At Sappi Fine Paper North America, operating income decreased by 77.7% to $40 million in fiscal 2001 from $179 million in fiscal 2000. This decrease was attributable primarily to reduced demand, low-priced imports and the continued slow down of the growth of the US economy. Production was curtailed to manage inventories. Operating margin decreased to 2.8% in fiscal 2001 from 11.1% in fiscal 2000.

Operating income for Sappi Fine Paper South Africa increased by 55.0% to $31 million in fiscal 2001. This increase is partly attributable to the effect of the depreciation of the Rand against the US dollar. As a result, operating margin increased significantly to 13.5% in fiscal 2001 from 8.8% in fiscal 2000.

Sappi Forest Products. Operating income for Sappi Forest Products decreased by 13.4% to $194 million in fiscal 2001. This decrease is primarily attributable to the decrease in volumes sold and lower selling prices realised, offset by cost containment and internal efficiencies. Operating margin increased slightly to 26.5% in fiscal 2001 from 25.2% in fiscal 2000.

Non-trading Profit (Loss)

Non-trading profit (loss) represents all income and expenditure relating to activities outside what is regarded as normal trading. Non-trading profit (loss) includes, amongst other things, profits and losses on the disposal of fixed assets and mill closure costs when these occur.

Non-trading loss was $17 million in fiscal 2002, $207 million in fiscal 2001 and $2 million in fiscal 2000.

- Non-trading loss in fiscal 2002 consisted primarily of a non-recurring charge of $10 million in respect of the write-off of deferred finance costs relating to refinancing the $140 million principal amount of 14% debentures due December 2001 of S.D. Warren Company (the "*North American 14% Debentures*"), a non-recurring charge of $9 million relating to the Transcript mill closure and a non-recurring charge of $4 million relating to the restructuring of the Usutu mill. Non-trading loss was reduced by a release of $7 million relating to an overprovision in fiscal 2001 for the closure costs relating to the Mobile mill closure.
- Non-trading loss in fiscal 2001 consisted primarily of a $183 million ($110 million after tax) charge for the write-off of the assets and closure costs relating to the Mobile mill closure, and a non-recurring charge of $9 million relating to the write-off of deferred finance costs relating to the refinancing of the $250 million S.D. Warren term loan and revolving credit facility in 2001.
- Non-trading loss in fiscal 2000 consisted primarily of a $21 million profit on the sale of Sappi Novobord, offset by a charge of $8 million for further asset impairment costs relating to our U.K. operations and a non-recurring charge of $17 million relating to the cost of refinancing the $232 million Sappi Fine Paper North America's 12% debt in fiscal 2000.

Net Finance Costs

Net finance costs consists of interest expense, net of interest received, interest capitalised, foreign exchange gains and losses and mark to market of financial instruments.

Net finance costs decreased to $74 million in fiscal 2002 from $92 million in fiscal 2001, despite the increased finance costs resulting from the approximately $483 million of additional indebtedness incurred to finance the Potlatch Acquisition and a $11 million charge relating to mark to market of financial instruments. The decrease in net finance costs in fiscal 2002 resulted primarily from the refinancing of certain higher cost loans, lower levels of debt for the period prior to the Potlatch acquisition and a foreign exchange gain of $4 million.

Net finance costs decreased to $92 million in fiscal 2001 from $97 million in fiscal 2000. The reduction in finance cost in fiscal 2001 resulted primarily from lower levels of borrowings and the refinancing of certain higher cost loans. Cash interest cover increased to 7.2 times for fiscal 2002 compared to 6.2 times for fiscal 2001, after having decreased from 7.3 times in fiscal 2000.

Our policy is to capitalise the holding costs of immature forests and the pre-commissioning finance costs on major capital projects. Finance costs capitalised in fiscal 2002 were $29 million compared to $33 million in fiscal 2001 and $47 million in fiscal 2000. Finance costs capitalised related mainly to the holding cost of forests and to capitalised interest on major projects under construction. The amount of interest to be capitalised in respect of the holding cost of plantations is limited by actual finance costs incurred as well as the South African Producer Price Index. The reduction in interest capitalised in fiscal 2002 is mainly due to the effect of the translation of the appreciation of the US dollar against the Rand and was furthermore limited to actual finance costs incurred.

Taxation

Total taxation amounted to $78 million in fiscal 2002, $9 million in fiscal 2001 and $197 million in fiscal 2000. Total taxation in fiscal 2002 increased by $69 million, mainly due to the non-recurring $73 million tax credit relating to the Mobile closure charge in fiscal 2001. Total taxation in fiscal 2001 decreased by $188 million from fiscal 2000, mainly due to lower levels of profit and the $73 million tax credit relating to the Mobile closure charge.

The effective tax rate was 26.1%, 6.2% and 34.4% for fiscal 2002, 2001 and fiscal 2000, respectively. The increase in the effective tax rate in fiscal 2002 and the decrease in fiscal 2001 is mainly the result of the $73 million tax credit relating to the Mobile closure charge in fiscal 2001. The effective tax rate for ongoing operations excluding Mobile was approximately 25% for fiscal 2001.

Certain of our companies are subject to taxation queries, which could give rise to additional taxation costs. While amounts have been provided for such costs in addition to amounts disclosed as contingent liabilities, management currently believes, based on legal counsel opinion, that no further material costs will arise. See note 29 to our audited Group annual financial statements included elsewhere in this Annual Report.

Pending negotiations between Belgium and the European Commission regarding the tax status of co-ordination centres in Belgium, like Sappi International S.A., our Group treasury operation, there is a possibility that Belgium will be compelled to remove, or substantially amend, the beneficial tax regime applicable to co-ordination centres. According to the new rules proposed in a draft bill, the tax base could in future be determined on a cost plus basis with all costs, financial costs and personnel costs included. Withholding tax and capital duty exemptions would remain. Clarity on the acceptability of these proposals to the EU Commission is expected by mid-2003.

It is generally assumed that any change in the tax status will not occur before the end of calendar 2005. The potential negative outcome of these proposed changes, is, based on current proposals and estimates, not expected to have a material impact on taxation payable by the Group, although we can not guarantee it.

The South African government has recently enacted changes in the tax laws. The changes that are more relevant to us are the following. (The summary below includes amendments contained in the Revenue Laws Amendment Bill 67, 2002 which is expected to be promulgated before the end of December 2002):

Residence-Based Taxation and the Taxation of Foreign Dividends. The South African tax system was previously based primarily on the source-based principle. However, in terms of legislation promulgated during fiscal 2001 and 2000, residents of South Africa became taxable in South Africa on their worldwide income for years of assessment commencing on or after January 1, 2001.

A company is regarded as South African tax resident if it is incorporated, established, formed or has its place of effective management in South Africa.

Subject to certain exemptions, the net income of a controlled foreign company ("CFC"), i.e., a foreign company, the rights to participate directly or indirectly in the share capital, share premium or reserves of which are more than 50% held by a South African resident or residents, is also imputed to the residents in the proportion of their participation rights in the CFC. For purposes of imputing the amount to be included in the SA resident shareholder(s) taxable income, the net income of a CFC, is calculated in accordance with South African tax principles. The net income of a CFC is not imputed to South African resident holders of participation rights to the extent that such income is attributable to amounts that have been or will be subject to tax on income in a "designated country" identified by the Minister of Finance at a statutory (not effective) rate of at least 27% in the case of amounts other than capital gains and 13.5% in the case of capital gains. Our non-South African manufacturing activities are located in countries that are currently included in the list of such "designated countries", published by the Minister of Finance of South Africa. There are also other exemptions from the imputation rules e.g. where the CFC in question has a business establishment as defined outside of South Africa and certain other requirements are met. In principle, amounts equal to foreign taxes paid or payable on the CFC's income without any right of recovery by any person will be allowed as a credit against the tax payable in South Africa.

Foreign dividends are, in principle, included in the taxable income of South African residents. However, foreign dividends will not be taxable in South Africa, if the profits from which the dividend was distributed are or were subject to tax in a designated country at a statutory rate of at least 27% in the case of amounts other than capital gains and 13.5% in the case of capital gains without any right of recovery by any person other than a right to carry over losses and the resident receiving the dividend holds a "qualifying interest" in the company declaring the dividend. Sappi Limited holds a qualifying interest as defined in all the Group's non-South African based subsidiaries. There are also other exemptions from tax on foreign dividends.

To the extent that a South African resident company in the Sappi Group receives a taxable foreign dividend, it will in principle be permitted to credit against any South African tax due, foreign company and withholding taxes paid on the profits from which the foreign dividend is paid. South African companies are not able to claim taxable foreign dividends as a credit in the calculation of their liability for secondary tax on companies.

Capital Gains Tax. Tax on capital gains was implemented with effect from October 1, 2001, based on increases in the values of qualifying assets after that date, and triggered by gains made on disposals of the relevant assets. Affected capital assets for companies include virtually all business assets. Companies liable to normal tax on 50% of the net capital gain. At the current corporate tax rate of 30%, the effective tax rate on net capital gains is therefore 15%. Capital losses may only be offset against capital gains. See "Item 10—Additional Information—Taxation".

Income Attributable to Minority Interests

Income attributable to minority interests was zero in fiscal 2002, $0.5 million in fiscal 2001, and $13 million in fiscal 2000. This reduction is mainly due to the acquisition of the minority interests in Leykam-Mürztaler Papier und Zellstoff Aktiengesellschaft and Usutu Pulp mill during fiscal 2000 and fiscal 1999. See "—Liquidity and Capital Resources—Mill Closures, Acquisition and Dispositions—Acquisition of Minority Interests in Leykam-Mürztaler Papier und Zellstoff Aktiengesellschaft".

Net Income

Net income increased by $82 million (59%), to $220 million in fiscal 2002, from $138 million in fiscal 2001 principally because fiscal 2001 net income was negatively impacted by the non-recurring $110 million after tax charge resulting from the closure of the Mobile mill in fiscal 2001. Excluding this charge, fiscal 2002 net income was lower mainly due to lower selling prices. Net income was $363 million in fiscal 2000.

Liquidity and Capital Resources

Operations

Net cash retained from operating activities amounted to $450 million in fiscal 2002, $543 million in fiscal 2001 and $789 million in fiscal 2000. The decrease in fiscal 2002 as compared to fiscal 2001 is primarily attributable to our lower levels of operating profit and an increase in working capital (increased receivables and decreased payables, partly offset by decreased inventories) in fiscal 2002, offset by lower finance costs paid. The increase in receivables in fiscal 2002 is as a result of reduced securitisation of certain receivables due to lower concentration limits. The decrease in payables is mainly due to the payments in fiscal 2002 in respect of the Mobile closure costs which were accrued at the end of fiscal 2001. The decrease in fiscal 2001 as compared to fiscal 2000 is primarily attributable to our lower level of operating profit in fiscal 2001, combined with higher taxation payments, partially offset by a decrease in working capital (decreased receivables and inventories, offset by decreased payables) and lower finance cost payments. The increase in fiscal 2000 as compared to fiscal 1999 is primarily attributable to our higher level of operating profit in fiscal 2000, combined with a reduction in finance costs and partially offset by an increase in working capital (receivables and inventories).

Investing

Cash utilised in investing activities was $701 million in fiscal 2002, $303 million in fiscal 2001, and $68 million in fiscal 2000. Cash utilised in investing activities in fiscal 2002 related mainly to capital expenditure on non-current assets of $205 million, $483 million relating to the Potlatch acquisition, as well as an increase of $16 million in investments and loans. Cash utilised in investing activities in fiscal 2001 related mainly to capital expenditure investment in non-current assets of $319 million, reduced by a decrease of $12 million in investments and loans. Cash utilised in investing activities in fiscal 2000 related mainly to capital expenditure investment in non-current assets of $253 million, reduced by the proceeds from the sale of Sappi Novobord for $57 million, and a decrease in investments of $91 million, reflecting the realisation of a $104 million collateral deposit which was utilised to repay indebtedness of Heritage

Springer.

Financing

Net cash used in financing activities was $29 million in fiscal 2002, $90 million in fiscal 2001 and $564 million in fiscal 2000. The decrease in net cash used in fiscal 2002 as compared to fiscal 2001 is primarily attributable to the $831 million net proceeds from interest bearing borrowings, which includes our $750 million bond issue in June 2002, reduced by the $769 million net repayments of interest bearing borrowings, a decrease of $65 million in bank overdrafts as well as the $12 million of share buy backs. The decrease in net repayment of interest bearing borrowings is primarily due to the repayment

of the $243 million 7.5% Convertible Notes issued through Sappi BVI Finance ("the $243 million convertible notes"), the repayment of the $140 million North American 14% Debentures ("the $140 million debentures") in December 2001, the repayment of an approximately $162 million European Investment Bank loan (euro 166 million) as well as the repayment of the $250 million "B" tranche of the syndicated loan facility (described below), offset by the utilisation of $245 million of the "A" tranche of the syndicated loan facility (described below) at the end of fiscal 2002. The decrease in net cash used in fiscal 2001 as compared to fiscal 2000 is primarily attributable to an increase in short-term borrowings, reduced by the effect of our share buy back programme. The decrease in net cash used in fiscal 2000 as compared to fiscal 1999 is primarily attributable to a smaller decrease in short-term borrowings in fiscal 2000. Net cash used in fiscal 2000 also reflects the acquisition of minority interests in Leykam-Mürztaler Papier und Zellstoff Aktiengesellschaft and Usutu Pulp for $126 million as well as the receipt of $114 million of proceeds from a global offering of our ordinary shares.

In the third quarter of fiscal 2001, we arranged a €900 million ($770 million) syndicated loan facility, which comprises two tranches, on an unsecured basis at between 55 and 70 basis points above the EURIBOR rate. The "A" tranche of this facility is a €562.5 million five-year revolving credit facility for general corporate purposes. The "B" tranche of €337.5 million was partly utilised in September 2001 when we completed the refinancing of the S.D. Warren term loan and revolving credit facility ($250 million). This resulted in the write-off of $9 million of deferred finance costs and in lower ongoing cash finance costs. We refinanced the $140 million debentures with the remainder of the "B" tranche, short-term overdrafts and cash on hand. We have utilised the "A" tranche of the syndicated loan facility to pay the purchase price for the Potlatch Acquisition. This facility is at our disposal on a revolving basis until 2006.

In June 2002, Sappi Papier Holding AG issued $500 million 6.75% Guaranteed Notes due 2012 and $250 million 7.50% Guaranteed Notes due 2032 ("the Notes"), both fully and unconditionally guaranteed on an unsecured basis by each of Sappi Limited and Sappi International S.A., a corporation incorporated in Belgium. The Notes were offered and sold within the United States to "Qualified Institutional Buyers", as defined in Rule 144 A under the Securities Act, and outside the United States in accordance with Regulation S under the Securities Act. The interest on the Notes is payable semi-annually on June 15 and December 15 of each year, commencing on December 15, 2002. The Notes are redeemable, at a premium, in whole or in part at any time by Sappi Papier Holding AG, Sappi Limited or Sappi International S.A.'s option. We used the proceeds of this issuance to repay permanently the "B" tranche, to repay short-term facilities and to make a partial repayment of the "A" tranche, thereby extending the maturity of our debt.

As of September 2002, we had aggregate unused borrowing facilities of $777 million ($183 million in South Africa and $594 million in Europe). At the end of fiscal 2001, we had aggregate unused borrowing facilities of $985 million ($188 million in South Africa, $79 million in the United States and $718 million in Europe). The $208 million decrease in aggregate unused borrowing facilities as of September 2002 as compared to fiscal 2001 is mainly due to the utilisation of $245 million of the "A" tranche, the permanent repayment of the "B" tranche ($59 million), offset by an increase of $96 million of general short term facilities. Unused borrowing facilities at the end of fiscal 2000 were $784 million. At the end of fiscal 2002, the ratio of net debt to gross capitalisation was 37%, up from 30% at the end of fiscal 2001 but down from 41% immediately following the Potlatch acquisition. At the end of fiscal 2000, the ratio of net debt to gross capitalisation was 33%. During the year we restructured our debt profile and now have a much improved debt maturity profile.

We have access to capital from a range of external sources. In accessing external sources of funds, consideration is given to the following factors:

- *age profile of repayment of debt;*

- *cost of financing;*
- *availability of sources;*
- *availability of natural and artificial hedges against currency and/or interest rate fluctuations;*
- *availability of tax efficient structures to moderate financing costs; and*
- *a target net debt to total capitalisation range of between 25% to 50%, depending on where we are in the cycle, except when we undertake large capital projects or acquisitions.*

Our borrowings are not seasonal and we mainly borrow in the currencies in which we operate, and accordingly our net debt and cash and cash equivalents are mainly denominated in US dollars, euro and Rand. See note 16 to our Group annual financial statements included elsewhere in this Annual Report. For a profile of our debt repayment schedule, see note 16 to our Group annual financial statements included elsewhere in this Annual Report.

For a description of financial instruments and our treasury/funding policies, see note 3 to our Group annual financial statements included elsewhere in this Annual Report.

All external loans raised in currencies other than the domestic operating currency of the entity to which the funds are applied, are immediately protected by forward exchange contracts. We also have a policy of maintaining a balance between fixed rate and variable rate loans that enables us to minimise, on a cost effective basis, the impact to reported earnings, while maintaining a reasonably competitive, market-related cost of funding. The specific balance is determined separately for our European, North American and southern African businesses to reflect more accurately the different interest rate environments in which these businesses operate. We monitor market conditions and may utilise interest rate derivatives to alter the existing balance between fixed and variable interest loans in response to changes in the interest rate environment. At the end of fiscal 2002, 70% of our gross debt was at fixed rates as compared to 53% at the end of fiscal 2001. This shift was mainly as a result of the fixed rate long-term Notes issued in June 2002. We had indicated that we would enter into interest rate swaps in respect of a portion of our fixed interest rate long-term debt to variable interest rate debt to reduce our interest cost. To date we have not swapped into variable interest rate debt because, while it would be prudent to buy a collar, the requirement that such instruments be marked to market would likely result in excessive volatility in quarterly earnings caused by the changes in interest rates. We will continue to monitor interest rate developments and take action when appropriate. See note 33 to our Group annual financial statements included elsewhere in this Annual Report.

Our rapid expansion, mainly through acquisitions, had been demanding on our capital resources and on the profile and mix of the funding actually used. At September 30, 2002, our net debt, calculated using components derived under South African GAAP, was $1.4 billion, up by $293 million, or 26.0%, from $1.1 billion at September 30, 2001. The increase is primarily attributable to the $483 million Potlatch acquisition, offset by strong internal cash generation, despite the difficult market conditions. At September 27, 2000, our net debt was $1.2 billion. Of our net debt of $1.4 billion at September 30, 2002, $120 million is payable within one year. This is a decrease of $369 million as compared to the end of fiscal 2001, mainly as a result of applying the proceeds from our bond issue to redeem the $243 million 7.5% Convertible Notes which extended the maturity profile of our debt. The Group has adequate working capital, cash on hand and short and long-term banking facilities to meet these short-term commitments.

There are at present some limitations on our ability to utilise facilities in any one of our divisions to finance activities, or refinance indebtedness, of any other division due to covenant restrictions and South African exchange controls. These limitations have been significantly reduced following the refinancing of our various North American debt instruments. These restrictions include limitations on our ability to significantly increase the debt of our subsidiaries. A constraint applicable to South African companies is the application of exchange controls, which inhibit the free flow of funds from

South Africa. See "—South African Exchange Controls". This affected the geographic distribution of our debt. As a result, our acquisitions in the United States and Europe were financed initially with indebtedness incurred by companies in these regions. We now have access to and have extensively utilised long-term borrowings of generally unsecured nature (except in the case of asset-linked finance). Interest rates reflect the long-term rates for the currencies being borrowed. Short-term borrowings are generally freely available at commercial rates in all countries in which we operate and are used mainly to finance working capital.

We have sold approximately $300 million of non-core assets since 1998 and used the proceeds largely to reduce indebtedness.

While reduction of net debt is a priority, opportunities to grow within our core businesses will continue to be evaluated. The financing of any future acquisition may involve the incurrence of additional indebtedness or the use of proceeds from asset dispositions.

Off-Balance Sheet Arrangements

We have entered into certain finance arrangements, in respect of which the obligations and any related assets are not included in our Group annual financial statements under generally accepted accounting principles. These Off-Balance Sheet Arrangements include lease arrangements described in note 28, securitisation facilities described in note 12 and other arrangements described in note 11, in each case to our Group annual financial statements included elsewhere in this Annual Report.

Capital Expenditures

Capital expenditures in fiscal 2002, fiscal 2001 and fiscal 2000 were as follows:

	Year Ended September		
	2002	2001	2000
	(audited)	(audited)	(audited)
	(US$ in millions)		
Sappi Fine Paper			
Sappi Fine Paper North America	49	99	96
Sappi Fine Paper Europe	96	116	78
Sappi Fine Paper South Africa	6	35	9
Total	151	250	183
Sappi Forest Products	29	43	35
Corporate	—	—	3
Consolidated Total(1)	180	293	221

(1) Excludes investment in timberlands. In fiscal 2002, fiscal 2001 and fiscal 2000, investment in timberlands amounted to $25 million, $28 million and $32 million, respectively.

We operate in an industry that requires high capital expenditures and, as a result, we need to devote a significant part of our cash flow to capital expenditure programmes, including investments relating to maintaining operations.

Capital spending for investment relating to maintaining operations during fiscal 2002, fiscal 2001 and fiscal 2000 amounted to approximately $85 million, $154 million and $129 million, respectively. The capital expenditure programme for these fiscal years was funded primarily through internally generated funds.

Our mills are generally well invested. Sappi Fine Paper North America's prior corporate parent invested approximately $1 billion on capital and investment expenditures from 1988 to 1994. In addition, there were approximately NLG 1,383 million of capital expenditures by KNP Leykam in the

two years preceding our acquisition of that company in December 1997, which included the commissioning of PM 11 at Gratkorn. Consequently, during fiscal 1997 to fiscal 2002, capital spending incurred related mainly to maintaining existing operations and selected high-return capacity expansion or quality-enhancing projects. At Muskegon in North America, Gratkorn in Europe, and Stanger in South Africa, major projects were completed to upgrade operating equipment. These projects will improve product quality, reduce costs and increase capacity. Potlatch spent approximately $525 million on the Cloquet mill during the period 1993 to 2000, resulting in a substantially new pulp mill. Capital expenditure by Potlatch in calendar 2000 and 2001 was $15.1 million and $6.1 million respectively, mainly on pulp mill optimisation and general mill maintenance. Total capital spending including the investment in plantations, for the Sappi Group during fiscal 2002 amounted to 58% of depreciation, amortisation and fellings. Capital spending for the Sappi Group during fiscal 2003 is expected to approximate depreciation, amortisation and fellings and will consist partly of $188 million normal maintenance expenditure and partly of certain upgrade projects mainly at our North American Cloquet and Somerset mills, at our European Gratkorn mill and at our southern African Tugela mill. Capital spending is expected to be funded primarily through internally generated funds. For further details about our capital commitments, see note 28 to our Group annual financial statements included elsewhere in this Annual Report.

Contingent Liabilities, Commitments and Contractual Obligations

We have various obligations and commitments to make future cash payments under contracts, such as debt instruments, lease arrangements, supply agreements and other contracts. The following tables summarise information contained within the Group annual financial statements included elsewhere in this Annual Report. The tables reflect those contingent liabilities, commitments and contractual obligations that can be quantified.

Contingent Liabilities and Commitments

		Amount of Commitment Expiration Per Period			
	Total	Less than 1 year	1 - 3 years	4 - 6 years	After 6 years
Guarantees[1]	66	38	27	—	1
Other Contingent Liabilities[2]	14	8	2	2	2
Capital Commitments[3]	228	163	65	—	—
Total	308	209	94	2	3

Contractual Obligations

		Payments Due by Period			
	Total	Less than 1 year	1 - 3 years	4 - 6 years	After 6 years
Long-Term Debt[4]	1,502	94	161	351	896
Capital Lease Obligations[4]	73	26	32	14	1
Revenue commitments[5]	336	48	84	67	137
Unconditional Purchase Obligations[6]	136	52	56	18	10
Total	2,047	220	333	450	1,044

(1) Guarantees do not include obligations recorded in our Group annual financial statements. Refer note 29.
(2) Other Contingent Liabilities include various lawsuits, administrative proceedings and taxation queries. Refer note 29.
(3) Capital commitments are in respect of fixed assets. Refer note 28.

(4) Refer note 16.
(5) Revenue Commitments are future minimum obligations under operating leases. Refer note 28.
(6) Unconditional Purchase Obligations are obligations to transfer funds in the future for fixed or minimum amounts or quantities of goods or services at fixed or minimum prices (for example, as in take-or-pay contracts or throughput contracts, relating to among others, timber, power).

Note references in the notes to the tables above are references to the notes to the Group annual financial statements included elsewhere in this Annual Report.

Share Buy Back

At a general meeting of shareholders held on December 15, 2000, a special resolution granting general authority for Sappi subsidiaries to purchase Sappi shares subject to the provisions of the South African Companies Act 61 of 1973, as amended, and the Listings Requirements of the JSE was approved. At the annual general meeting of shareholders held on February 25, 2002, a special resolution granting authority to Sappi or Sappi subsidiaries to permit the buy back of up to 10% of the issued shares of Sappi Limited in any one fiscal year, was approved. Pursuant to this approval, we or one of our subsidiaries may buy back shares from time to time. This authority will be valid until the next annual general meeting. Under the South African Companies Act, subsidiaries may not hold more than 10% of the issued share capital of the parent company. As at December 11, 2002, the Sappi share price was $12.83 (R112.98).

Following the approval on December 15, 2000, our cumulative buy back by Group entities, at the end of fiscal 2002, is approximately 13 million shares (or approximately 5.5% of our issued shares) at an average price of $7.93 (R64.16), 4.2 million of which had been utilised by the Sappi Limited Share Incentive Trust to meet its obligations. We held approximately 8.8 million treasury shares at the end of fiscal 2002.

Under the JSE regulations, a company may not repurchase its shares for periods of 40 trading days prior to the announcement of half-year and full-year results. We apply a voluntary restriction on repurchases of 7 trading days prior to the announcement of first and third quarterly results.

Dividends

Sappi Limited declared total cash dividends in respect of the ordinary shares of $0.28 per share in fiscal 2002, $0.26 per share in fiscal 2001 and $0.25 per share in fiscal 2000. Dividends paid in years prior to fiscal 2000 have been paid in South African Rand, and have been converted to US dollars at the rate of exchange at the date of declaration of the dividend.

The current dividend policy of Sappi Limited is to provide regular annual dividend payments which incorporate, over time, real growth for shareholders by providing dividend payments varying in line with changes in the business cycle, but maintaining a long-term average dividend "cover" of three times earnings. Our dividends were covered 3.4, 2.3 and 6.1 times in fiscal 2002, 2001 and 2000, respectively.

Mill Closures, Acquisitions and Dispositions

Potlatch Acquisition. On May 13, 2002, we acquired Potlatch Corporation's coated fine paper business by purchasing Potlatch's Cloquet, Minnesota pulp and paper mill as well as the brands, order books and working capital of the Cloquet mill and the brands, order books and inventories of Potlatch's Brainerd, Minnesota paper mill for an aggregate purchase price of $483 million. The purchase consideration was funded from cash and existing Group facilities. We did not acquire Potlatch's Brainerd mill, which Potlatch has closed. The Brainerd mill previously had a production capacity of 140,000 metric tonnes of coated woodfree paper and serviced a customer base that in the future we intend to service from the Cloquet mill and other Sappi mills. The coated woodfree paper business of Potlatch sold 330,000 metric tonnes of coated paper in 2001. The Cloquet pulp and paper mill has a capacity of 232,000 metric tonnes of coated paper production capacity and a state-of-the-art pulp mill

with a production capacity of 410,000 metric tonnes. We employed approximately 200 fewer people when we acquired the Cloquet mill than were previously employed there. We have reimbursed Potlatch approximately $3.5 million for certain costs in respect of severance payments.

The Cloquet mill includes a hydroelectric facility that is licensed by the Federal Energy Regulatory Commission. The acquisition of the hydroelectric facility from Potlatch was completed on June 25, 2002, upon the approval of the Federal Energy Regulatory Commission to the transfer of the license from Potlatch to Sappi becoming final. In addition to generating a portion of its own power, the Cloquet mill has entered into a co-generation agreement with Minnesota Power and has entered into a take-or-pay agreement to purchase a portion of its power from Minnesota Power, which terminates in 2008.

In connection with the acquisition, we have also agreed to assume Potlatch's obligations under several long-term cross-border leases involving a substantial portion of the Cloquet assets we are acquiring. Under the lease arrangements, Potlatch sold assets to an unrelated third party, leased them back and received an upfront payment. In terms of the agreement, there are no further lease payments foreseen. See "Item 3—Key Information—Risk Factors—Risks Related to Our Business—There are risks related to the recently completed Potlatch Acquisition".

Closure of Transcript Mill. On October 9, 2001, we announced the intention to close the Transcript mill in Scotland, and ceased production in the quarter ended March 2002. In connection with the closure, we provided a $9 million charge for the write-off of the assets and closure costs in fiscal 2002. This facility produced carbonless paper products which is non-core and being rapidly replaced by other products or electronic media.

Closure of Mobile Mill. In fiscal 2001, we provided a $110 million after tax charge for the write-off of the assets and closure costs for the Mobile mill in Alabama and ceased production at the mill in December 2001. Of this charge, $4 million after tax was released in fiscal 2002. The Mobile mill is located on a multi-user site and was dependent on sharing facilities with other producers to maintain an efficient cost structure. The closure of a nearby pulp mill resulted in dramatically increased energy costs. Because we were unable to invest on the site without a better overall cost structure, we decided to close the mill.

Disposal of Novobord and Mining Timber. We sold our South African particle board business, Novobord, for $57 million, effective September 2000. We disposed of our mining timber operations in South Africa effective October 1, 2000.

Acquisition of KNP Leykam. On December 31, 1997, we completed the acquisition of a 91.5% ownership interest in KNP Leykam from KNP BT. The aggregate consideration paid in connection with the KNP Leykam acquisition amounted to approximately NLG1.8 billion. We paid part of the consideration through the issuance of 44,600,423 ordinary shares (which were valued at approximately NLG0.8 billion). We also issued indebtedness in the amount of approximately NLG1 billion, including the interest-free short-term liability referred to above. This indebtedness matured on December 31, 1999. We financed the settlement of this indebtedness with a syndicated two-year term loan facility of euro 343 million ($346 million) arranged by a group of international banks. This facility was repaid in September 2000. During February 1999, we increased our ownership interest in KNP Leykam to 92.2% and in March 2000, we increased this interest to 100%.

Acquisition of Minority Interests in Leykam-Mürztaler Papier und Zellstoff Aktiengesellschaft. During September 1999, we commenced a major reorganisation of our North American and European fine paper businesses. The reorganisation was aimed at amalgamating these businesses under a single holding company, improving access to operating cash flows, centralising borrowings and improving tax and operating efficiency. The reorganisation resulted in the delisting of Leykam-Mürztaler from the Vienna and Frankfurt Stock Exchanges and the acquisition of the minority interests in that company

for approximately $98 million. This was funded from a portion of the proceeds to us from our global equity offering in November 1999. The acquisition of these minority interests increased our ownership interest in KNP Leykam to 100%. The first part of this process was successfully completed in January 2000 when the minority interests in Leykam-Mürztaler had been reduced to 8.2%. On March 9, 2000, the shareholders of Leykam-Mürztaler approved the merger of that company with a wholly owned subsidiary of Sappi and we subsequently paid 35 euro per share to the minority shareholders. Profits (attributable to the minority interest acquired) were recognised and consolidated from April 1, 2000.

Acquisition of S.D. Warren Minority Interests. During fiscal 1997, we undertook a series of transactions for the purpose of acquiring ownership or the right to acquire 100% of SDW Holdings' common equity for an aggregate purchase price of $155 million. As a result of these transactions and related transactions during fiscal 2000, we acquired all of the minority common equity interests (including both common stock and warrants) in SDW Holdings held by certain investors and repaid related financings. The acquisition of the minority common equity interests of SDW Holdings was accounted for as a purchase transaction.

Pension fund

The Group has reviewed its pension fund valuations to take account of the recent significant changes in the performance and outlook of financial markets. Using revised and lower discount rates and assumed rates of return, the pension funds in our European business are adequately funded. There is a surplus in the South African fund (which has not been brought to account) but, in the UK and North American funds, a shortfall is projected. We expect the projected future additional annual income statement charges required to correct the projected shortfall in our North American and UK funds to be approximately $18 million pre-tax (5 US cents per share).

In light of these current conditions and reduced assumptions, funding requirements will cause our North American operations to make a minimum cash contribution of $8 million during fiscal 2003. Based upon projections of investment performance and actuarial assumptions for the foreseeable future, it is likely that our North American operations will be required to make contributions in excess of this amount in each of the succeeding four years. The funding status of plans throughout the Group will continue to be reviewed annually.

The estimated surplus of the South African defined benefit pension plan has not been reflected on the Group's balance sheet pending the formal actuarial valuation and the outcome of the statutory allocation of the surplus between the company and the members of the fund, in accordance with current legislation.

Insurance

The Group has an active programme of risk management in each of our geographical operating regions to address and to reduce exposure to property damage and business interruption. All production and distribution units are audited regularly and are subject to risk assessments, which receive the attention of senior management. The risk programmes are co-ordinated at Group level in order to achieve a harmonisation of methods. Work on improved enterprise risk management is progressing well. Its aim is to lower the risk of incurring losses from uncontrolled incidents.

Furthermore we follow a practice of insuring our assets against unavoidable loss arising from catastrophic events. These include fire, flood, explosion, earthquake and machinery breakdown. Insurance also covers the business interruption costs which may result from these events. Specific environmental risks are also insured.

We have a global insurance structure and the majority of insurance is placed with our own captive insurance company which in turn reinsures the vast majority of the risk with third-party insurance companies.

Following the events of September 11, 2001, and losses on property damage which have seriously affected the insurance industry, the insurance market continues to harden. We successfully placed the renewal of our insurance cover on November 1, 2002. Self-insured deductibles for any one occurrence have increased to $25 million with aggregate limits of $75 million. We believe protection is in line with industry practice. For property damage and business interruption, in particular, we have cover comfortably in excess of what we have determined to be the maximum foreseeable losses. After careful consideration, the Board decided not to take separate cover for losses from acts of terrorism, which is consistent with current practice in the paper manufacturing industry.

We have increased insurance cover for credit risks, which until now was restricted to the European region only.

Critical Accounting Policies

Our Group annual financial statements have been prepared in accordance with South African GAAP, which requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgement based on various assumptions and other factors such as historical experience, current and expected economic conditions, and in some cases, actuarial techniques. The Group constantly re-evaluates these significant factors and makes adjustments where facts and circumstances dictate. Historically, actual results have not significantly deviated from those determined using the estimates described above. The Group believes that the following accounting policies are critical due to the degree of estimation required.

Post employment benefits. The Group accounts for its pension benefits and its other post retirement benefits using actuarial models. These models use an attribution approach that generally spreads individual events over the service lives of the employees in the plan. Examples of "events" are plan amendments and changes in actuarial assumptions such as discount rate, expected long-term rate of return on plan assets, and rate of compensation increases. The principle underlying the required attribution approach is that employees render service over their service lives on a relatively consistent basis and, therefore, the income statement effects of pension benefits or post retirement healthcare benefits are earned in, and should be expensed in the same pattern.

Numerous estimates and assumptions are required, in the actuarial models, to determine the proper amount of pension and other post retirement liabilities to record in the Group's annual financial statements. These include discount rate, return on assets, salary increases, health care cost trends, longevity and service lives of employees. Although there is authoritative guidance on how to select these assumptions, our management and its actuaries exercise some degree of judgement when selecting these assumptions. Selecting different assumptions, as well as actual versus expected results, would change the net periodic benefit cost and funded status of the benefit plans recognised in the Group annual financial statements.

The impact on the future financial results of the Group in relation to post employment benefits is dependent on economic conditions, employee demographics and investment performance.

Asset impairments. The Group periodically evaluates its long-lived assets for impairment, including identifiable intangibles and goodwill, whenever events or changes in circumstance indicate that the carrying amount of the asset may not be recoverable. Our judgements regarding the existence of

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impairment indicators are based on market conditions and operational performance of the business. Future events could cause management to conclude that impairment indicators exist.

In order to assess if there is any impairment, we estimate the future cash flows expected to result from the use of the asset and its eventual disposition. If the carrying amount (being the greater of the discounted expected future cash flows and the net selling price of the asset) exceeds the recoverable amount of the asset, we will recognise an impairment loss for the difference. Considerable management judgement is necessary to estimate discounted future cash flows. Accordingly, actual outcomes could vary significantly from such estimates. Factors such as changes in the planned use of buildings, machinery or equipment or closing of facilities or lower than anticipated sales for products could result in shortened useful lives or impairment. These changes can have either a positive or negative impact on our estimates of impairment and can result in additional charges. In addition, further changes in the economic and business environment can impact our original and ongoing assessments of potential impairment.

Plantations. We state our plantations at the lower of cost less depletions and realisable value. Cost includes all expenditure incurred on acquisition, forestry development, establishment and maintenance of plantations, and finance charges. Depletions include the cost of timber felled, including finance charges, which is determined on the average method, plus amounts written off standing timber to cover loss or damage caused, for example, by fire, disease and stunted growth. Significant assumptions and estimates are used in the recording of plantation cost and depletion. Changes in the assumptions or estimates used in these calculations may affect the Group's results, in particular, plantation and depletion costs. The South African Accounting Practices Board issued a new statement AC 137 Agriculture in November 2001. This statement becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. The objective of this statement is to prescribe the accounting treatment, financial statement presentation and disclosures related to agricultural activity. The Group will adopt AC 137 when it becomes effective and is currently evaluating the effects of the statement.