For our South African fine paper operations, operating expense per metric tonne in US dollars increased by 18.9% (in Rand terms operating expense per metric tonne decreased by 4.7%) as a result of cost reductions. For Forest Products operating expense per metric tonne, in dollar terms, increased 4.8% particularly as a result of the strengthening of the Rand against the dollar. In Rand terms and excluding the effect of the accounting standard on plantations AC137 ("AC137"), operating expenses per metric tonne were contained at fiscal 2003 levels.

Operating Profit

Group operating profit decreased by $84 million (30.9%) to $188 million in fiscal 2004, from $272 million in fiscal 2003, primarily attributable to decreases in operating profit for our Fine Paper division ($158 million), (mainly due to a decrease of $103 million at our North American Fine Paper division), offset mainly by an increased operating profit of $78 million for our Forest Products division.

Our Group operating margin, or the ratio of operating profit to sales, decreased to 4.0% in fiscal 2004 compared to 6.3% in fiscal 2003. The lower operating profit and operating margin reflect the continuing difficult trading conditions in our major fine paper markets, resulting in lower average prices realised in local currency in all our fine paper operations, and are also partly attributable to the currency translation effect on the costs of our European and southern African operations.

Sappi Fine Paper. Operating profit for Sappi Fine Paper decreased by $158 million (96.3%) to $6 million in fiscal 2004 mainly due to lower operating profit in fiscal 2004 for Sappi Fine Paper North America ($103 million), as well as decreases in operating profit at our European ($35 million) and South African Fine Paper divisions ($20 million). Operating margin was 0.2% in fiscal 2004 as compared to 4.6% in fiscal 2003.

Operating profit for Sappi Fine Paper Europe decreased by $35 million (29.7%) to $83 million in fiscal 2004 from $118 million in fiscal 2003. Operating margin decreased to 3.9% in fiscal 2004 from 6.2% in fiscal 2003. These decreases in operating profit and operating margin reflects the difficult trading conditions in Europe in the earlier part of the fiscal year, and were primarily due to lower average prices realised in euro terms. Improved productivity and cost reductions decreased operating expense per metric tonne in euro terms by 4.8% in fiscal 2004, which offset to some extent the reduction in operating profit and operating margin.

Sappi Fine Paper North America incurred an operating loss of $92 million in fiscal 2004 compared to an operating profit of $11 million in fiscal 2003. This decrease in operating profit reflecting the continuing difficult trading conditions in the US in the earlier parts of fiscal 2004, which resulted in lower average selling prices realised. Operating profit was also negatively impacted in fiscal 2004 by higher raw materials and energy costs and by a $20 million restructuring charge.

The operating profit of $15 million for Sappi Fine Paper South Africa decreased from $35 million in fiscal 2003. Selling prices realised in Rand terms decreased by 12.8%, while the operating expenses per metric tonne in Rand terms decreased by 4.7%. Operating margin decreased to 4.8% in fiscal 2004 from 13.0% in fiscal 2003, mainly due to the decrease in average selling prices realised in Rand terms.

Sappi Forest Products. Sappi Forest Products operating profit increased by $78 million (69.0%) to $191 million in fiscal 2004. This is mainly attributable to higher average selling prices realized, which increased on average by 11.9%, and also to the 10.3% increase in volumes sold. The fair value adjustment for plantations under AC137, had the effect of increasing operating profit by $70 million in fiscal 2004. In Rand terms and excluding the fair value adjustment for plantations, operating expenses by metric tonne were contained at fiscal 2003 levels. Operating margin increased to 20.8% in fiscal 2004, from 15.2% in fiscal 2003.

Corporate. Operating losses increased by $4 million as a result of the inclusion of the UK pension costs, which in the prior year and up to the closure of the London office were included in the Fine Paper results.

Net Finance Costs

Net finance costs consist of gross interest and other finance costs, interest received, interest capitalised, foreign exchange gains and losses and change in fair value of financial instruments. Net finance costs were $87 million in fiscal 2005 compared to $110 million in fiscal 2004. Gross interest cost increased by $13 million to $146 million in fiscal 2005, mainly as a result of increased interest rates in fiscal 2005. The benefit of the swaps in prior years was reduced by an increase in interest rates as benchmark swap rates increased by 200 basis points from fiscal 2004. Average gross interest-bearing borrowings of $2,049 million in fiscal 2005 decreased by $23 million compared to $2,072 million in fiscal 2004.

Net finance costs also included a $17 million gain relating to the change in fair value of financial instruments (fiscal 2004—$11 million loss) driven by movements in interest rates and exchange rates. It includes a gain of $13 million recorded in the third quarter of fiscal 2005 as a result of an accounting mismatch, which arose from our inability to apply hedge accounting in respect of our interest rate swaps for a period during that quarter.

Net finance costs were $110 million in fiscal 2004 compared to $111 million in fiscal 2003. Gross interest cost decreased by $17 million over fiscal 2003 to $133 million as a result of a full year's benefit of having swapped fixed rate debt to floating rates during fiscal 2003. During fiscal 2004, we concluded an additional $107 million of fixed to variable interest rate swaps. The benefit of the swaps was reduced by an increase in interest rates as benchmark swap rates increased by 96 basis points from fiscal 2003. Increased average borrowing levels in fiscal 2004 also adversely affected interest costs.

Net finance costs in fiscal 2004 also included an $11 million loss relating to mark-to-market adjustments on financial instruments (fiscal 2003—$6 million gain) driven by movements in interest rates and exchange rates.

Net finance cost before finance costs capitalised ($88 million) was covered 6.3 times by cash generated by operations ($554 million) in fiscal 2005, compared to 5.5 times in fiscal 2004 and 5.8 times in fiscal 2003. The reduction in fiscal 2004 was mainly due to lower levels of profits and cash flow.

Finance costs capitalised in fiscal 2005 amounted to $1 million, compared to $2 million in each of fiscal 2004 and fiscal 2003. Finance costs capitalised relate mainly to the capitalised interest on major projects under construction. Following the adoption in fiscal 2004 of AC137, we no longer capitalised interest to the holding costs of plantations.

Taxation

Total taxation amounted to a tax credit of $11 million in fiscal 2005, compared to a tax credit of $17 million in fiscal 2004 and a tax charge of $18 million in fiscal 2003. Total taxation in fiscal 2005 increased by $6 million from fiscal 2004. The effective tax rate was 4.9% for fiscal 2005 compared with negative 22.5% for fiscal 2004 and positive 11.0% for fiscal 2003. Despite the loss in fiscal 2005, the decrease in the tax benefit and the increase in the effective rate in fiscal 2005 were primarily as a result of the tax relief on the net loss before tax of $320 million for Sappi Fine Paper North America not being fully recognised under applicable accounting rules. Further reduction in the benefit is due to non-relief of the impairment charges relating to the Usutu mill. The impact of these two adjustments increased the group’s tax charge by $121 million. This was, however, partially offset by tax rate reductions in the Netherlands and South Africa.

Total taxation in fiscal 2004 decreased by $35 million from fiscal 2003 due to profits before tax reducing to $78 million from $161 million in fiscal 2003, and as a result of the geographical split of profits and losses. Further reductions in tax were due to the reversal of tax provisions previously raised for exposures that have been resolved as well as the reduction in fiscal 2004 of the Austrian tax rate from 34% to 25%. The impact of all these adjustments was $26 million. This was however offset by the reversal of net deferred tax assets of $20 million in Europe and southern Africa.

The decrease in the effective tax rate in fiscal 2004 was primarily the result of the geographical split of profits and losses and the utilisation of previously unrecognised tax losses. Our North American operations, where the nominal tax rate is 39.5%, reported a Net Loss before Tax of $140 million. The tax rate benefited further from the reversal of tax provisions previously raised for exposures that have been resolved in fiscal 2004 and the reduction in fiscal 2004 of the Austrian tax rate from 34% to 25%. The impact of all these adjustments was $26 million. This was however offset by the reversal of net deferred tax assets of $20 million in Europe and southern Africa.

Tax liabilities are calculated according to the tax laws applicable to the jurisdiction in which a legal entity has fiscal residence. Certain jurisdictions apply group taxation and the tax liabilities of legal entities trading in such jurisdictions are calculated in accordance with group taxation principles. In certain cases entities are subject to tax in more than one jurisdiction. Where the entity is entitled to a corresponding tax credit in the country of fiscal residence, this entitlement is reflected in the tax charge. Should there not be any entitlement to a tax credit, the foreign tax paid is included as part of the tax charge for an entity.

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 that no further material costs will arise. See note 33 to our Group annual financial statements included elsewhere in this Annual Report.

Sappi International S.A. (“SISA”) is a corporation incorporated in Belgium. SISA is our group treasury and operates in Belgium under a co-ordination centre license granted by the Belgian government that includes an alternative method of calculating the taxation liability of a co-ordination centre. This license was originally granted in 1993 and is valid until December 31, 2005. The Belgian government has legislated a new general tax measure with effect from January 1, 2006. This tax measure allows for a tax deduction on the notional cost of a company’s equity. As it is a general tax measure it does not only benefit a specific group of taxpayers in Belgium, and as such was approved by the European Commission as being compatible with European requirements. There is no time limit to this tax measure and we do not anticipate that the tax charge for SISA will be materially affected by the new legislation.

Sappi accounts for taxation using the undistributed tax rate for SA GAAP and using the distributed rate for US GAAP. This is reflected as a reconciling item in the annual financial statements (refer note 42 to our Group Annual Financial Statements included elsewhere in this Annual Report). The company currently has an after tax Secondary Tax on Companies (“STC”) credit of $31 million (fiscal 2004 and fiscal

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2003: $38 million). During fiscal 2005 we changed our policy on STC. We adopted AC501—accounting for STC. This standard now requires the recognition of a deferred tax asset for unused STC credits to the extent that they will be utilised in the future. This has resulted in the recognition of a deferred tax asset for unused STC credits. When STC credits are utilised with declaration of dividends, it will result in the recognition of a deferred tax charge for STC in the income statement in the period that the dividend is declared.

Basis of Income Taxation

South Africa has a dual income tax system in terms of which residents are taxed on their worldwide income and non-residents are taxed on their South African source (or deemed source) income. Certain categories of income and activities are exempt from taxation.

Residence, in the case of natural persons, is established either by being ordinarily resident in South Africa or by satisfying a physical presence test in terms of which they become residents by virtue of their being physically present in South Africa for certain prescribed periods of time. In the case of legal entities, residence is established by virtue of incorporation or formation, or having a place of effective management in South Africa. Excluded from the definition of “resident” are persons or entities which are, in terms of double taxation agreements entered into by South Africa, not treated as resident in South Africa.

Resident companies of South Africa are subject to corporate income tax at a rate of 29%, which was decreased from 30% in fiscal 2005. The South African tax law exempts dividends received from domestic entities from taxation, in part to avoid double taxation of corporate earnings. However, resident companies are subject to STC upon the declaration of a dividend, equal to 12.5% of such dividend, net of the STC tax liability. Any excess of dividends received by a company in a relevant dividend cycle, excluding those foreign dividends which are not exempt from South African income tax, over the dividends paid in such cycle is carried forward by the company to the succeeding dividend cycle as an STC credit.

The imposition of STC, together with the corporate income taxes, effectively imposes a dual corporate tax system in South Africa, with a liability for both the 12.5% STC and the 29% corporate income tax. This creates an effective tax rate on South African companies of 36.9% on distributed earnings. STC tax on companies is however only recognised under current SA GAAP when a dividend is distributed. The STC becomes payable one month after the end of the month in which the dividend was declared.

Dividends received by or accruing to South African residents from companies which are not tax resident in South Africa are subject to tax, but certain foreign dividends are exempt from tax, including:

- Foreign dividends declared by a company listed on a stock exchange licensed in South Africa or on an exchange recognised by the Minister of Finance in the Government Gazette to a shareholder if more than 10% of the equity share capital of the listed company at the time of declaration is held by South African residents;
- Foreign dividends to residents holding a certain minimum interest (currently 25% of the total equity shares; however, according to recent draft legislation which has not yet been enacted, this minimum interest will soon be reduced to 20% of the equity shares and voting rights) in the foreign company declaring the dividend, but certain dividends are excluded from this exemption by certain anti-avoidance measures;
- Foreign dividends declared out of profits that are subject to tax in the hands of the South African resident recipient of the dividend in terms of South Africa’s controlled foreign company legislation;
- Foreign dividends declared out of profits that are subject to full South African tax; and
- Foreign dividends declared by a company out of profits which arose from dividends declared to such company by a South African resident company.

South African residents, who are natural persons earning interest and non-exempt dividends from foreign sources, are allowed an exemption on the first R15,000 of such income (the exemption is firstly to be applied to foreign dividends and only if they do not exceed R2,000, the excess is to be applied to foreign interest).

Income Tax and Capital Gains Tax

Profits derived from the sale of shares in a South African company will generally only be subject to income tax (at a corporate rate of 29% and a maximum individual rate of 40% based on a sliding scale) in South Africa if the seller carries on business in South Africa as a share dealer, and the profits are realised in the ordinary course of that business.

Capital Gains Tax was introduced with effect from October 1, 2001 and has been introduced in the Income Tax Act 58 of 1962 by way of the incorporation of the Eighth Schedule therein ("Eighth Schedule"). Under the Eighth Schedule, all natural persons, legal persons and trusts resident in South Africa are liable to pay capital gains tax on the disposal of a capital asset. The definition of an asset is very wide and includes assets that are movable, immovable, corporeal or incorporeal, but excludes certain limited items which are specifically excluded from the definition of an asset. Non-residents of South Africa will not be subject to capital gains tax except in respect of the disposal of immovable property situated in South Africa (or any interest or right in such immovable property) and any assets of his/its permanent establishment through which a trade is being carried on in South Africa. Profits derived from the sale of South African shares held by non-residents as long-term investments will generally not be subject to capital gains tax in South Africa. However, the sale of South African shares held by a non-resident will attract capital gains tax in the event that the shares comprise an asset of that non-resident's permanent establishment in South Africa, or if the foreign shareholder (alone or together with any connected persons) holds more than 20% of the issued share capital of the South African company and more than 80% of the net asset value of that company is attributable to immovable property situated in South Africa. An American Depository Share will be regarded as a share for the purpose of Capital Gains Tax in South Africa. The Treaty only permits the imposition of South African tax on capital gains of a United States resident seller from the sale of shares where such shares form part of the business property of a permanent establishment which the seller has in South Africa or pertain to a fixed base available to the seller in South Africa for the purpose of performing independent personal services. Companies will be liable to capital gains tax on 50% of the net capital gain. At the current corporate tax rate of 29%, the effective tax rate on net capital gains will therefore be 14.5%.

For further information see "Item 10—Additional Information—Taxation".

Net (Loss)/Profit

We incurred a net loss of $213 million in fiscal 2005 compared to a net profit of $95 million in fiscal 2004, primarily due to the Muskegon and Usutu impairment charges of $233 million pre-tax ($223 million after tax). The decrease is also due to low selling prices realized in local operating currencies, the effect of the strong Rand on our South African margins and higher raw materials and energy costs, especially in our North American and European operations. Net profit was also negatively impacted by restructuring charges of $22 million pre-tax ($21 million after tax). Net profit was positively impacted by the ongoing initiatives that we put in place over the last few years to offset the impact of cost increases, by the release of a $6 million provision and lower charges for bad debt provisions of $7 million, both at Sappi Fine Paper Europe. It was also enhanced by the benefit of $52 million before tax relating to the plantation adjustment ($18 million less than fiscal 2004—primarily due to fewer timber price increases).

Earnings per share decreased to a loss of 94 US cents per share in fiscal 2005, from earnings per share of 42 US cents per share in fiscal 2004 and 62 US cents in fiscal 2003.

Net profit decreased by $48 million (33.6%) to $95 million in fiscal 2004 from $143 million in fiscal 2003, mainly due to low prices in local operating currencies, the effect of the strong Rand on our South African margins and higher raw materials and energy costs, especially in our North American operations. Net profit was also negatively impacted by restructuring charges of $32 million pre-tax ($22 million after tax), but positively impacted by $47 million after tax, following the implementation of AC 137 in fiscal 2004. Net profit was also favourably impacted by net tax credits of $6 million, described under taxation above.

Liquidity and Capital Resources

Operations

Fiscal 2005

Cash retained from operating activities amounted to $271 million in fiscal 2005 compared to $345 million in fiscal 2004. During fiscal 2005 we generated cash from operations of $554 million compared to $601 million in fiscal 2004. The reduction of $47 million in cash generated compared to fiscal 2004 is mainly the result of lower profit before tax in fiscal 2005. Cash generated was reduced by finance costs paid (net of interest income) of $112 million ($3 million more than fiscal 2004), by taxation paid of $43 million ($12 million more than fiscal 2004) and also by $60 million cash being utilised in working capital ($10 million more than fiscal 2004).

Total non-cash items in fiscal 2005 amounted to $691 million, which was $278 million higher than the $413 million in fiscal 2004, and included:

- The asset impairment and machine and mill closure costs of $232 million, mainly relating to the Muskegon and Usutu mills.
- Depreciation and fellings charges of $488 million, which were $25 million higher than fiscal 2004 due to the currency translation effect ($14 million) and the additional accounting week, based on average weekly charges ($9 million).
- Increased other long term liabilities (Pension liability) of $48 million, mainly at our European operations.
- The $21 million North American restructuring provision.
- Increased provision for obsolete inventory of $10 million.
- Loss on sale and write-off of fixed assets of $10 million, ($7 million higher than fiscal 2004), reduced by
- Fair value gains on plantations of $118 million ($7 million lower than fiscal 2004), due to lower timber price increases when compared to fiscal 2004, and
- The release of a $6 million provision at Sappi Fine Paper Europe in fiscal 2005.

The increase in fiscal 2005 in working capital of $60 million compared to a $50 million increase in fiscal 2004, and consisted of:

- $98 million decrease in payables consisting largely of a decrease in other payables ($72 million), mainly at our North American operations of $39 million, due to lower pension accruals ($30 million) and decreased provision for rebates ($12 million) and at our European operations of $13 million, mainly relating to decreased employee accruals ($9 million). Trade payables decreased at our European operations by $21 million compared to fiscal 2004 and decreased at our North American operations by $15 million compared to fiscal 2004. This decrease in trade payables was

mainly due to the fiscal 2005 year end occurring after the calendar month end payment run, compared to the fiscal 2004 year end which occurred before the calendar month end payment run.

- $35 million decrease in receivables related mainly to a decrease in trade receivables at our South African Fine Papers division of $9 million and a net decrease in trade and other receivables of $8 million at Forest Products, resulting from higher levels of securitisation compared to fiscal 2004. During the year our South African operations entered into an increased securitization structure with Rand Merchant Bank.
- $3 million decrease in inventories related mainly to a decrease at our European operations of $10 million and at our North American operations of $5 million, mainly as a result of production downtime, offset by an increase in inventory at our South African Fine Papers division of $13 million, primarily due to higher finished goods and work in progress inventory compared to fiscal 2004.

The increase of $11 million in finance costs paid in fiscal 2005 was mainly due to increased levels of average borrowings and higher interest rates paid on borrowings.

Taxation paid of $43 million in fiscal 2005 was $12 million higher than fiscal 2004. This was mainly the result of the finalization of certain long outstanding issues with the South African Revenue Authorities.

Fiscal 2004

Cash retained from operating activities amounted to $345 million in fiscal 2004 and $421 million in fiscal 2003. During fiscal 2004 we generated cash from operations of $601 million compared to $645 million in fiscal 2003. The reduction in cash compared to fiscal 2003 is the result of a decrease in profits before tax which was $78 million in fiscal 2004, $83 million lower than fiscal 2003. Cash was further reduced by tax paid of $31 million, a $64 million increase compared to fiscal 2003. Working capital utilised was $50 million, $29 million less than the utilisation in fiscal 2003. Cash was also reduced by finance costs paid of $136 million, $7 million less than fiscal 2003 and was enhanced by adjustments for non-cash items of $413 million.

Total adjustments for non-cash items in fiscal 2004 were $413 million, $40 million higher than the $373 million in fiscal 2003, and included:

- Depreciation and fellings charges of $463 million, $69 million higher than fiscal 2003, due to increased additions to fixed assets as well as the currency translation effect.
- Provisions of $86 million, mainly relating to increased pension and post retirement benefit provisions.
- Lower asset impairment and machine and mill closure costs, $32 million less than fiscal 2003 ($32 million in fiscal 2003—Sappi Fine Paper North America (principally related to the Westbrook machine closure)) reduced by
- Fair value gains on plantations of $125 million, $83 million higher than fiscal 2003, due to timber price increases and reduced delivery costs.

During fiscal 2004, working capital increased by $50 million compared to a $79 million increase in fiscal 2003. The $50 million increase in working capital consists of:

- $27 million increase in inventories relating to our European operations primarily due to the replenishing of stock levels at year end.
- $38 million increase in receivables related mainly to an increase in trade receivables of $54 million at our North American operations primarily due to an early cut-off date used for securitisation

purposes. Trade receivables at our European operations decreased by $17 million due to lower net sales compared to fiscal 2003.

- $15 million increase in payables consisted largely of an increase in other payables, mainly at our North American operations of $54 million due to collections of securitised receivables on behalf of State Street Bank. Trade and other payables at our Forest Products division decreased by $40 million due to lower capital and interest accruals compared to fiscal 2003.

The decrease of $7 million in finance costs paid in fiscal 2004 was mainly due to the benefit of the fixed to variable interest rate swaps.

Taxation paid in fiscal 2004 was $64 million higher than fiscal 2003. This is impacted by a tax refund of $58 million received by our North American operations in fiscal 2003. No similar refund was received in fiscal 2004.

Investing

Cash utilised in investing activities was $379 million in fiscal 2005 and $356 million in fiscal 2004. Cash utilised in investing activities in fiscal 2005 related mainly to capital expenditure on non-current assets of $294 million, our investment in China ($61 million), as well as an increase of $29 million in investments and loans, mainly due to increased pension and other post retirement payments at Sappi Fine Paper Europe ($24 million).

Cash capital expenditure decreased to $294 million in fiscal 2005 from $331 million in fiscal 2004. The decrease in cash capital expenditure of $37 million in fiscal 2005 was impacted by the currency translation effect of $11 million. The $294 million spent in fiscal 2005 consisted of $183 million ($219 million in fiscal 2004) relating to expenditure to maintain operations and $111 million of expenditure to expand operations. Included in fiscal 2004 were the group software upgrades and certain head office expenditure.

The capital expenditure of $111 million in fiscal 2005 to expand operations mainly consisted of:

- Projects at our European operations amounting to $58 million, including the replacement of operating equipment and finishing house automation of $14 million at our Gratkorn mill and $11 million on the rebuild of our Ehingen mill.
- $27 million at our Forest Products division, including $18 million on de-bottlenecking at Saiccor mill.
- Expenditure of $26 million at our North American operations, including $17 million at the Cloquet mill on product improvements and cost reductions.

Cash utilised in investing activities was $356 million in fiscal 2004 and $310 million in fiscal 2003. Cash utilised in investing activities in fiscal 2004 related mainly to capital expenditure on non-current assets of $331 million, as well as an increase of $27 million in investments and loans, mainly due to top up payments made to a European pension fund.

Cash capital expenditure excluding acquisitions, increased to $331 million in fiscal 2004 from $297 million in fiscal 2003. The increase in fiscal 2004 is mainly due to the currency translation effect ($42 million). The $331 million spent in fiscal 2004 consisted of $219 million relating to expenditure to maintain operations and $112 million of expenditure to expand operations. Capital expenditure to maintain operations of $219 million is higher than $165 million spent in fiscal 2003 and includes the group software upgrade and certain head office expenditure.

The capital expenditure of $112 million in fiscal 2004 to expand operations mainly consisted of:

- Projects at our European operations amounting to $39 million, in particular a new sheeter and woodyard upgrade at our Gratkorn mill.
- $68 million at our Forest Product division, including $17 million at Ngodwana mill for a de-bottlenecking project, as well as $22 million at the Tugela mill to reduce production costs.

Our capital expenditure programme varies from year to year, and high expenditure in one year is not necessarily indicative of future capital expenditure as explained in detail in our discussion on Capital expenditure included elsewhere in this Operating and Financial Review and Prospects.

Financing

Net cash of $7 million was utilised in fiscal 2005, compared to $121 million utilised in fiscal 2004 and $147 million raised in fiscal 2003. Cash utilised in fiscal 2005 related mainly to the repayment of short-term interest-bearing borrowings ($249 million), partly reduced by an increase in overdraft ($156 million—mainly at Sappi Trading Pulp ($134 million)), and by the proceeds from long-term interest bearing borrowings ($114 million).

Cash utilised in fiscal 2004 related mainly to the repayment of bank overdrafts of $162 million, partially offset by the net proceeds from interest-bearing borrowings raised of $57 million.

In June 2002, SPH 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 SISA. 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, which commenced on December 15, 2002. The Notes are redeemable, at a premium, in whole or in part at any time by SPH, Sappi Limited or SISA’s option. We used the proceeds of this issuance to refinance existing indebtedness, thereby extending the maturity of our borrowings. Between March and July 2003 we concluded contracts to swap the fixed rate exposure to floating rates, linked to USD LIBOR. The benefit of the reduced finance cost resulting from the swaps has increased by approximately $11 million to $19 million in fiscal 2004, when compared to fiscal 2003. Due to the increasing US dollar interest rates in fiscal 2005 the benefit of the reduced finance cost from the swaps has decreased to $5 million in fiscal 2005 from $19 million in fiscal 2004. In the event that short-term rates increase further, the benefit will reduce accordingly and could result in additional interest costs if rates increase significantly.

In May 2003, SPH raised a facility in the amount of $575 million, repayable in 2 tranches from OeKB. Tranche A (“OeKB A tranche”) of $115 million was repaid in a single payment on December 31, 2004 and Tranche B (“OeKB B tranche”) of $460 million is repayable in a single payment on December 31, 2010. The OeKB A tranche bore interest at the OeKB floating rate plus an applicable margin of 0.5% and the OeKB B tranche bears interest at an agreed fixed rate of 4.10%. Interest is payable quarterly in arrears on both tranches. The $575 million proceeds were partly used to refinance $374 million of other borrowings. The balance of $201 million was invested with several financial institutions in short-term deposits.

During fiscal 2003, Sappi Manufacturing concluded a framework agreement in South Africa for the issuance of a domestic Commercial Paper facility. The programme facility was R500 million (approximately $70 million). During fiscal 2004 Sappi Manufacturing increased the Commercial Paper facility to R1 billion (approximately $157 million) of which approximately R290 million ($46 million) was utilised at the end of September 2005. The average interest rate that the Commercial Paper facility currently attracts is the JIBAR rate plus 5 basis points.

In June 2005 SPH raised a new credit facility of euro 600 million, with a maturity date of June 2010. The new facility replaced and refinanced a facility raised in fiscal 2001 maturing in July 2006. The refinancing was undertaken to improve the terms and conditions of the replacement facility, specifically the pricing of the margin and the commitment fee, and also to ensure the long-term nature of the new facility. The funding margin is determined by a rating grid and based on the current credit rating attracts a margin between 40.0 and 47.5 basis points over EURIBOR, depending on the level of utilisation. This syndicated credit facility is to be used for general corporate purposes and was unutilised at the end of fiscal 2005.

As is the norm for bank loan debts, a portion of our financial indebtedness is subject to cross default provisions. Breaches in bank covenants in certain subsidiaries, if not corrected in time, might result in a default in group debt, and, in this case, a portion of our consolidated liabilities might eventually become payable on demand. At the end of fiscal 2005 and fiscal 2004, the group was in compliance with the bank covenants restrictions. Sappi and Sappi Manufacturing must abide by certain financial covenants.

In previous years the banking covenants were calculated at the combined level of SPH and SISA. During fiscal 2005 this has been changed to measure the covenants at the consolidated Sappi Limited level, following the issuance in fiscal 2005 of a Sappi Limited guarantee of the long-term borrowings of the SPH/SISA group. Accordingly, it is more appropriate to measure the covenants at the consolidated group level. Covenants that exist for Sappi Manufacturing (Pty) Ltd have not been affected and remain at that level.

We presently meet all the financial ratios that apply to our major credit agreements. The covenants on the facility are based on our Net Debt to Total Capitalisation ratio and EBITDA to Net Interest ratio, and are measured based on our quarterly results.

The Group has adequate working capital, cash on hand and short and long-term banking facilities to meet its short-term commitments. As at the end of fiscal 2005, Sappi had aggregate unused borrowing facilities (committed and uncommitted) of $1,229 million ($350 million in South Africa and $879 million in Europe) compared to $1,275 million ($283 million in South Africa and $987 million in Europe) at the end of fiscal 2004. The $46 million decrease over fiscal 2004 is largely due to the currency translation effect, as the euro/USD rate weakened from 1.23 to 1.20 and the R/USD strengthened from 6.42 to 6.37 in fiscal 2005. At the end of fiscal 2003, Sappi had aggregate unused borrowing facilities (committed and uncommitted) of $1,118 million ($179 million in South Africa and $939 million in Europe).

The maturity profile of long-term interest bearing borrowings of the Group has been extended substantially in the past 4 years. Average time to maturity for long-term interest bearing borrowings at the end of fiscal 2001 was 4.7 years, and has been extended to 8.4 years at the end of fiscal 2005. This is largely due to the issue of 10 and 30-year bonds in fiscal 2002 ($750 million) and an 8-year syndicated loan facility (euro 500 million or $575 million) arranged in fiscal 2003. The Group also has substantial unutilised short-term facilities, both in terms of cash resources and committed and uncommitted banking facilities. At the end of fiscal 2005 Sappi had $367 million of cash resources and unutilised available banking facilities of $1,229 million (of which $753 million is committed). At the end of fiscal 2004 we had $484 million of cash resources and unutilised available banking facilities of $1,275 million (of which $723 million was committed). The $47 million decrease in unutilised available banking facilities in fiscal 2005 is due to the currency translation effect.

The continued availability of uncommitted facilities could be impacted by factors such as:

- Liquidity problems in the banking market that result in restricted availability or non-availability of uncommitted banking facilities.
- A downgrade of Sappi’s public debt ratings, which could result in banks reviewing the availability of uncommitted facilities.

Sappi has 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 borrowings;
- Cost of financing;
- Availability of sources;
- Availability of natural and artificial hedges against currency and/or interest rate fluctuations; and
- Availability of tax efficient structures to moderate financing costs.

Certain limits of interest bearing borrowings as a percentage of shareholders equity are maintained 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 interest bearing borrowings and cash and cash equivalents are mainly denominated in US dollars, euro and Rand. See note 21 to our Group annual financial statements included elsewhere in this Annual Report. For a profile of our borrowings repayment schedule, see note 21 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 37 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 protected by forward exchange contracts or currency swaps. 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 on 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 2005, approximately 45% of our gross borrowings were at fixed rates, compared with approximately 42% at the end of fiscal 2004 and 45% at the end of fiscal 2003. The increase in fixed interest rate borrowings in fiscal 2005 was largely due to the new OeKB $54 million loan described above at a fixed rate. The decrease in fixed interest rates in fiscal 2004 was achieved by swapping the fixed interest rates of the public bonds and other fixed rate debt to floating interest rates linked to US LIBOR. See note 37 to our Group annual financial statements included elsewhere in this Annual Report.

Our expansion, mainly through acquisitions, had been demanding on our capital resources and on the profile and mix of the funding actually used. At the end of fiscal 2005, our total interest bearing borrowings and overdraft, were $2.0 billion, in line with the level of $2.1 billion at the end of fiscal 2004 and fiscal 2003. At the end of fiscal 2005 cash and cash equivalents decreased by $117 million from $484 million at the end of fiscal 2004, mainly due to the dividend payment ($68 million) and the repayment of loans in fiscal 2005.

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 control regulations. 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 borrowings of our subsidiaries. A constraint applicable to South African companies is the application of exchange controls, which may inhibit the free flow of funds from South Africa. See “—South African Exchange Controls”. This affected the geographic distribution of our borrowings. As a result, our acquisitions in the United States and Europe were financed initially with

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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.

While reduction of borrowings 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 asset-related finance arrangements that we believe have been structured such that various obligations, which are significant, and 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 32, securitisation facilities described in note 18 and an equity accounted investment described in note 16, in each case to our Group annual financial statements included elsewhere in this Annual Report, and are detailed as follows:

Lease Arrangements. In 1997 we sold one of our paper machines at our Somerset mill for $150 million and entered into a leaseback arrangement. This transaction diversified our sources of funding and provides a longer-term horizon to our repayment profile. This qualifies as an operating lease under the applicable accounting principles. The lease term expires after 15 years, and we have an option to either return the paper machine; renew the lease for at least 2 years, but for no longer than 80% of its remaining useful life; or repurchase it at its fair market value at the end of the lease term. An option exists to repurchase the paper machine at an earlier date of 29 January 2008 for the original purchase price multiplied by a factor of 50.10%. To exercise the option, we must provide notice of between 180 and 360 days prior to the early buyout date. There is no right of refusal associated with the early buyout option. The future minimum obligations under this lease are included in the amounts presented above.

In 1982 a cogeneration facility was installed adjacent to our Westbrook mill at a cost of $86 million, to supply steam and electricity to the mill on a take-or-pay basis. We have taken the position that this is an operating lease. An unrelated investor owns the facility. The agreement expires in 2008 and we have an option to purchase the facility at the end of the basic term or any renewal term, at its fair market value at that time. We also have a right of first refusal to buy the facility should the owner elect to sell it. The future minimum obligations under this arrangement are included in the amounts presented above.

Although those lease arrangements are a method of financing, a leasing arrangement that qualifies for accounting treatment as an operating lease results in neither debt nor the relevant assets being reflected on our balance sheet.

Trade Receivables Securitisation. To improve our cash flows in a cost-effective manner, we sell between 86% and 99% of our eligible trade receivables on a non-recourse basis to special purpose entities ("SPEs") that are owned and controlled by third party financial institutions. These SPEs are funded in the Commercial Paper market. For the purpose of liquidity requirements under the State Street Bank securitisation facility, banks with a short term (Standard & Poor's) S&P rating of at least A1 and a short-term Moody's rating of at least P-1 (and equivalent rating from any other rating agency, if any) provide a standby liquidity facility. In the event that such a bank is downgraded, a replacement bank with a rating of A1 needs to be appointed to ensure continuity of the securitisation programme. On some programmes, the downgraded bank can be required to deposit the unused portion of its commitment to avoid replacement. These SPEs are not limited to transactions with us but securitise assets on behalf of their sponsors for a diverse range of unrelated parties. We have a servicing agreement with the entities acquiring our receivables, acting as agent for the collection of cash and administration of the trade receivables sold.

With Rand Merchant Bank, virtually all receivables are securitised, however we retain 15% of the credit risk on the receivables on a proportionate basis, after all recoveries, including insurance recoveries. With State Street Bank we retain some of the economic risk in the receivables we transfer to these entities via first tier loss provisions, which limits our loss exposure on the receivables to a predetermined amount. To this extent, the receivables remain on our balance sheet. At the end of fiscal 2005 this amounted to $59 million (fiscal 2004: $53 million). We have no obligation to repurchase any receivables which may default and do not guarantee the recoverability of any amounts over and above the first tier loss provisions mentioned above. The total amount of trade receivables sold at the end of fiscal 2005 amounted to $465 million (fiscal 2004: $470 million).

If these securitisation facilities were to be terminated, we would discontinue further sales of trade receivables and would not incur any losses in respect of receivables previously sold in excess of our first tier loss amounts. There are a number of events which may trigger termination of the facility, amongst others, an unacceptable amount of defaults; terms and conditions of the agreements not being met; or breaches of various credit insurance ratios (not applicable to all programs). The impact on liquidity varies according to the terms of the agreement; generally however, future trade receivables would be recorded on balance sheet until a replacement agreement was entered into.

An allowance for doubtful debts has been recorded for any trade receivables which may be uncollectable.

Resulting from the implementation of International Financial Reporting Standards (IAS32 and IAS39) in fiscal 2006, see—International Financial Reporting Standards ("IFRS"), $268 million of the $465 million of our securitised receivables at the end of fiscal 2005 will be brought on to the balance sheet, (fiscal 2004:$409 million of the $470 million securitised), which will also increase short-term debt by $346 million (fiscal 2004: $490 million) and decrease trade and other payables by $78 million at the end of fiscal 2005 (fiscal 2004: $81 million). The related expense will no longer be reflected in SG&A, but will be included in finance costs. The increase in finance cost and decrease in SG&A for fiscal 2005 will be approximately $14 million.

Equity Accounted Investment. In 1998, our interests in timberlands located in Maine and certain equipment and machinery were sold to a third party timber company, Plum Creek, in exchange for cash of $3 million and three promissory notes receivable in the aggregate amount of $171 million. A special purpose entity ("SPE"), in which we indirectly hold 90% of the equity, acquired the notes receivable from the company in exchange for a note of $156 million and an equity contribution. The SPE repaid us the note of $156 million, which it funded through the issue of notes payable to a consortium of institutional investors, pledging the Plum Creek notes as collateral. The qualifying SPE is bankruptcy remote and serves to protect the investors in the notes from any credit risk relating to Sappi Limited by isolating cash flows from the Plum Creek notes receivable. The structure was set up to raise funding using the promissory notes as collateral in a manner that would not result in either debt or the Plum Creek notes being reflected on our balance sheet. This would not be the case if we monetised the promissory notes through an issuance of secured notes directly or by an entity that was required to be consolidated in our financial statements under the applicable accounting principles.

Interest is collected quarterly on the Plum Creek Notes and paid semi-annually to the SPE's noteholders. The SPE earns annual profits on the interest spread between the notes receivable and notes payable. There are three tranches of notes receivable and notes payable with term dates of February 2007, 2009 and 2011. We have not guaranteed the obligations of the SPE and the holders of the notes payable issued by the SPE have no recourse to us.

The SPE is not consolidated in our financial statements because we have taken the position that it is controlled by an unrelated investor which has sufficient equity capital at risk to support such a position. The SPE has a put option available through May 4, 2006, that may require us to purchase all, but not less

than all, of the SPE's interests at fair market value to be calculated in accordance with the agreement. Our investment of $19 million at the end of fiscal 2005 (fiscal 2004: $20 million) in the SPE is included in our financial statements on an equity-accounted basis. This is the maximum amount of our exposure to any possible loss and we have no funding commitments for the SPE.

Capital Expenditures

Capital expenditures in fiscal 2005, fiscal 2004 and fiscal 2003 were as follows:

	Year Ended September		
	2005	2004	2003
	($ millions)		
Sappi Fine Paper			

Sappi Fine Paper North America	90	75	78
Sappi Fine Paper Europe	124	102	104
Sappi Fine Paper South Africa	27	10	13
Total	241	187	195
Sappi Forest Products	101	146	101
Corporate	3	1	—
Group Total	345	334	296

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 2005, fiscal 2004 and fiscal 2003 amounted to approximately $183 million, $219 million and $165 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 former corporate parent invested approximately $1 billion on capital and investment expenditures from 1988 to 1994. In addition, there was 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 2004, 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 are expected to 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.

The capital expenditure to expand operations during fiscal 2005 included major projects at our European Gratkorn and Ehingen mills, South African Saiccor mill and Cloquet mill in North America. Total capital spending for the Sappi Group during fiscal 2005 amounted to 82% of depreciation. Capital spending for the Sappi Group during fiscal 2006 is expected to amount to approximately 90% of depreciation including expenditure relating to the proposed Saiccor expansion project. Capital spending is expected to be funded primarily through internally generated funds. For further details about our capital commitments, see note 32 to our Group annual financial statements included elsewhere in this Annual Report.

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 table includes

information contained within the Group annual financial statements included elsewhere in this Annual Report, as well as information regarding purchase obligations. The tables reflect those contractual obligations at the end of fiscal 2005 that can be quantified.

	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
	($ millions)				
Long-Term Debt Obligations(1)	1,795	241	187	75	1,292
Capital Lease Obligations(1)	75	29	19	3	24
Operating Lease Obligations(2)	225	50	73	47	55
Purchase Obligations(3)	412	235	149	28	—
Other Long-Term Liabilities Reflected on Balance Sheet(4)	26	2	4	2	18
Group Total	2,533	557	432	155	1,389

(1) Refer to note 21.

(2) Operating leases are future minimum obligations under operating leases. Refer to note 32.

(3) 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 and power).

(4) In addition to the Other Long-Term Liabilities of $331 million on Balance sheet, the company has an additional amount of $305 million relating to post-employment benefits, post-retirement benefits other than pension obligations, workmen's compensation, and other items which do not have a payment profile. Refer to note 22.

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

Following an initial approval by our shareholders on December 15, 2000 of purchases by our subsidiaries of Sappi common shares, at the annual general meeting of shareholders held on March 7, 2005, a special resolution granting authority to Sappi Limited or Sappi subsidiaries to buy back up to 10% of the issued shares of Sappi Limited in any one fiscal year, was approved. Pursuant to this approval, Sappi Limited or its subsidiaries may buy back shares from time to time. This authority is 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.

Following the initial approval in December 2000, our cumulative buy back by Group entities, at the end of fiscal 2005, is approximately 19.4 million shares (or approximately 8.1% of our issued shares) at an average price of $9.61 (R74.55) per share, of which 7.0 million shares had been utilised by the Sappi Limited Share Incentive Trust to meet its obligations. During fiscal 2005 we acquired approximately 1.3 million shares for a total consideration of approximately $15.9 million. We held approximately 13.2 million treasury shares (or approximately 5.5% of our issued shares) at the end of fiscal 2005. As at December 7, 2005, the Sappi share price was $11.33 (R73.99).

The JSE Limited listing requirements changed during 2003. Under the revised rules a company may not repurchase its shares during a closed period, which is defined as the period between the end of a financial reporting period and the publication of the results for that period and any period during which the company is trading under a cautionary announcement. Previously this was restricted for periods of 40 trading days prior to the announcement of half-year and full-year results.

Dividends

Sappi Limited declared total cash dividends in respect of the ordinary shares of $0.30 per share in fiscal 2005, $0.30 per share in fiscal 2004 and $0.29 per share in fiscal 2003. Dividends paid in years prior to fiscal 2000 have been paid in South African Rand, and have been converted to US dollar 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 our current intention is to maintain a long-term average dividend “cover” of three times net profit. In fiscal 2005 we declared a $0.30 per share dividend. Our dividends were covered 1.2 times based on average earnings during the 5 year period which ended in fiscal 2005 (fiscal 2004: 3.0 times).

Mill Closures, Acquisitions, Dispositions and Impairment; and Joint Venture

Usutu impairment. During the first quarter of fiscal 2005 we announced the impairment of our Usutu mill. The Usutu mill is an unbleached kraft pulp mill and forms part of the Sappi Forest Products reporting segment. Due to continued losses an impairment review was conducted which led to the recognition of impairment charges of $50 million. Plans are in place to improve the mill’s productivity in the face of the relative strength of the Rand against the dollar. The mill has a valuable plantation resource and at a weaker exchange rate of the Rand against the dollar, the mill will have good prospects of returning to profitability.

Muskegon impairment. During the third quarter of fiscal 2005 we announced the impairment of our North American Muskegon mill, and recorded impairment charges of $183 million in fiscal 2005. A detailed discussion of this impairment is contained in the section “Restructuring”, elsewhere in this Operating and Financial Review and Prospects.

Joint Venture with Shandong Chenming Paper Holdings Limited. During fiscal 2005 we acquired 34% of Jiangxi Chenming Paper Company Limited (“Jiangxi Chenming”) in a joint venture with Shandong Chenming Paper Holdings Limited (“Shandong Chenming”) (47.2%), together with Jiangxi Paper Industry Company Limited (3.8%), Shinmoorim Paper Manufacturing Company Limited of South Korea (7.5%), and the International Finance Corporation (“IFC”) (7.5%). Our equity contribution was approximately $60 million.

The mill has a 350,000 metric tonnes per annum light-weight coated paper machine together with a bleached thermo mechanical pulp (BTMP) mill, de-inked pulp plant, and power plant. The mill is located in Nanchang, the capital of Jiangxi Province which is in southeast China. The mill was commissioned in August 2005.

The total cost of the project is approximately $440 million. The IFC had arranged the debt financing for the project, which is without recourse to Sappi. The IFC holds 7.5% of the equity and has also approved $50 million in long-term debt for its own account.

Westbrook machine closure. We announced the closure of the number 14 paper line at our Westbrook mill in Maine, North America in November 2003. This followed our decision to take out capacity to improve the supply demand balance in the United States. The machine that was closed was our highest cost paper machine. In the last quarter of fiscal 2003 we wrote off the assets and related inventory and took a charge of $19 million after tax ($32 million pre-tax). We also incurred a further charge of approximately $16 million pre-tax in the first quarter of fiscal 2004 in respect of severance, retrenchment and related costs. The total number of employees affected by this closure was 145 people.

Clan Sawmill. We ceased operations at Clan sawmill (South Africa) in the last quarter of fiscal 2003 and closed the mill in December 2003. The mill, with an annual log intake of 80,000 m^3, used old technology and did not have a competitive log supply. The closure did not have a material impact on our results, but resulted in the loss of approximately 300 jobs.

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. We employed approximately 200 fewer people when we acquired the Cloquet mill than were previously employed there. We 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 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. There are no further lease payments foreseen; however, we have agreed to indemnify other parties to the lease arrangements for specified liabilities, including tax liabilities, which could be substantial if they arise. In addition, we are subject to a number of risks, which could affect our use of the assets or require payment of substantial amounts. Potlatch has agreed generally to indemnify us against losses resulting from these risks, but we cannot assure you that Potlatch will or will be able to fulfil its indemnity obligations. While these lease arrangements are in place, we will be subject to significant restrictions on our use of and ability to transfer our rights in the leased assets. These restrictions will limit our flexibility in conducting our business and could impair our ability to operate our business in the most efficient manner.

Pensions and Post-retirement Benefits Other than Pensions

The Group provides various post-retirement benefits to its active and retired employees worldwide including: pension, post-retirement health and other life benefits.

The unfunded status of the company’s pension plans increased by $28 million to a deficit of $367 million at the end of fiscal 2005, from the deficit of $339 million at the end of fiscal 2004. Post-retirement benefit liabilities (other than pension) increased by $6m to $178 million from the end of fiscal 2004.

Benefit obligations and fair value of plan assets across the regions are as follows at the end of fiscal 2005 and fiscal 2004:

	2005		2004	
	Benefit Obligation	Fair value of plan assets	Benefit Obligation	Fair value of plan assets
	($ millions)			
Pensions	1,589	1,222	1,420	1,081
Post-retirement Benefits other than				

pensions	178	—	172	—

Actual returns for the various regional pension funds during fiscal 2005 were significantly better than actuarial projections, which improved asset levels as at the end of fiscal 2005. However, discount rates in all funds have been adjusted downwards, reflecting lower prevailing interest rates. The lower discount rates across the regions increased liabilities by approximately $134 million, thereby having a negative effect on the funded status of the Group's plans from the end of fiscal 2004 to the end of fiscal 2005.

The key assumptions used to compile plan assets and liabilities at the end of fiscal 2005 and fiscal 2004 were as follows:

	Europe		North America		United Kingdom		South Africa	
	2005	2004	2005	2004	2005	2004	2005	2004
	%	%	%	%	%	%	%	%
Discount rate	3.68	4.63	5.50	5.65	5.00	5.50	8.10	9.00
Return on assets	5.19	5.20	8.25	8.50	5.75	5.50	9.71	10.18
Salary increase	2.99	3.14	3.50	3.75	4.00	4.00	5.49	6.00

The Group's net periodic pension expense in fiscal 2006 is expected to decrease to $38 million from $62 million in fiscal 2005 due to the recognition of prior actuarial losses through IFRS adoption. Employer contributions for pensions are expected to rise by approximately $16 million to $79 million primarily due to increases in North American funding requirements.

A 1% increase in discount rates would decrease the pension liability by approximately $193 million and the related pension expense by approximately $14 million per annum.

A 1% increase in the healthcare cost trend rates would increase the accumulated other post-retirement benefit obligation by $12 million and the aggregate of the service and interest cost components of net periodic other post-retirement benefit expense by $1 million per annum.

The South African pension fund is, from fiscal 2005, closed to new employees.

For further information see note 34 and 35 to our Group annual financial statements included elsewhere in this Annual Report.

Insurance

The Group has an active programme of risk management in each of its 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 on-going and aims to lower the risk of incurring losses from uncontrolled incidents.

Sappi follows a practice of insuring its 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. In line with the previous years 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.

Sappi has a global insurance structure and the majority of insurance is placed with its own captive insurance company Lignin which in turn reinsures the vast majority of the risk with third-party insurance companies.

We have successfully placed the renewal of our 2006 insurance cover at rates lower than 2005. Self-insured deductibles for any one property damage occurrence have remained at $25 million, with an unchanged aggregate limit of $40 million. 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.

Insurance cover for credit risks currently applies to Sappi's North American, European and South African domestic trade receivables.

Critical accounting policies and estimates

The preparation of financial statements in conformity with SA GAAP 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, except for post-employment benefits. The group believes that the following accounting policies are critical due to the degree of estimation required.

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 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 exceeds the recoverable amount (being the greater of the discounted expected future cash flows and the net selling price of the asset) of the asset, we will recognise an impairment loss for the difference. Considerable management judgement is necessary to estimate discounted future cash flows, including judgements and estimates as to future product pricing, raw material costs, volumes of product sold, appropriate discount rates (weighted average cost of capital), changes in the planned use of machinery or equipment or closing of facilities. Where independent information is available this is used. Actual circumstances or outcomes could vary significantly from such estimates, including as a result of changes in the economic and business environment. These variances could result in changes in 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.

Goodwill impairment tests are performed annually to compare the fair value of each of our reporting units (cash generating) to its carrying amount. Goodwill impairment testing is conducted at reporting unit levels of our business and is based on a cash flow based valuation model to determine the fair value of the reporting unit. The assumptions used in estimating future cash flows were based upon our business forecasts and incorporated external information from industry sources, where applicable. Actual outcomes could vary significantly from our business forecasts. Changes in certain of these estimates could have a material effect on the estimated fair value of the reporting unit. In addition to the judgements described in the preceding paragraph that are necessary in estimating future cash flows, significant judgements in estimating discounted cash flows also include the selection of the discount rate (weighted average cost of capital) and the terminal value (net present value at end of period where there is a willing buyer and seller)

multiple used in our valuation model. The discount rate used in our valuation model considered a targeted debt and equity mix, a market risk premium, and other factors consistent with valuation methodologies. The terminal value multiple used in our valuation model considered the valuations for comparable companies.

Based on the results of the impairment evaluation described above, the recorded goodwill was not impaired as the fair value of each reporting unit exceeded the carrying value. Small changes to the valuation model would not significantly impact the results of our valuation; however, if future cash flows were materially different than our forecasts, then the assessment of the potential impairment of the carrying value may be impacted.

Deferred taxation. The group estimates its income taxes in each of the jurisdictions in which it operates. This process involves estimating its current tax liability together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet.

The group then assesses the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent recovery is not likely, a valuation allowance is established. In recognising deferred tax assets the company considers profit forecasts including the effect of exchange rate fluctuations on sales and external market conditions. Where it is probable that a position may be successfully challenged, based on reported challenges by revenue authorities of similar positions taken by other taxpayers, as well as items already raised by revenue authorities during audits, but for which resolution has not yet been reached, a valuation allowance or tax provision is raised for the tax on the probable adjustment. Management’s judgement is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against the net deferred tax assets. Where management believes that it is more likely than not that the deferred tax assets will be realised through the recognition of future taxable income, deferred tax assets have been recognised. Although the deferred tax assets for which valuation allowances have not been recognised are considered realisable, actual amounts could be reduced if future taxable income is not achieved. This can materially affect our reported net income and financial position.

Hedge accounting for financial instruments. For the purposes of hedge accounting, we classify hedges into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges, which hedge exposure to variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction. The financial instruments that are used in hedging transactions are assessed both at inception and quarterly thereafter to ensure they are effective in offsetting changes in either the fair value or cash flows of the related underlying exposures. Hedge accounting is mainly used for debt instruments to hedge interest rate and foreign currency risk exposures. We do not use hedge accounting for trading transactions.

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument to fair value is recognised immediately against income. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised against income. The designation of a derivative instrument as a fair value hedge in this manner can affect our reported net income. External market data is applied in re-measuring the hedging financial instrument.

In relation to cash flow hedges, which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in shareholders’ equity and the ineffective portion is recognised in income. The gains or losses, which are recognised directly in shareholders’ equity, are transferred to income in the same period in which the hedged transaction affects income. The designation of a derivative instrument as a cash flow hedge in this manner can also materially affect our reported net income. External market data is applied in measuring

the hedge effectiveness of the financial instrument. Hedge ineffectiveness is recognised immediately against income. The net gain, after taxation, on revaluation of hedging instruments deferred in equity was $16 million in fiscal 2005 (fiscal 2004 $1 million net gain and fiscal 2003: $14 million net loss).

Plantations. We state our plantations at their fair value. Fair value is determined using the present value method for immature timber and the standing value method for mature timber. All changes in fair value are recognised in income in the period in which they arise.

Land, logging roads and related facilities are accounted for under property, plant and equipment. The trees are accounted for as plantations. Land is not depreciated. Logging roads and related facilities are depreciated at various rates over a period of 3 to 10 years depending on expected life of each road or related facility. Trees are generally felled at the optimum age when ready for intended use. At the time the tree is felled it is taken out of plantations (non-current assets) and accounted for under inventory (current assets).

Assumptions and estimates are used in the recording of plantation volumes, cost per metric tonne, and depletion. Changes in the assumptions or estimates used in these calculations may affect the Group’s results, in particular, plantation and depletion costs.

A major assumption and estimation is the growth estimation. The inputs to our growth model are complex and involve estimations, all of which are regularly updated. Growth models derived from measured data from permanent sample plots are used for growth estimation. The long term sample plot network is representative of the species and sites on which we grow trees. Periodic adjustments are made to existing models for new genetic material.

Depletions include the fair value of timber felled, which is determined on the average method, plus amounts written off standing timber to cover loss or damage caused by, for example, fire, disease and stunted growth. Depletions are accounted for on a cost per metric tonne allocation method. Tonnes are calculated using the projected growth to rotation age and extrapolated to current age on a straight line basis.

The fair value of immature timber (softwood less than eight years and hardwood less than five years) is the discounted value of the expected delivered market price for estimated timber volumes less cost of delivery and estimated maintenance costs up to when the timber becomes usable by our own mills. The discount rate used is the pre-tax Rand cost of capital of the South African companies. The fair value of mature timber is based on the market price for estimated timber volumes less cost of delivery.

Cost of delivery includes all costs associated with getting the harvested agricultural produce to the market, being harvesting, loading, transport and allocated fixed overheads.

The group is exposed to financial risks arising from climatic changes, disease and other natural risks such as fire, flooding and storms and human-induced losses arising from strikes, civil commotion and malicious damage. These risks are covered by an appropriate level of insurance as determined by management. In addition, management focuses close attention to good husbandry techniques and fire-fighting methods. The plantations have an integrated management system that is certified to ISO 9001, ISO 14001, OHSAS 18001 and FSC standards.

For further information see note 13 of our Group annual financial statements included elsewhere in this Annual Report.

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 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 consolidated financial statements and set the expense for the next fiscal year. 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 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.

Pension plans

The key assumptions used to compile pension plan assets and liabilities at the end of fiscal 2005 and fiscal 2004 were as follows:

	Europe		North America		United Kingdom		South Africa	
	2005	2004	2005	2004	2005	2004	2005	2004
	%	%	%	%	%	%	%	%
Discount rate	3.68	4.63	5.50	5.65	5.00	5.50	8.10	9.00
Return on assets	5.19	5.20	8.25	8.50	5.75	5.50	9.71	10.18
Salary increase	2.99	3.14	3.50	3.75	4.00	4.00	5.49	6.00

The benefit obligations and fair value of plan assets at the end of fiscal 2005 were as follows:

	Benefit obligation	Fair value of Plan assets	Net Funded/ (Unfunded) status
		($ millions)	
Pension funds			
Europe	624	457	(167)
North America	442	289	(153)
United Kingdom	222	170	(52)
South Africa	301	306	5
	1,589	1,222	367

Actual returns for the various regional pension funds during fiscal 2005 were significantly better than actuarial projections, which improved asset levels as at the end of fiscal 2005. However, discount rates in all funds have been adjusted downwards, reflecting lower prevailing interest rates. The lower discount rates across the regions increased liabilities by $134 million, thereby having a negative effect on the funded status of the Group’s plans at the end of fiscal 2005 compared to the end of fiscal 2004.

The unfunded status of the company’s pension plans increased by $28 million to a deficit of $367 million at the end of fiscal 2005 from a deficit of $339 million at the end of fiscal 2004.

Net periodic pension costs using the assumptions above were as follows at the end of fiscal 2005, fiscal 2004 and fiscal 2003:

	2005	2004	2003
		($ millions)	
Pension costs			
Europe	16	13	15
North America	25	25	19
United Kingdom	6	8	4
South Africa	15	7	3
	62	53	41

The Group’s net periodic pension expense in fiscal 2006 is expected to decrease to $38 million from $62 million in fiscal 2005 due to the recognition of prior actuarial losses through IFRS adoption. Employer contributions for pensions are expected to rise by approximately $16 million to $79 million primarily due to increases in North American funding requirements.

A 1% increase in discount rates would decrease the pension liability by approximately $193 million and the related pension expense by approximately $14 million per annum.

Post retirement benefits—other than pensions

The key assumptions used to compile post retirement benefit obligations other than pensions were as follows at the end of fiscal 2005 and fiscal 2004:

	North America 2005	North America 2004	South Africa 2005	South Africa 2004
	%	%	%	%
Discount rate to estimate accumulated benefit	5.50	5.65	8.10	9.00
Health care cost trends to value APBO	10.00	10.00	5.60	6.50
Which gradually reduce to an ultimate rate of	5.00	5.00	5.60	6.50
Over a period of (years)	5	5	—	—

The benefit obligations and fair value of plan assets at the end of fiscal 2005 were as follows:

	Benefit obligation	Fair value of Plan assets
	($ millions)	
Other post-retirement benefits		
North America	109	—
South Africa	69	—
	178	—

Discount rates are drawn from high quality corporate bond yield indices with terms similar to those of fund liability profiles. Discount rate assumptions have been adjusted downwards in all funds, reflecting, respectively, prevailing lower interest rates. This has increased the net unfunded status of other post-retirement benefits plans by $6m to $178 million at the end of fiscal 2005 from the end of fiscal 2004.

Post retirement benefit costs—other than pensions using the assumptions above were as follows at the end of fiscal 2005, fiscal 2004 and fiscal 2003:

	2005	2004	2003
	($ millions)		
Other post-retirement benefits cost			
North America	11	16	—
South Africa	7	6	6
	18	22	6

A 1% increase in the health care cost trend rates would increase the accumulated other post-retirement benefit obligation by approximately $12 million and the aggregate of the service and interest cost components of net periodic other post-retirement benefit cost by $1 million per annum.

A 1% decrease in the health care cost trend rates would decrease the accumulated other post-retirement benefit obligation by approximately $11 million and the aggregate of the service and interest cost components of net periodic other post-retirement benefit cost by $1 million per annum.

Provisions. Provisions are required to be recorded when the group has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will occur, and where a reliable estimate can be made of the amount of the obligation. Best estimates, being the amount that the Group would rationally pay to settle the obligation, are recognised as provisions at balance sheet date. Risks, uncertainties and future events, such as changes in law and technology, are taken into account by management in determining the best estimates.

Where the effect of discounting is material, provisions are discounted. The discount rate used is the pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability, all of which requires management judgement.

The establishment and review of the provisions requires significant judgement by management as to whether or not there is a probable obligation and as to whether or not a reliable estimate can be made of the amount of the obligation, which requires judgements as to the likelihood of future payment. All provisions are reviewed at each balance sheet date. Various uncertainties can result in obligations not being considered probable or estimable for significant periods of time. As a consequence, potentially material obligations may have no provisions and a change in facts or circumstances that results in an obligation becoming probable or estimable can lead to a need for the establishment of material provisions. In addition, where estimated amounts vary from initial estimates the provisions may be revised materially, up or down, based on the facts.

The Group periodically restructures its business units for productivity and business improvement initiatives and records charges for reductions in its workforce, the closure of manufacturing facilities, and other actions related thereto. These events require estimates of liabilities for employee separation payments and related benefits, equipment removal, environmental cleanup and other costs. The actual costs incurred could differ materially from those estimated at balance sheet date.

The Group is required to record provisions for estimated environmental liabilities, based on current interpretations of environmental laws and regulations, when expenditures are considered probable and can be reasonably estimated. These estimates reflect management assumptions and judgements as to the probable nature, magnitude and timing of required investigations, remediation and monitoring activities, changes in governmental regulations, insurance recoveries and the contributions by other potentially responsible parties. These assumptions and judgements are subject to various uncertainties which could result in estimated costs that could materially differ from the actual costs incurred.

The Group is required to record provisions for legal contingencies when the contingency is probable of occurring and the amount of the loss can be reasonably estimated. Liabilities provided for legal matters require judgements regarding projected outcomes and ranges of losses based on historical experience and recommendations of legal counsel. Litigation is however unpredictable and actual costs incurred could differ materially from those estimated at the balance sheet date.

Provisions for dismantling of property, plant and equipment are only recognised when a legal or constructive obligation arises.

For further information, see “Item 8-Financial Information-Legal Proceedings”.

Changes in Accounting Policies and Practices

There was one accounting policy change in each of fiscal 2005, fiscal 2004 and fiscal 2003. During fiscal 2005 we changed our policy on STC. We adopted AC501—accounting for STC. This standard now requires the recognition of a deferred tax asset for unused STC credits to the extent that they will be utilised in the future. This has resulted in the recognition of a deferred tax asset for unused STC credits. When STC credits are utilised with declaration of dividends, it will result in the recognition of a deferred tax charge for STC in the income statement in the period that the dividend is declared. The implementation of this policy decreased net profit after tax by $8 million (fiscal 2004: $3 million). It had the effect of increasing shareholders' equity by $38 million at the beginning of fiscal 2005. For further detail on the deferred tax asset and deferred tax expense recognised for STC, refer note 9 and 14 of our Group annual financial statements included elsewhere in this Annual Report.

During fiscal 2004 we changed our accounting policy with regard to plantations. We previously stated our plantations at the lower of cost less depletions and realisable value. Cost included all expenditure incurred on acquisition, forestry development, establishment and maintenance of plantations, and finance charges. Following the adoption of AC137, we no longer capitalise silvicultural expenses and finance costs to plantations nor do we amortise plantations to the income statement. Movements in the fair value of plantations now impact operating profit. The implementation of this policy had the effect of enhancing net profit before tax by $66 million and enhancing net profit after tax by $47 million for fiscal 2004. The new policy will lead to increased volatility from one reporting period to the next.

The group's policy is to show separately, as other income or expenses, certain items that are of such size, nature or incidence that their separate disclosure is relevant to explain the group's performance. Previously these items, entitled non-trading income or loss, were excluded from operating profit. Circular 3/2004 issued by the South African Institute of Chartered Accountants requires the inclusion of these items. Consequently, operating profit had been restated to take these requirements into account. This had resulted in a decrease in operating profit of $27 million for fiscal 2003 (fiscal 2002: decrease of $17 million).

During fiscal 2003 we changed our accounting policy with regard to the translation of equity categories to conform with the requirements of AC 430 (Reporting currency—Translation from Measurement Currency to Presentation Currency), the effects of which are negligible on net profit or equity for fiscal 2003 or prior years.

Data for prior fiscal years has been restated to reflect these changes in accounting policy where required by the appropriate accounting standards.

Our accounting policy changes are reflected in note 3 of our Group annual financial statements included elsewhere in this Annual Report.

New Accounting Standards

International Financial Reporting Standards ("IFRS")

We are required by the JSE Limited to report under IFRS from fiscal 2006. Our preparation for the adoption of IFRS is advanced. The adoption of IFRS will lead to some changes in the Group's accounting policies, results, and the presentation of its financial statements, and other disclosures within the Annual Report, which are currently in accordance with South African GAAP.

Based on our current assessment of published IFRS requirements, the principal effects on our financial statements are the treatment of employee benefit liabilities and expenses, share based payments and securitised receivables. No significant reporting adjustments for property, plant and equipment are currently foreseen.

Previously unrecognised actuarial employee benefit gains and losses will be recognised, resulting in an increase in pension and other post retirement benefit liabilities and a corresponding reduction in equity. This adjustment will lead to a reduction in employee benefit expenses in fiscal 2006 and future fiscal years because the amortization of past losses is no longer required. The cost of share options and grants, as calculated using the binomial method will be reflected in the income statement over the vesting period. A significant portion of our securitised receivables will be brought on to the balance sheet, increasing both trade receivables and short-term debt. The related expense will no longer be reflected in SG&A, but will be included in finance costs. There will be other changes which are not expected to have a significant impact on earnings or balance sheet ratios.

The net impact of these changes is currently not expected to have a material impact on earnings per share in fiscal 2006.

The consideration of our adoption of IFRS is subject to ongoing review and possible amendment through interpretive guidance from the International Accounting Standards Board. Further, the presentation of the transition to IFRS at year-end as well as income statement and balance sheet captions may be different to the initial expectation of the impact noted above.

For a discussion of new South African and US accounting standards, and the implementation of IFRS, see note 43 of our Group annual financial statements included elsewhere in this Annual Report.

United States GAAP Reconciliation

Our Group annual financial statements are prepared in accordance with South African GAAP, which differ from United States GAAP in certain significant respects. A comparison of our results and shareholders' equity for fiscal 2005, fiscal 2004 and fiscal 2003 shown under South African GAAP and after reflecting certain adjustments which would arise if United States GAAP were to be applied instead of South African GAAP, is as follows for fiscal 2005, fiscal 2004 and fiscal 2003:

	2005 (audited)	2004 (audited)	2003 (audited)
		($ millions)	
Net profit:			
South African GAAP	(213)	95	143
United States GAAP	(332)	46	148
Shareholders' equity:			
South African GAAP	1,881	2,157	1,983
United States GAAP	1,579	1,979	1,908

As more fully described and quantified in note 42 to our Group annual financial statements included elsewhere in this Annual Report, the major differences between South African GAAP and United States

GAAP relate to STC on undistributed reserves, fair value hedges, accounting for plantations, accounting for business combinations, pre-commissioning expenses and pension programmes and post-retirement medical benefits. For a discussion of a material weakness in fiscal 2005 in our internal control over financial reporting relating to our US GAAP reconciliation, see "Item 15—Controls and Procedures". Our results and shareholders' equity in accordance with United States GAAP for prior years have been restated—See note 42 to our Group annual financial statements included elsewhere in this Annual Report for further detail.