers. There are generally adequate sources of supply, and in only one case is Sappi Fine Paper South Africa dependent upon a sole source of supply. Most of these chemicals are subject to price fluctuations based upon a number of factors, including energy and crude oil prices and transportation costs, and commodity demand vs. supply imbalances.

ENVIRONMENTAL AND SAFETY MATTERS

Environmental Matters

We are subject to a wide range of environmental laws and regulations in the various jurisdictions in which we operate, and these laws and regulations have tended to become more stringent over time. Environmental compliance is an increasingly important consideration in our businesses, and we expect to continue to incur significant capital expenditures and operational and maintenance costs related to reductions in air emissions (including greenhouse gases), wastewater discharges and waste management. We constantly monitor the potential for changes in the laws regulating air emissions and other pollution control and take actions with respect to our operations accordingly. See note 34 to our Group annual financial statements included elsewhere in this Annual Report for more information.

North America

Sappi Fine Paper North America is subject to stringent environmental laws in the United States. These laws include the Federal Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and their respective state counterparts. In December 2003, Sappi Fine Paper North America received a notice of violation and a finding of violation from the US Environmental Protection Agency, alleging violations of the Clean Air Act's new source performance standards in connection with repairs performed at the Muskegon pulp mill in the early 1990s. In July 2005, Sappi announced its decision to

cease operations at the Muskegon pulp mill. In September 2006 Sappi Fine Paper North America entered into a consent decree with the US Environmental Protection Agency, in which Sappi (i) agreed to more stringent permit requirements should the pulp mill ever start up again and (ii) paid a fine of \$586,106.

The US is a non-signatory of the Kyoto Protocol, but we closely monitor State and Federal Greenhouse Gas (GHG) initiatives in anticipation of potential effects, if any, on our operations.

Europe

Our European facilities are subject to extensive environmental regulation in the various countries in which they operate. For example:

- In Germany, where two Sappi Fine Paper Europe mills are located, the Federal Emission Control Act, the Federal Water Act and the Federal Ground Act regulate air emissions, wastewater discharges and liability for contaminated sites, respectively.
- In the Netherlands, where two Sappi Fine Paper Europe mills are located, paper manufacturers, including Sappi, have made an agreement with the national government to improve environmental management and further limit emissions.
- At our Nijmegen mill, we are subject to a potential damage charge of approximately \$264,000 (euro 208,000), representing the alleged cost of cleaning up contaminated pulp from the local sewer system. The proposed charge relates to a discharge of pulp from our Nijmegen mill in 2000. We are pursuing a settlement of this matter with the local authorities.
- In Austria and Belgium, water emissions and waste disposal requirements similar to those in Germany, the United Kingdom and the Netherlands apply to our facilities.
- In the United Kingdom, we received the required permits under the Pollution Prevention and Control Regulations, which were enacted to implement the EC Directive 96/61/EC on Integrated Pollution Prevention and Control.
- The Sappi Fine Paper Europe organisation is certified according to the international standard of environmental management systems (ISO 14001), and to the European EMAS (Eco-Management and Audit Scheme). All of our European mills publish their environmental reports on an annual basis.
- The countries within which we operate in Europe are all signatories of the Kyoto Protocol and we have developed a GHG strategy in line with this protocol. Our European mills have been set CO₂ emission limits for the allocation period 2005 to 2007. Based on an analysis of our mill production by a Sappi Fine Paper Europe team, we believe that it is unlikely our European mills will exceed their CO₂ emission limits. Consequently we sold 90,000 surplus CO₂ credits in 2005 and 208,650 in 2006 on the European Climate Exchange.

South Africa

The primary South African environmental laws affecting our operations are:

- The National Water Act, addresses the water shortages in South Africa in a manner that we believe will not significantly impact our manufacturing and forestry operations. Abstraction of water, discharge of effluent and management of forests are all regulated under a license system in which first allocations go to, among other things, human consumption, before allocations are made to agriculture, industry and forestry. All water use is subject to a charge. We expect to incur additional costs over the next decade to comply with the National Water Act, but are unable to quantify these at this time.

- The National Environmental Management Act, adopted the philosophy of integrated environmental management, which provides for the integration of environmental considerations into all stages of any development process. The Act includes a number of significant principles, such as private prosecution of companies in the interest of the protection of the environment and the establishment of aggressive waste reduction goals. We expect to incur additional costs to comply with the National Environmental Management Act, which will not be material.
- The National Environmental Management Act (Air Quality Act) was promulgated in the beginning of 2005. The Air Quality Act will eventually replace the 1965 Atmospheric Pollution Prevention Act and will impose stringent compliance standards on our operations when implemented, including those related to carbon dioxide and sulphur dioxide air emissions. Limited sections of the Act were implemented in September 2005. We expect to incur additional costs to comply with the Air Quality Act, which we believe will not be material.
- South Africa is also a signatory of the Kyoto Protocol. We are identifying and initiating Clean Development Mechanism projects, as defined in the Kyoto Protocol, at a number of our South African mills.

The requirements under these statutes may result in additional expenditures and operational constraints. Although we are in frequent contact with regulatory authorities during the phasing in of the legislation, we are uncertain as to the ultimate effect on our operations. Our current assessment of the legislation is that any compliance expenditures or operational constraints, will not be material to our financial condition.

Safety Matters

The forestry, timber and pulp and paper industries involve inherently hazardous activities including, among other things, the operation of heavy machinery. Nearly all countries in which we have significant manufacturing operations including South Africa, the United States and European countries, regulate health and safety in the workplace. We actively seek to reduce the frequency of accidents in our workplaces and to improve health and safety conditions by extensive training and educational programmes.

The Sappi global safety improvement initiative, Project Zero, has been in operation for more than a year and is now a mature business initiative accepted throughout the Sappi Group. Project Zero symbolises the goal of no injuries and involves standardising behaviour-based safety programmes throughout the Sappi Group and focusing on the particular activities which have resulted in injuries or fatalities.

In the United States, Sappi Fine Paper North America must comply with a number of federal and state regulations regarding health and safety in the workplace. The most important of these regulations is the Federal Occupational Safety and Health Act.

In Europe, we participate in various governmental worker accident and occupational health insurance programmes. In Belgium, and The Netherlands, these programmes are funded by mandatory contributions by employers and employees. In Germany, we participate in a similar mandatory contribution scheme controlled by the German government, which permits employer and employee participation in its administration. In Austria and the United Kingdom, employee liability insurance is funded by the employer. The safety and health issues are integrated into the management systems and all mills of Sappi Fine Paper Europe comply with health and safety legislation and are OHSAS 18001 certified.

In South Africa, we must comply with the Occupational Health and Safety Act (Number 85 of 1993) and related regulations. Our South African businesses have instituted measurement for evaluating compliance with this legislation. Of the nine mills / business units, seven are OHSAS 18001 certified.

ORGANISATIONAL STRUCTURE

Sappi Limited is the ultimate holding company of the Sappi Group. The following table sets forth the more significant subsidiaries and joint ventures owned directly or indirectly by Sappi Limited.

Name of Company	Trading Name	Country of Incorporation	Type of Company	% Holding and Voting Power
<i>North America</i>				
S.D. Warren Company	Sappi Fine Paper	United States	Operating	100
Sappi Cloquet LLC	Sappi Fine Paper	United States	Operating	100
<i>Europe</i>				
Sappi Alfeld GmbH	Sappi Fine Paper	Germany	Operating	100
Sappi Austria Produktions GmbH & Co KG	Sappi Fine Paper	Austria	Operating	100
Sappi Deutschland GmbH	Sappi Fine Paper or Sappi Trading	Germany	Operating	100
Sappi Ehingen GmbH	Sappi Fine Paper	Germany	Operating	100
Sappi Esus Beteiligungsverwaltungs GmbH	Sappi Fine Paper	Austria	Holding	100
Sappi Europe SA	Sappi Fine Paper	Belgium	Operating	100
Sappi Holding GmbH	Sappi Holding	Austria	Holding	100
Sappi International SA	Sappi International	Belgium	Finance	100
Sappi Lanaken NV	Sappi Fine Paper	Belgium	Operating	100
Sappi Lanaken Press Paper NV	Sappi Fine Paper	Belgium	Operating	100
Sappi Maastricht BV	Sappi Fine Paper	Netherlands	Operating	100
Sappi Nijmegen BV	Sappi Fine Paper	Netherlands	Operating	100
Sappi Papier Holding GmbH	Sappi Papier Holding or Sappi Fine Paper	Austria	Holding and Operating	100
Sappi Trading Pulp AG	Sappi Trading	Switzerland	Holding and Operating	100
<i>Southern Africa</i>				
Sappi Management Services (Pty) Ltd.	Sappi Management Services.	South Africa	Management	100
Sappi Manufacturing (Pty) Ltd.	Sappi Manufacturing or Sappi Forest Products or Sappi Fine Paper or Sappi Saiccor or Sappi Kraft or Sappi Forests or Sappi Waste Paper	South Africa	Operating	100
Usutu Pulp Co. Ltd.	Sappi Usutu	Swaziland	Operating	100
<i>Asia</i>				
Jiangxi Chenming Paper Co Ltd	Jiangxi Chenming Paper	China	Operating Joint Venture	34
<i>Guernsey</i>				
Lignin Insurance Co. Ltd.	Lignin Insurance	Guernsey	Finance	100

PROPERTY, PLANT AND EQUIPMENT

For a description of the production capacity of our mills, see Sappi Fine Paper Facilities and Operations and Sappi Forest Products Facilities and Operations .

For a description of the timberlands we own or have recently sold, see Sappi Fine Paper Facilities and Operations Sappi Fine Paper North America , Sappi Forest Products Facilities and Operations Sappi Forests and Supply Requirements .

For a description of our capital expenditures, see Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources .

The following table sets forth the location and use of our principal headquarters, manufacturing and distribution facilities. These facilities are owned unless otherwise indicated.

Location	Use	Approximate Size(1)
Sappi Limited		
Johannesburg, South Africa	Sappi Headquarters(2)	15,078 m ²
Sappi Fine Paper		
Sappi Fine Paper North America(3)		
Boston, Massachusetts	Headquarters(4)	34,928 sq ft
Skowhegan, Maine (Somerset Mill)	Manufacturing facility: coated paper, softwood and hardwood pulp	2,355 acres
Muskegon, Michigan	Manufacturing facility: coated paper and a warehouse(5)	5,185,000 sq ft
Westbrook, Maine	Manufacturing facility: speciality and high bulk coated paper and research and development facility	275 acres
	Storage and shredding facility	13,446 sq ft
	Roll coating facility	13,575 sq ft
Allentown, Pennsylvania	Coated paper sheeting facility	30 acres
Dayton, New Jersey	Distribution centre(6)	607,489 sq ft
Cloquet, Minnesota	Manufacturing facility: coated paper and pulp(10)	650 acres
South Portland, Maine	Shared financial and customer service office(11)	48,433 sq ft
Sappi Fine Paper Europe		
Brussels, Belgium	Headquarters(9)	3,836 m ²
Gratkorn, Austria	Manufacturing facility: coated paper and pulp	999,053 m ²
Maastricht, Netherlands	Manufacturing facility: coated paper and research and development facility	14.7 ha
Nijmegen, Netherlands	Manufacturing facility: coated paper	10.7 ha
Lanaken, Belgium	Manufacturing facility: coated paper and pulp	35.0 ha
Alfeld, Germany	Manufacturing facility: coated paper, uncoated paper and pulp	332,844 m ²
Ehingen, Germany	Manufacturing facility: coated paper and pulp	356,951 m ²
Blackburn, England	Manufacturing facility: coated paper	36 ha
Wesel, Germany	Distribution centre(8)	62,140 m ²

Sappi Fine Paper South Africa

Enstra, South Africa	Manufacturing facility: uncoated paper and hardwood pulp(10)	582.7 ha
Stanger, South Africa	Manufacturing facility: coated paper, tissue and bagasse pulp(10)	55.4 ha
Adamas, South Africa	Manufacturing facility: uncoated paper and recycled packaging paper	7.2 ha

Sappi Forest Products

Johannesburg, South Africa	Headquarters	Included under Sappi Limited headquarters
----------------------------	--------------	---

Sappi Saiccor

Umkomaas, South Africa	Manufacturing facility: chemical cellulose(10)	159.4 ha
------------------------	--	----------

Sappi Kraft

Ngodwana, South Africa	Manufacturing facility: linerboard, newsprint and kraft pulp	1,282.9 ha
Tugela, South Africa	Manufacturing facility: linerboard, corrugating medium, sackkraft and industrial kraft	914.4 ha
Cape Kraft, South Africa	Manufacturing facility: linerboard and corrugating medium	9.5 ha
Bunya, Swaziland (Usutu Pulp Mill)	Manufacturing facility: kraft pulp	45.0 ha

Sappi Forests

Barberton, South Africa (Lomati Sawmill)	Sawmill	24.6 ha
--	---------	---------

(1) The approximate size measurement relates to, in the case of manufacturing and distribution facilities, the perimeter of the property on which the principal manufacturing or distribution facilities are situated and, in the case of offices, the interior offices space owned or leased.

(2) Subject to a lease expiring in 2015.

(3) All of Sappi Fine Paper North America principal properties are pledged as collateral under Sappi Fine Paper North America's credit facilities.

(4) Subject to a lease expiring in 2011.

(5) Subject to a lease that operates on a month-to-month basis.

(6) Subject to a lease expiring in 2010.

(8) Of the total 62,140 m², 8,800m² is subject to a lease that operates on a year-to-year basis. The remainder of the property is subject to a heritable building right (Erbbaurecht).

(9) Subject to leases expiring in 2008.

(10) Substantial assets are leased pursuant to capital lease agreements. During fiscal 2006, Sappi announced the expansion of the existing capacity at Saiccor mill. The current capacity of the mill is approximately 600,000 metric tonnes per annum. The result of the expansion is an expected increase in capacity of 300,000 tonnes, of which 75,000 tonnes is to replace existing higher cost capacity, while simultaneously reducing the environmental impact of the operation. The estimated cost of the project is \$460 million.

- (11) Subject to a lease expiring in 2015.

39

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis together with our Group annual financial statements, including the notes, included elsewhere in this Annual Report. Certain information contained in the discussion and analysis set forth below and elsewhere in this Annual Report includes forward-looking statements that involve risk and uncertainties. See Forward-Looking Statements , Item 3 Key Information Selected Financial Data , Item 3 Key Information Risk Factors , Item 4 Information on the Company , Item 10 Additional Information Exchange Controls and notes 2, 12, 15, 17, 21, 22, 23, 25, 26, 28, 29, 31, 35 and 36 to our Group annual financial statements included elsewhere in this Annual Report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in this Annual Report. The following discussion and analysis are based on the results of operations prepared in accordance with International Financial Reporting Standards (IFRS), which differ from United States Generally Accepted Accounting Principles (US GAAP).

The consolidated financial statements of the Sappi Group as of and for the years ended September 2006 and 2005, including the applicable notes thereto, contained in Item 18 Financial Statements of this Annual Report on Form 20-F and the consolidated financial information of the Sappi Group as of and for the years ended September 2006 and 2005 contained herein have been aligned with International Financial Reporting Standards (IFRS). The consolidated financial statements and related financial information of the Sappi Group as of and for each of the years ended September 2004, 2003 and 2002, cannot be provided on an IFRS aligned basis without unreasonable effort or expense. The Sappi Group has not amended, and does not intend to amend, its previously filed financial statements for the years affected by the change in accounting policy that ended prior to the year ended September 2005. For this reason, our Annual Reports on Form 20-F for those prior years, the consolidated financial statements and applicable notes thereto, auditors' reports and related financial information contained in such reports should not be compared to this Annual Report on Form 20-F. For a description of the change in accounting policy and resulting adjustments, see Item 5 Operating and Financial Review and Prospects, and note 2 to our Group annual financial statements, included herein.

Fiscal 2006 included 52 accounting weeks, compared to 53 accounting weeks in fiscal 2005. Our fiscal years operate on a 52 accounting week cycle, except every 6th fiscal year which includes an additional accounting week (additional accounting week). The following discussion of our operating and financial review and prospects refers to the impact of the additional accounting week in fiscal 2005 on our sales, raw material and other input costs of manufacturing, operating expenses and, selling, general and administration expense (SG&A expense), based on average weekly sales and costs for the fiscal year.

Company and Business Overview

We are a global company which through acquisitions in the 1990s has been transformed into a global market leader in coated fine paper. Two acquisitions were pivotal in establishing us as a global company, namely the acquisition in 1994 of S.D. Warren Company, now known as Sappi Fine Paper North America, and the acquisition in 1997 of KNP Leykam, now integrated into Sappi Fine Paper Europe. Opportunities to grow within our core businesses will continue to be evaluated.

We have integrated our fine paper acquisitions into a single fine paper business, which operates under the name Sappi Fine Paper. We are organised into two operating segments; Sappi Fine Paper and Sappi Forest Products. We also operate a trading network, called Sappi Trading, for the international marketing and distribution of chemical cellulose and market pulp throughout the world and of the group's other products in areas outside our core operating regions of North America, Europe and Southern Africa.

Sappi Fine Paper generated approximately 80% of our sales during fiscal 2006 and fiscal 2005. Of our sales for fiscal 2006 and fiscal 2005, approximately 84% were made in US\$, Euro and other non-ZAR denominated currencies. Our South African businesses sell approximately 45% of their products in US\$.

See Inflation and Foreign Exchange and note 31 to our Group annual financial statements included elsewhere in this Annual Report. Our sales by source and destination in fiscal 2006 and fiscal 2005 were as follows:

	Sales by Source 2006		Sales by Source 2005		Sales by Destination 2006		Sales by Destination 2005	
North America	29	%	29	%	30	%	30	%
Europe	44	%	45	%	40	%	40	%
Southern Africa	27	%	26	%	15	%	15	%
Far East and others					15	%	15	%
Total	100	%	100	%	100	%	100	%

Sappi Fine Paper has a total paper production capacity of 4.2 million metric tonnes per annum. We are a global leader in the coated fine paper business with a capacity of 3.9 million metric tonnes of coated fine paper per annum.

Our North American market share increased towards the end of fiscal 2005 to slightly above fiscal 2004 levels. This market share declined during 2006, due to a surge in US imports. After declining during fiscal 2005, our European market share increased during fiscal 2006; although still not at the same levels as seen during fiscal 2004. We are one of the world's largest producers of chemical cellulose. The Group is 100% integrated on a net basis in terms of pulp usage, meaning that, while some of our facilities are market buyers of pulp and others are market sellers, in the aggregate we produce slightly more pulp than we utilise. By region, the Southern African operations are net sellers of pulp, Sappi Fine Paper North America is fully integrated and the European operations are approximately 46% self-sufficient for pulp in Continental Europe, but entirely dependent on market pulp in the United Kingdom. We supply approximately 70% of the wood requirements for our South African businesses from sources we own or manage. Both our North American and European operations are dependent on outside suppliers of wood for their production requirements.

Despite a decline in fiscal 2006 we have, in recent years, sought to internationalise our shareholder base and increase our exposure in the world's major financial markets. On November 5, 1998, our American Depository Receipts commenced trading on the New York Stock Exchange. We believe that, as at the end of fiscal 2006, based on registered addresses and disclosure by nominee companies, excluding the shares owned by a subsidiary of Sappi, our beneficially held shareholding by Region is as follows:

	2006	2005
North America	30 %	46 %
Europe & Elsewhere	10 %	12 %
Southern Africa	60 %	42 %

Principal Factors Impacting on our Results

The results of operations of our business are affected by numerous factors. Given the high fixed cost base of pulp and paper manufacturers, industry profitability is highly sensitive to changes in prices. Prices are significantly affected by changes in industry capacity and output levels, customer inventory levels and cyclical changes in the world economy. Profitability in our industry is, however, also influenced by factors such as sales volume, the level of raw material, energy and other input costs, exchange rates, and operational efficiency.

The principal factors that have impacted our business during the financial periods presented in the following discussion and analysis and that are likely to continue to impact our business are:

- Cyclical nature of our industry and its impact on sales volume;

- b) Movement in market prices for our products;
- c) Sensitivity to currency movements;
- d) Movement in market prices for raw materials and other input costs of manufacturing; and
- e) Other significant factors impacting costs, including new acquisitions, restructuring and cost reduction initiatives.
- f) Our ability to maintain and continuously improve operational efficiencies and performance.

Because many of the factors are beyond our control and certain of these factors have historically been volatile, past performance will not necessarily be indicative of future performance and it is difficult to predict future performance with any degree of certainty.

Markets

The markets for our pulp and paper products are cyclical, with prices significantly affected by factors such as changes in industry capacity and output levels, customer inventory levels and cyclical changes in the world economy. The pulp and paper industry has often been characterised by periods of imbalances between supply and demand, causing prices to be volatile. Prices also vary significantly by geographic region and product. Coated fine paper, our core product used for many types of publications, is susceptible to the highly cyclical advertising market, a major driver in our business.

Coated Fine Paper

Paper demand from fiscal 2004 to fiscal 2006 remained positive as the upswing in world economic growth and resultant increase in advertising activities resulted in a significant increase in demand for coated fine papers. The increase in demand was particularly pronounced in Europe where coated fine paper demand remained buoyant with a growth rate of 7.3% during fiscal 2004 and 4.3% in fiscal 2005, despite a temporary retreating rate of economic growth during 2005. The temporary slump is evident as demand for coated fine paper during fiscal 2006 increased by only 1.4% compared to previous years. North American demand growth, which lagged that of Europe during 2005 (1.1%), improved during fiscal 2006 and reached 4.3%.

Increases in industry capacity in Europe and North America were limited during this period, with companies reluctant to undertake major new capital projects in these regions due to the large amount of excess capacity already present. Despite global overcapacity, high Asian demand growth rates and freely available funding led to significant coated fine paper capacity additions between fiscal 2000 and fiscal 2006 in Asia, particularly in China. This wave of expansion finished by the end of calendar 2005 and as of early December 2006, to the best of our knowledge, no new coated fine paper machines were under construction or in the final stages of planning anywhere in the world.

Despite increased demand, operating rates were low in fiscal 2002 through the first half of fiscal 2004 due to excess capacity, causing price erosion in both Europe and North America. Despite the weakening US\$ during this period, net imports into the United States continued to grow, putting further pressure on prices. Prices in North America, however, did start to improve in the latter half of fiscal 2004 due to a sharp increase in seasonal demand. These tight supply/demand conditions in North America continued into fiscal 2005, and more so in fiscal 2006 as inventory throughout the supply chain dropped, giving rise to further price increases. In total, North American apparent consumption grew by 4.3% in fiscal 2006, largely due to increased advertising pages and printer consumption of coated fine papers.

In Europe, demand for coated fine paper grew by 1.4% in fiscal 2006, a significant decline on the previous years' growth of 4.3%. Despite demand growth and sharp increases in input costs, our attempt to

increase prices in the European market in fiscal 2005 was unsuccessful due to intense competition for market share.

Input unit costs increased further in 2006, but the impact on operating cost per tonne sold was limited by the non-reoccurrence of impairment and restructuring charges and some operational performance improvements. The effect of this was a decrease in a decreased operating cost per tonne sold of US\$17 per metric tonne from US\$686 per metric tonne in fiscal 2005 to US\$669 per metric tonne in fiscal 2006.

Average selling prices realised for the Sappi Fine Paper businesses decreased by US\$21 per metric tonne, from US\$962 per metric tonne to US\$941 per metric tonne.

The graph below reflects apparent consumption. Apparent consumption is consumption as indicated by mill sales volumes, which ignores the impact of customer inventory. The sales volume to our customers is used as the indicator of demand, with the difference between apparent and real demand being the movement in inventories.

US vs. European Apparent Consumption of Coated Paper

Source: AF&PA & Cepifine
US short tons converted to metric tonnes

The recent price history for benchmark coated woodfree grades in North America and Europe is shown in the following chart:

US and European Fine Paper Prices

January 2002 - September 2006

Prices are list prices. Actual transaction prices could differ from prices depicted in graph
Source: RISI

Pulp

Pulp prices tend to display higher volatility than paper prices. In recent years the price of the benchmark pulp grade, Northern Bleached Softwood Kraft (NBSK), has ranged from a low of US\$395 (Nov-1993) to a high of US\$925 (Sept-1995) per metric tonne.

Throughout fiscal 2004 and fiscal 2005, global demand for pulp was low in comparison to fiscal 2006 and price fluctuations were driven primarily by currency changes, inventory movement and non-integrated paper capacity expansion.

High pulp demand during fiscal 2006 resulted in the continued increase of pulp prices, trading at the end of fiscal 2006 (NBSK: US\$712 per metric tonne) at US\$128 per metric tonne higher than at the end of fiscal 2005 (NBSK: US\$583 per metric tonne). The pulp demand during the latter part of fiscal 2006 remained high with none of the usual seasonal lulls experienced. As a result inventory levels declined considerably to levels last seen during 2000.

The traditional softwood pulp price premium to hardwood was disrupted in fiscal 2005 as a result of pulp mills shifting from hardwood to softwood production, and hardwood pulp mills closing temporarily. This led to hardwood pulp prices exceeding that of softwood in the final quarter of fiscal 2005. However, during October 2005 softwood price premiums were restored as some softwood mills closed in Eastern Canada, while hardwood supply increased during the latter part of fiscal 2005 as an additional 1.9 million

metric tonnes came on stream with large expansions at Hainan Island in China and Veracel in Brazil. As a result, the softwood pulp price premium to hardwood increased considerably during fiscal 2006.

Since Sappi sells roughly as much pulp as is purchased, fluctuations in market pulp prices have a negligible direct impact on the Group's overall profitability. At a divisional level, pulp prices do, however, affect profitability since Sappi Fine Paper Europe is a net buyer of hardwood pulp and Sappi Forest Products is a net seller of hardwood pulp.

The price of NBSK and NBHK pulp is depicted in the following chart:

Northern Bleached Softwood and Hardwood Kraft Pulp

January 2000 - November 2006

Source: PIX

Chemical cellulose accounts for the majority of Sappi