

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

## Risk Factors

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

### Risks Related to Our Industry.

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

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

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

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

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

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

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

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

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

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

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

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

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

For further information, see "Item 4—Information on the Company—Business Overview—Environmental and Safety Matters—

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

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

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

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

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

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

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

#### **Risks Related to Our Business**

***Our indebtedness may impair our financial and operating flexibility.***

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

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

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

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

***Labour agreements are under negotiation at several of our mills.***

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

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

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

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

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

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

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

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

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

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

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

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

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

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***Several customers account for a significant amount of our revenues.***

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

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

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

#### **Risks Related to Our Shares**

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

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

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

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

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **HISTORY AND DEVELOPMENT OF THE COMPANY**

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

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

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

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