

## 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.

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 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 approximately 5% of consolidated sales during fiscal 2007.

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.***

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. A significant weakening of the US dollar in comparison to the euro could redirect a significant amount of imports from Europe.

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

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

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

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

Although the insurance market has been stable for the last three to four years, it 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 negotiated the renewal of our 2008 insurance cover at rates similar to those of 2007 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 favorable 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 programs provide adequate coverage for reasonably foreseeable losses, we continue working on improved risk management to lower the risk of incurring losses from uncontrolled incidents. We are unable to assure you that actual losses will not exceed our coverage or that such excess will not be material.

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

We believe that new technologies or novel processes may emerge and that existing technologies may be further developed in the fields in which we operate. These technologies or processes could have an impact on production methods or on product quality in these fields. Unexpected rapid changes in employed technologies or the development of novel processes that affect our operations and product range could render the technologies we utilize 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.*

Our level of indebtedness and the terms of our indebtedness could negatively impact our business and liquidity. As of September 2007, our interest bearing debt (long term and short term interest bearing debt plus overdraft) was US\$ 2,621 million. While reduction of our indebtedness is one of our priorities, 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.

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

During fiscal 2008, we have approximately US\$ 793 million of renewable facilities that mature. We will seek to refinance such indebtedness when it becomes due through the issuance of new debt in the global capital markets. In the third quarter of fiscal 2007, the global debt markets were subject to significant pressure triggered by the collapse of the sub-prime mortgage market in the U.S. This liquidity crunch has continued through to the end of the year. In addition, our credit rating issued by Standard & Poors was recently downgraded from BB+ to BB. These adverse developments in the credit markets and in our credit rating may negatively impact the amount and terms of the debt we are able to issue. Our liquidity will be adversely affected if we must repay all or a portion of our maturing debt from available cash or through use of our existing liquidity facilities. In addition, our results of operations will be adversely impacted to the extent the terms of the debt we are able to issue are less favorable than the terms of the debt being refinanced. It is also possible that we will need to agree to covenants that place additional restrictions on our business.

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 realized from any such disposition would depend upon circumstances at the time.

**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 rate 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 \$1.42, \$1.27 and \$1.20 per euro at the end of fiscal 2007, 2006 and 2005, respectively. It reached a low of approximately \$0.83 per euro on October 25, 2000 and, on December 3, 2007, was trading at approximately \$1.46 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 R6.89, R7.77 and R6.37 per US dollar at the end of fiscal 2007, 2006 and 2005, 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 3, 2007 was trading at approximately R6.85 per US dollar.

For further information, see notes 2, 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—Foreign Exchange, Inflation and Interest Rates".

**There are risks relating to the 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".

While the geographic diversity of our operations may help to mitigate these risks, our Southern African operations have in recent years accounted for a disproportionate percentage of our operating profits. In fiscal 2007, 45% of our sales originated from Europe, 28% from North America and 27% from southern Africa. 40% of our operating assets were located in Europe, 22% in North America and 38% in southern Africa. However in fiscal 2007 23% of our operating profits were from Europe, 6% in North America and 71% in southern Africa.

**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 programs 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.

For further information, see "Item 5—Operating and Financial Review and Prospects—South African Economic and Political Environment".

***A limited number of customers account for a significant amount of our revenues.***

We sell a significant portion of our products to several major customers, including PaperlinX, Igepa, xpedx and Antalix. 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—Information on the Company—Sappi Fine Paper—Marketing and Distribution—Customers" and "Item 4—Information on the Company—Sappi Forest Products—Marketing and Distribution—Customers".

***Because of the nature of our business and workforce, we are facing challenges in the retention of management and the employment of skilled people 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 focusing 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.

***The inability to recover increasing input costs through increased prices of our products has had, and may continue to have, an adverse impact on our profitability.***

The selling prices of the majority of the products manufactured and the purchase prices of many of the raw materials we use generally fluctuate in correlation with the global commodity cycles. In addition, we have been experiencing increasing costs of a number of raw materials due to global trends beyond our control. The global warming and carbon footprint imperatives are causing the increased use of sustainable, non-fossil fuel, sources for electricity generation. Electricity generation companies are competing for the same raw material, namely wood and wood chips, in the same markets as us, driving prices upwards, especially during winter in the Northern hemisphere. In addition, the price of crude oil is at historically high levels and is likely to remain at such levels for the foreseeable future because of, among other things, political instability in the oil producing regions of the world. This impacts the oil based commodities required by our business in the areas of energy (including electricity), transport, and chemicals.

As occurred during the 2006 and 2007 fiscal years, a major potential consequence of the increase in the price of input commodities is the Group's potential inability to counter this effect through increased selling prices. This results in reduced operating profit, and has a negative impact on business planning.

While the Group is in the process of implementing steps to reduce the Group's cost of commodity inputs, other than maintaining a high level of pulp integration, the hedging techniques we apply on our raw materials and products are on a small scale and short term in nature. Moreover, despite our present relatively high level of pulp integration, in the event of significant increases in the prices of pulp, our non-integrated and partially integrated operations could be

adversely affected if they are unable to raise paper prices by amounts sufficient to maintain margins.

***Catastrophic events, such as fires, affecting our plantations may adversely impact our ability to supply our southern African mills with timber from the region.***

The southern African landscape is prone to, and ecologically adapted to, frequent fires. The risk of uncontrolled fires entering and burning significant areas of plantation is high, but under normal weather conditions this risk is managed through comprehensive fire prevention and protection plans. In 2007, southern Africa experienced a number of abnormal weather events (hot, dry conditions fanned by extremely strong winds), which resulted in disastrous plantation fires across vast areas of the eastern South African seaboard. There is some cause for concern that these abnormal weather conditions may be occurring more frequently as a result of the potential impact of climate change. In addition, because the transformation of land ownership and management in southern Africa has been moving ownership and management of plantations to independent growers, we have less ability to directly manage fire risk, as well as risks of other catastrophic events, such as pathogen and pest infestations. As a consequence, the risk of plantation fires or other catastrophic events remains high and may be increasing. Continued or increased losses of our wood source could jeopardize our ability to supply our mills with timber from the region.

#### **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 known as the Johannesburg Stock Exchange). Historically, trading volumes and liquidity of shares listed on the JSE have been low in comparison with other major international markets. In fiscal 2007, 247 million ordinary shares of Sappi Limited were traded on the JSE and 50 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 19.1%, as shown in our shareholders' register at September 30, 2007, 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 organized under the Companies Act 61 of 1973 of the Republic of South Africa.

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

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

In August 2006, we announced the expansion of the existing capacity at Sappi Saiccor in South Africa, where Chemical Cellulose products are produced. The current capacity of the mill is approximately 600,000 metric tonnes per annum. The expansion will increase capacity by a net 225,000 metric tonnes per annum and is expected to startup in the second calendar quarter of 2008.

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

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

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

### **BUSINESS OVERVIEW**

#### **Business Strategy**

Our objective for the coming years is to build on our position as a global leader in the coated fine paper market, which was from the beginning of the 1990's one of the fastest growing market sectors in the paper industry, and to explore opportunities across the broad spectrum of coated paper to utilize our experience in paper coating as well as the chemical cellulose market and to support this with a high level of economic pulp integration. These represent our core products and sectors in the paper and forest products industry. We see opportunities to grow our low cost fiber