SAPPI LTD
Form 20-F
December 15, 2006

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

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended October 1, 2006

OR

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

For the transition period from [ ] to [ ]

Commission file number 1-14872

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

Date of event requiring this shell company report [ ]

SAPPI LIMITED

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant s name into English)

Republic of South Africa

(Jurisdiction of incorporation or organisation)

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

(Address and telephone number of principal executive offices)

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

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

(Title of each class)

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

(Name of each exchange on which registered)

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

None

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

None

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

239,071,892 Ordinary Shares

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

YES x NO o

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

YES o NO x

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

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

YES x NO o

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

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

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

ITEM 17 o ITEM 18 x

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

YES o NO x

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

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OUR USE OF TERMS AND CONVENTIONS IN THIS ANNUAL REPORT

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

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

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

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

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

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

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

ACCOUNTING PERIODS AND PRINCIPLES

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

CURRENCY OF PRESENTATION AND EXCHANGE RATES

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

FORWARD-LOOKING STATEMENTS

In order to utilise the Safe Harbor provisions of the United States Private Securities Litigation Reform Act of 1995 (the Reform Act), we are providing the following cautionary statement. Except for historical information contained herein, statements contained in this Annual Report may constitute forward-looking statements within the meaning of the Reform Act. The words believe , anticipate , expect , intend , estimate assume , positioned , will , may , should , risk and other similar expressions, which are predictions of or indicate future events and future tre which do not relate to historical matters identify forward-looking statements. In addition, this document includes forward-looking statements relating to our potential exposure to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity price risk. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors which are in some cases beyond our control and may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements (and from past results, performance or achievements). Certain factors that may cause such differences include but are not limited to: the highly cyclical nature of the pulp and paper industry; pulp and paper production, production capacity, input costs (including raw materials, energy and employee costs) and pricing levels in North America, Europe, Asia and southern Africa; any major disruption in production at our key facilities; changes in environmental, tax and other laws and regulations; adverse changes in the markets for our products; any delays, unexpected costs or other problems experienced with any business acquired or to be acquired and achieving expected savings and synergies; consequences of our leverage; adverse changes in the political situation and economy in the countries in which we operate or the effect of governmental efforts to address present or future economic or social problems; and the impact of future investments, acquisitions and dispositions (including the financing of investments and acquisitions) and any delays, unexpected costs or other problems experienced in connection with dispositions.

These factors are fully discussed in this Annual Report. For further discussion on these factors, see Item 3 Key Information Selected Financial Data , Item 3 Key Information Risk Factors , Item 4 Information on the Company , Item 5 Operating and Financial Review and Prospects Finan Condition and Results of Operations , Item 10 Additional Information Exchange Controls and note 31 to our Group annual financial statements included elsewhere in this Annual Report. You are cautioned not to place undue reliance on these forward-looking statements. These forward-looking statements are made as of the date of the filing of this Annual Report and are not intended to give any assurance as to future results. We undertake no obligation to publicly update or revise any of these forward-looking statements, whether to reflect new information or future events or circumstances or otherwise.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Financial Data

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

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

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

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

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

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

Other Information:

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

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

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

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

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

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

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

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

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

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

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

Risk Factors

In addition to other information contained in this Annual Report, you should carefully consider the following factors before deciding to invest in our ordinary shares and American Depository 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 profitabily.

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

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

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

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

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

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

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

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

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

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

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

Risks Related to Our Business

Our indebtedness may impair our financial and operating flexibility.

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

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

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

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

Labour agreements are under negotiation at several of our mills.

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

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

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

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

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

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

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

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

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

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

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

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

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

Several customers account for a significant amount of our revenues.

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

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

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

Risks Related to Our Shares

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

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

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

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

ITEM 4. INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF THE COMPANY

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

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

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

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

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

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

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

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

BUSINESS OVERVIEW

Business Strategy

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

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

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

Maintain a global presence.

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

Maintain a high level of economic pulp integration.

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

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

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

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

Drive growth through market focus and innovation.

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

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

The Pulp and Paper Industry

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

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

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

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

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

Pulp:	
Paper pulp	Main raw material used in production of printing, writing and packaging paper. Pulp is the generic term that describes the cellulose fibre derived from wood. These cellulose fibres may be separated by mechanical, thermo-mechanical or chemical processes. The chemical processes involve removing the glues (lignins) which bind the wood fibres to leave cellulose fibres. Paper made from chemical pulp is generally termed woodfree . Uses include paper, paperboard and tissue.
Chemical cellulose	Manufactured by similar processes to paper pulp, but purified further to leave virtually pure cellulose fibres. Chemical cellulose is used in the manufacture of a variety of cellulose textile and non-woven fibre products, including viscose staple fibre (rayon), solvent spun fibre (lyocell) and filament. It is also used in various other cellulose-based applications in the food, cigarette, chemical and pharmaceutical industries. These include the manufacture of acetate tow microcrystalline cellulose, cellophane, ethers and moulding powders. The various grades of chemical cellulose are manufactured in accordance with the specific requirements of customers in different market segments. The purity of the chemical cellulose is one of the key determinants of it s suitability for particular applications with the purer grades of chemical cellulose generally supplied into the speciality segments.
Timber products:	Sawn timber for construction and furniture manufacturing purposes.

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

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

(1) 100 gsm sheets, RISI.

(2) 60 lb. Coated Web, RISI.

(3) 50 lb. Offset, RISI.

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

(5) Selected indicative prices, Sappi.

Fine Papers

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

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

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

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

See Item 5 Operating and Financial Review and Prospects Markets .

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

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

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

Packaging Products

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

Packaging Paper. As with fine paper, the market for packaging papers is affected by cyclical changes in the world economy, local economic growth, retail sales and by changes in production capacity and output levels. The southern African containerboard market has been positively affected by strong gross domestic product growth and corresponding growth in retail sales during fiscal 2006. Demand for sack kraft is largely driven by the demand for cement, potatoes, sugar and milling products. Sappi s sack kraft market share was negatively affected by lower priced imported products and production constraints in 2005, a trend that continued through 2006 despite positive demand growth in the local market.

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

Groundwood Products

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

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

Pulp

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

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

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

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

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

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

Timber Products

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

Business Review

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

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

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

- Sappi Fine Paper, which has fine paper and related paper pulp businesses in North America, Europe, South Africa and a 34% share in a Chinese joint venture; and

- Sappi Forest Products, which produces commodity paper products (newsprint and packaging papers), pulp (including chemical cellulose and hardwood and softwood pulp) and forest and timber products (including pulpwood, sawlogs and sawn timber) for southern Africa and export markets. Sappi Forest Products is based in South Africa.

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

The markets for our pulp and paper products are significantly affected by changes in industry capacity and output levels and by cyclical changes in the world economy. For further information,
see Information on the Company Business Overview The Pulp and Paper Industry and
Item 5 Operating and Financial Review and Prospects .

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

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

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

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

SAPPI FINE PAPER

Overview

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

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

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

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

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

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

(3) Excludes Chinese joint venture tons.

(4) Includes pulp used internally and pulp sold.

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

Facilities and Operations

Sappi Fine Paper North America

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

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

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

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

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

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

(2) Other consists primarily of market pulp.

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

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

(1) Includes pulp sold to third parties.

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

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

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

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

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

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

Sappi Fine Paper Europe

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

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

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

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

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

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

	Mill Location **Germany** **Alfeld**	**Ehingen**	**Austria** **Gratkorn**	**Netherlands** **Maastricht**	**Nijmegen**	**Belgium** **Lanaken**	**United Kingdom** **Blackburn**
Paper capacity (000s metric tonnes)	360	250	860	320	240	490	120
Number of paper machines	5	1	2	2	1	2	1
Products	Coated and Uncoated fine paper, coated specialities paper	Coated fine paper and uncoated fine paper	Coated fine paper and uncoated fine paper	Coated fine paper and coated speciality paper	Coated fine paper	Coated groundwood paper and coated fine paper	Coated fine paper
Percentage pulp integration(1)	60 %	79 %	58 %	None	None	53 %	None
Capital expenditures (October 2004 to September 2006) (US$ million)	19	94	67	22	7	24	3

(1) Includes pulp sold to third parties.

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

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

Gratkorn. Paper has been produced at the Gratkorn, Austria site for more than four centuries. In course of a major expansion and renovation project the Gratkorn mill has been transformed from a five-machine mill into a two-machine mill. As a result of this project, Gratkorn now has an annual capacity of 860,000 metric tonnes of triple-coated fine paper on just two paper machines and 250,000 metric tonnes of TCF chemical pulp. The machines at Gratkorn are among the largest and most efficient paper machines in the world. After extension of Gratkorn s sheeting plant it also has an annual sheet finishing capacity of 800,000 metric tonnes.

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

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

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

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

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

Sappi Fine Paper South Africa

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

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

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

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

	Mill Locations		
	Enstra	**Stanger**	**Adamas**
Paper capacity (000s metric tonnes)	200	110	40
Number of paper machines	3	2	2
Products	Uncoated fine Paper	Coated fine Paper, coated label paper and tissue	Prestige stationary, branded printing paper and board, envelope paper and corrugated medium
Percentage pulp integration	63 %	77 %	None
Capital expenditures (October 2004-September 2006) (US$million)	16	17	8

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

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

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

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

Marketing and Distribution

Overview

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

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

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

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

Sappi Fine Paper North America

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

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

In 2006, the Sappi Fine Paper North America sales force sold coated graphic paper to approximately 350 merchant distribution locations. By selling exclusively through merchant channels, Sappi Fine Paper North America believes it has created a loyal group of merchant customers. Rather than competing with merchant distributors, the Sappi Fine Paper North America sales force focuses on generating demand with key printers, publishers and end users, which are then serviced by the merchant distributors.

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

Sappi Fine Paper Europe

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

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

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

Sappi Fine Paper South Africa

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

Customers

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

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

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

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

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

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

Sappi Fine Paper s converter customers include both multinational and regional converters. The most significant converter customers, based on sales during fiscal 2006, include: VanLeer, Fasson, Jackstadt, VAW Flexible Packaging, Alcan, UCB Transpac, Lawson Mardon Packaging and Perstop. These customers use our products in the production of pressure sensitive and other types of labels as well as flexible packaging. Nampak, the CTP Group of companies, Paarl Media Lithotech, Merpak and Freedom Stationery and Silvery are also significant converter customers. These companies use our products in the production of packaging products. No converter customer, however, represented more than 10% of our total sales during fiscal 2006.

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

Competition

Overview

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

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

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

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

North America

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

Europe

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

Southern Africa

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

SAPPI FOREST PRODUCTS

Overview

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

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

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

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

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

(1) Includes newsprint and packaging products.

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

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

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

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

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

(2) Represents 78,000 cubic metres.

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

Facilities and Operations

Sappi Saiccor

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

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

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

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

Sappi Kraft

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

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

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

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

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

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

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

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

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

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

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

Sappi Forests

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

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

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

Marketing and Distribution

Overview

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

Customers

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

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

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

Competition

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

SUPPLY REQUIREMENTS

Overview

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

North America

Wood

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

Pulp

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

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

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

Energy Requirements

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

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

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

Chemicals

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

Europe

Wood

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

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

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

Pulp

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

Energy Requirements

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

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

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

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

Chemicals

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

Southern Africa

Wood

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

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

Pulp

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

Energy Requirements

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

Chemicals

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

ENVIRONMENTAL AND SAFETY MATTERS

Environmental Matters

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

North America

Sappi Fine Paper North America is subject to stringent environmental laws in the United States. These laws include the Federal Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and their respective state counterparts. In December 2003, Sappi Fine Paper North America received a notice of violation and a finding of violation from the US Environmental Protection Agency, alleging violations of the Clean Air Act s new source performance standards in connection with repairs performed at the Muskegon pulp mill in the early 1990s. In July 2005, Sappi announced its decision to cease operations at the Muskegon pulp mill. In September 2006 Sappi Fine Paper North America entered into a consent decree with the US Environmental Protection Agency, in which Sappi (i) agreed to more stringent permit requirements should the pulp mill ever start up again and (ii) paid a fine of $586,106.

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

Europe

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

- In Germany, where two Sappi Fine Paper Europe mills are located, the Federal Emission Control Act, the Federal Water Act and the Federal Ground Act regulate air emissions, wastewater discharges and liability for contaminated sites, respectively.

- In the Netherlands, where two Sappi Fine Paper Europe mills are located, paper manufacturers, including Sappi, have made an agreement with the national government to improve environmental management and further limit emissions.

- At our Nijmegen mill, we are subject to a potential damage charge of approximately $264,000 (euro 208,000), representing the alleged cost of cleaning up contaminated pulp from the local sewer system. The proposed charge relates to a discharge of pulp from our Nijmegen mill in 2000. We are pursuing a settlement of this matter with the local authorities.

- In Austria and Belgium, water emissions and waste disposal requirements similar to those in Germany, the United Kingdom and the Netherlands apply to our facilities.

- In the United Kingdom, we received the required permits under the Pollution Prevention and Control Regulations, which were enacted to implement the EC Directive 96/61/EC on Integrated Pollution Prevention and Control.

- The Sappi Fine Paper Europe organisation is certified according to the international standard of environmental management systems (ISO 14001), and to the European EMAS (Eco-Management and Audit Scheme). All of our European mills publish their environmental reports on an annual basis.

- The countries within which we operate in Europe are all signatories of the Kyoto Protocol and we have developed a GHG strategy in line with this protocol. Our European mills have been set CO_2 emission limits for the allocation period 2005 to 2007. Based on an analysis of our mill production by a Sappi Fine Paper Europe team, we believe that it is unlikely our European mills will exceed their CO_2 emission limits. Consequently we sold 90,000 surplus CO_2 credits in 2005 and 208,650 in 2006 on the European Climate Exchange.

South Africa

The primary South African environmental laws affecting our operations are:

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

- The National Environmental Management Act, adopted the philosophy of integrated environmental management, which provides for the integration of environmental considerations into all stages of any development process. The Act includes a number of significant principles, such as private prosecution of companies in the interest of the protection of the environment and the establishment of aggressive waste reduction goals. We expect to incur additional costs to comply with the National Environmental Management Act, which will not be material.

- The National Environmental Management Act (Air Quality Act) was promulgated in the beginning of 2005. The Air Quality Act will eventually replace the 1965 Atmospheric Pollution Prevention Act and will impose stringent compliance standards on our operations when implemented, including those related to carbon dioxide and sulphur dioxide air emissions. Limited sections of the Act were implemented in September 2005. We expect to incur additional costs to comply with the Air Quality Act, which we believe will not be material.

- South Africa is also a signatory of the Kyoto Protocol. We are identifying and initiating Clean Development Mechanism projects, as defined in the Kyoto Protocol, at a number of our South African mills.

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

Safety Matters

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

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

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

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

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

ORGANISATIONAL STRUCTURE

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

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

PROPERTY, PLANT AND EQUIPMENT

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

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

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

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

Location	**Use**	**Approximate Size**(1)
	Sappi Limited	
Johannesburg, South Africa	Sappi Headquarters(2)	15,078 m²
	Sappi Fine Paper	
Sappi Fine Paper North America(3)		
Boston, Massachusetts	Headquarters(4)	34,928 sq ft
Skowhegan, Maine (Somerset Mill)	Manufacturing facility: coated paper, softwood and hardwood pulp	2,355 acres
Muskegon, Michigan	Manufacturing facility: coated paper and a warehouse(5)	5,185,000 sq ft
Westbrook, Maine	Manufacturing facility: speciality and high bulk coated paper and research and development facility	275 acres
	Storage and shredding facility	13,446 sq ft
	Roll coating facility	13,575 sq ft
Allentown, Pennsylvania	Coated paper sheeting facility	30 acres
Dayton, New Jersey	Distribution centre(6)	607,489 sq ft
Cloquet, Minnesota	Manufacturing facility: coated paper and pulp(10)	650 acres
South Portland, Maine	Shared financial and customer service office(11)	48,433 sq ft
Sappi Fine Paper Europe		
Brussels, Belgium	Headquarters(9)	3,836 m²
Gratkorn, Austria	Manufacturing facility: coated paper and pulp	999,053 m²
Maastricht, Netherlands	Manufacturing facility: coated paper and research and development facility	14.7 ha
Nijmegen, Netherlands	Manufacturing facility: coated paper	10.7 ha
Lanaken, Belgium	Manufacturing facility: coated paper and pulp	35.0 ha
Alfeld, Germany	Manufacturing facility: coated paper, uncoated paper and pulp	332,844 m²
Ehingen, Germany	Manufacturing facility: coated paper and pulp	356,951 m²
Blackburn, England	Manufacturing facility: coated paper	36 ha
Wesel, Germany	Distribution centre(8)	62,140 m²

Sappi Fine Paper South Africa		
Enstra, South Africa	Manufacturing facility: uncoated paper and hardwood pulp(10)	582.7 ha
Stanger, South Africa	Manufacturing facility: coated paper, tissue and bagasse pulp(10)	55.4 ha
Adamas, South Africa	Manufacturing facility: uncoated paper and recycled packaging paper	7.2 ha
	Sappi Forest Products	
Johannesburg, South Africa	Headquarters	Included under Sappi Limited headquarters
Sappi Saiccor		
Umkomaas, South Africa	Manufacturing facility: chemical cellulose(10)	159.4 ha
Sappi Kraft		
Ngodwana, South Africa	Manufacturing facility: linerboard, newsprint and kraft pulp	1,282.9 ha
Tugela, South Africa	Manufacturing facility: linerboard, corrugating medium, sackkraft and industrial kraft	914.4 ha
Cape Kraft, South Africa	Manufacturing facility: linerboard and corrugating medium	9.5 ha
Bunya, Swaziland (Usutu Pulp Mill)	Manufacturing facility: kraft pulp	45.0 ha
Sappi Forests		
Barberton, South Africa (Lomati Sawmill)	Sawmill	24.6 ha

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

(2) Subject to a lease expiring in 2015.

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

(4) Subject to a lease expiring in 2011.

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

(6) Subject to a lease expiring in 2010.

(8) Of the total 62,140 m^2, 8,800m^2 is subject to a lease that operates on a year-to-year basis. The remainder of the property is subject to a heritable building right (Erbbaurecht).

(9) Subject to leases expiring in 2008.

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

(11) Subject to a lease expiring in 2015.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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

Company and Business Overview

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

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

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

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

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

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

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

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

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

Principal Factors Impacting on our Results

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

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

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

b) Movement in market prices for our products;

c) Sensitivity to currency movements;

d) Movement in market prices for raw materials and other input costs of manufacturing; and

e) Other significant factors impacting costs, including new acquisitions, restructuring and cost reduction initiatives.

f) Our ability to maintain and continuously improve operational efficiencies and performance.

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

Markets

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

Coated Fine Paper

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

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

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

In Europe, demand for coated fine paper grew by 1.4% in fiscal 2006, a significant decline on the previous years growth of 4.3%. Despite demand growth and sharp increases in input costs, our attempt to increase prices in the European market in fiscal 2005 was unsuccessful due to intense competition for market share.

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

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

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

US vs. European Apparent Consumption of Coated Paper

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

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

US and European Fine Paper Prices

January 2002 - September 2006

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

Pulp

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

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

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

The traditional softwood pulp price premium to hardwood was disrupted in fiscal 2005 as a result of pulp mills shifting from hardwood to softwood production, and hardwood pulp mills closing temporarily. This led to hardwood pulp prices exceeding that of softwood in the final quarter of fiscal 2005. However, during October 2005 softwood price premiums were restored as some softwood mills closed in Eastern Canada, while hardwood supply increased during the latter part of fiscal 2005 as an additional 1.9 million metric tonnes came on stream with large expansions at Hainan Island in China and Veracel in Brazil. As a result, the softwood pulp price premium to hardwood increased considerably during fiscal 2006.

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

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

Northern Bleached Softwood and Hardwood Kraft Pulp

January 2000 - November 2006

Source: PIX

Chemical cellulose accounts for the majority of Sappi s third party pulp sales. The chemical cellulose we produce, at our Saiccor operation in Southern Africa (Saiccor), is used principally as an input in the production of various synthetic textiles and acetate flake used in the manufacturing of acetate tow for cigarette filter tips.

The movement in price of certain chemical cellulose grades is linked to the price of NBSK. Higher technical specifications allow chemical cellulose to typically trade at a premium to NBSK. BHK (Bleached Hardwood Kraft pulp) generally sells at a lower price than NBSK.

We diversified our range of chemical cellulose products and secured new agreements to supply customers in the acetate sector during fiscal 2003. We increased sales significantly in this sector in fiscal 2004 and continued to achieve growth in volumes and prices in each of fiscal 2005 and 2006. Also, a significant competitive source of supply was recently removed from the industry when Weyerhauser closed its 140,000 tonne per annum Cosmopolis plant in September 2006. The full impact of this closure will only be felt as from fiscal 2007.

Demand from all of the market segments in which Saiccor is active was strong throughout fiscal 2004 with prices also increasing steadily, but showing some weakness towards the end of fiscal 2004. Saiccor s capacity during fiscal 2005 continued to be fully booked with overall demand steady, despite a general fall off in the demand for Saiccor s chemical cellulose from China during that year. In line with the movement in the NBSK prices, Saiccor prices increased in the early part of fiscal 2005, but this trend was reversed later in the year. In fiscal 2006 our chemical cellulose business, which is 100% export-based, continued to be fully booked. We maintained a strong market position in the key Viscose Staple Fibre segment but also posted record sales of higher alpha products, which are primarily sold into the acetate tow segment.

Following the successful completion of an environmental impact assessment, a project to expand the mill s annual capacity by more than 200,000 metric tones commenced during the latter part of fiscal 2006.

Currency Fluctuations

The principal currencies in which our subsidiaries conduct business are the US$, Euro and ZAR. Although our reporting currency is the US$, a significant portion of our sales and purchases are made in currencies other than the US$. In Europe and North America, sales and expenses are generally denominated in Euro and US$, respectively; however, pulp purchases in Europe are primarily denominated in US$. In Southern Africa, costs incurred are generally denominated in ZAR, as are local sales. Exports from our Southern African businesses to other regions, which represent approximately 45% of sales in fiscal 2006, are denominated primarily in US$.

We made sales in a range of foreign currencies in fiscal 2006 and fiscal 2005 as follows:

(Percentage of Sales)	2006	2005
US$	45.8	44.8
Euro	30.3	30.5
ZAR	15.6	15.7
Other	8.3	9.0
Total	100	100

The appreciation of the ZAR or the Euro against the US$ tends to diminish the value of exports from Southern Africa and Europe in local currencies, while depreciation of these currencies against the US$ will have the opposite impact. Since expenses are generally denominated in local currencies, the depreciation of the US$ has a negative effect on gross margins on exports and such domestic sales, which are priced relative to international US$ prices. The appreciation of the US$ has the opposite impact. European importers of pulp denominated in US$ have experienced cost increases, in terms of local currency, due to a weakening of the Euro against the US$. Our consolidated financial position, results of operation and cash flows may be materially affected by movements in the exchange rate between the US$ and the respective local currencies to which our subsidiaries are exposed. The principal currencies in which our subsidiaries conduct business that are subject to the risks described in this paragraph are the Euro and ZAR. The following table depicts the average and year end exchange rates for the ZAR and Euro against the US$ used in the preparation of our financial statements in fiscal 2006 and fiscal 2005:

	2006	2005
Average Exchange Rate(1)		
ZAR(2)	6.6039	6.2418
Euro(2)	1.2315	1.2659
Year end Exchange Rate(1)		
ZAR(2)	7.7738	6.3656
Euro(2)	1.2672	1.2030

(1) Source: audited Group annual financial statements of Sappi Limited.

(2) US$1 = ZAR, Euro 1 = US$.

The Euro declined to approximately US$1.20 per Euro at the end of fiscal 2005. It reached a high of US$1.17 at the end of November 2005, a low of US$1.28 at the end of June 2006 and closed fiscal 2006 at US$1.27. The ZAR strengthened to a level of approximately R5.59 per US$ on December 27, 2004, but weakened again to R6.91 per US$ on June 6, 2005. The ZAR was trading at approximately R6.37 per US$ at the end of fiscal 2005. During fiscal 2006 the ZAR weakened to US$6.71 at the end of October 2005 before strengthening to US$6.00 at the end of April 2006. Thereafter it again weakened to end the year at US$7.77, with an average of US$6.60 for fiscal 2006. The profitability of certain of our Southern African operations are directly dependent on the ZAR proceeds of the US$ exports. Furthermore, prices in the local market are also influenced by import parity competitive pricing. If the ZAR remains at the year end levels, import parity pricing pressure on margins will be reduced and at the same time the margin, in local currency, on US$ denominated exports will increase. The following graph depicts currency movements for the ZAR and Euro against the US$:

Euro and ZAR Exchange Rate Movement against USD

Daily Close January 1999 to November 2006

US$1 = ZAR, Euro 1 = US$.

Raw Material and Other Input Costs of Manufacturing

Our business is sensitive to fluctuations in market prices of raw materials used in the manufacture of our products. These comprise mainly purchased materials, (such as wood and caustic soda), pulp, energy and chemicals (including calcium carbonate and latex). Total raw material costs (excluding pulp purchases) of approximately US$1,501 million in fiscal 2006, increased by US$91 million (3.7%) from fiscal 2005. Raw material costs were made up as follows:

	2006 US$ million	%	2005 US$ million	%	Variance US$ million	%	Variance Analysis Additional Week 2005	Price	Volume and Mix	Total	Price Increase %
Raw Material Costs											
Wood	410	16.3	416	17.1	(6)	(1.5)	8	32	(46)	(6)	8
Energy	433	17.2	365	15.0	68	18.8	7	83	(22)	68	23
Chemicals	658	26.1	653	26.9	5	0.8	12	(0)	(7)	5	(0)
Pulp	563	22.4	514	21.2	49	9.6	10	38	1	49	7
Other	452	18.0	479	19.7	(27)	(5.6)	9		(36)	(27)	
Total Raw Materials	**2,516**	**100**	**2,426**	**100**	**89**	**3.7**	**46**	**153**	**(110)**	**89**	**6**

During fiscal 2006 we experienced significant increases in the cost of wood (8%), energy (23%) and pulp (7%). Our energy and chemical raw material costs, especially coating chemicals, are driven to a large extent by oil prices. The average cost of Brent Crude Oil increased on average by 23.1% during fiscal 2006, to US$64 per barrel, from US$52 per barrel during fiscal 2005. The cost of our raw materials, on a constant US$ per metric tonne basis in fiscal 2006, increased by 7.7% (US$25 per metric tonne) over fiscal 2005.

Sappi Fine Paper Europe s materials, energy and chemical costs increased by US$64 million in fiscal 2006. An analysis of raw material costs is as follows:

	2006 US$ million	%	2005 US$ million	%	Variance US$ million	%	Variance Analysis Additional Week 2005	Price	Volume and Mix	Total	Price Increase %
Raw Material Costs											
Wood	123	10.0	112	9.6	11	10.0	2	15	(6)	11	14
Energy	197	16.0	151	12.9	46	30.4	3	52	(9)	46	34
Chemicals	375	30.4	387	33.1	(13)	(3.2)	7	(6)	(14)	(13)	(2)
Pulp	377	30.6	353	30.2	24	6.9	7	31	(14)	24	9
Other	160	13.0	165	14.2	(6)	(3.4)	3		(9)	(6)	
Total Raw Materials	**1,232**	**100**	**1,168**	**100**	**64**	**5.5**	**22**	**92**	**(51)**	**64**	**8**

	2006	2005	Variance	%
US$/ metric tonne	503	481	21	4.4
Euro / metric tonne	408	380	28	7.4

The exchange rate impact on raw material costs was US$32 million positive. Average raw materials costs in Euro per metric tonne increased 7.4% to Euro 408 per metric tonne in fiscal 2006, compared to fiscal 2005 (Euro380 per metric tonne). In US$ per metric tonne costs increased 4.4% to US$503 per metric tonne. Energy cost increases contributed 4% US$21 per metric tonne, wood costs 1% US$6 per metric tonne and pulp 3% US$13 per metric tonne to cost increases.

Sappi Fine Paper North America s materials, energy and chemical costs increased US$43 million in fiscal 2006. An analysis of raw material costs is as follows:

	2006 US$ million	%	2005 US$ million	%	Variance US$ million	%	Variance Analysis Additional Week 2005	Price	Volume and Mix	Total	Price Increase %
Raw Material Costs											
Wood	184	22.3	186	23.8	(2)	(1.0)	4	6	(12)	(2)	3
Energy	135	16.3	119	15.2	16	13.8	2	24	(10)	16	20
Chemicals	192	23.2	190	24.3	2	1.2	4	2	(3)	2	1
Pulp	122	14.8	92	11.7	30	32.7	2	6	22	30	6
Other	193	23.4	196	25.0	(3)	(1.6)	4		(7)	(3)	
Total Raw Materials	**826**	**100**	**783**	**100**	**43**	**5.4**	**16**	**38**	**(10)**	**43**	**5**

	2006	2005	Variance	%
US$/ metric tonne	579	546	33	6.0

Average raw material costs in US$ per metric ton increased by 6.0% to US$579 per metric tonne in fiscal 2006. Energy cost increases contributed US$17 (3%) per metric tonne and wood costs US$4 (1%) per metric tonne to cost increases.

Sappi Fine Paper South Africa showed no significant overall cost variations year on year. An analysis of raw material costs is as follows:

	2006 US$ million	%	2005 US$ million	%	Variance US$ million	%	Variance Analysis Additional Week 2005	Price	Volume and Mix	Total	Price Increase %
Raw Material Costs											
Wood											
Energy	22	11.7	23	12.6	(1)	(3.2)	0	1	(1)	(1)	2
Chemicals	41	21.4	40	21.5	1	3.5	1	(1)	1	1	(2)
Pulp	63	33.0	67	36.4	(4)	(6.0)	1	1	(6)	(4)	2
Other	65	33.9	54	29.5	11	19.4	1		10	11	
Total Raw Materials	**191**	**100**	**184**	**100**	**7**	**3.9**	**3**	**1**	**3**	**7**	**0**

	2006	2005	Variance	%
US$/ metric tonne	583	581	2	0.4
ZAR / metric tonne	3,852	3,627	225	6.2

The exchange rate impact on raw material costs was to reduce reported costs by US$10 million. The average raw material costs in ZAR increased 6.2% to ZAR3, 852 per metric tonne.

Forest Products material costs increased US$6 million in fiscal 2006. An analysis of raw material costs is as follows:

	2006 US$ million	%	2005 US$ million	%	Variance US$ million	%	Variance Analysis Additional Week 2005	Price	Volume and Mix	Total	Price Increase %
Raw Material Costs											
Wood	104	37.7	117	43.3	(13)		2	11	(26)	(13)	
Energy	79	28.7	72	26.7	7	9.7	1	6	0	7	9
Chemicals	50	18.2	36	13.3	14	38.3	1	5	8	14	15
Pulp	1	0.3	2	0.8	(1)	(55.7)	0		(1)	(1)	
Other	42	15.1	43	15.9	(1)	(3.1)	1		(2)	(1)	
Total Raw Materials	**276**	**100**	**270**	**100**	**6**	**2.2**	**5**	**22**	**(21)**	**6**	**8**

	2006	2005	Variance	%

US$/ metric tonne	92	82	10	12.3
ZAR / metric tonne	608	512	96	18.8

The exchange rate impact on raw material costs was to reduce reported costs by US$15 million. The average raw material costs in ZAR increased 18.8% to ZAR608 per metric tonne. In US$ per metric tonne material costs increased 12.3% to US$92 per metric tonne.

Restructuring

We announced the restructuring and impairment of our North American Muskegon mill during the third quarter of fiscal 2005, to eliminate high cost capacity and to position the mill as a high quality, low cost mill. This is part of our ongoing plan to achieve acceptable returns in our North American operations. We recorded impairment charges of US$183 million in the third and fourth quarters of fiscal 2005. We closed PM4, which had an annual capacity of 105,000 metric tonnes of coated fine paper and closed and mothballed the pulp mill, which had an annual capacity of 110,000 metric tonnes of bleached chemical pulp. We also restructured our North American regional overhead structure to reduce Selling, General and Administrative expenses (SG&A), and in the fourth quarter of fiscal 2005 we recorded a restructuring charge of approximately US$21 million, mainly in respect of manpower reduction. The combined effect of the Muskegon restructuring and the restructuring of the regional SG&A function was expected to result in a reduction of approximately 420 people or 14% of our North American headcount, a pre-tax benefit of approximately US$50 million compared to fiscal 2005. During fiscal 2006 we continued with the implementation of the restructuring plan. The reduction in headcount has been revised to 377 people. At the end of fiscal 2006 headcount had been reduced by 353 people.

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 during fiscal 2005 of US$50 million to meet the requirements of Accounting Standard IAS36 Impairment of Assets. A detailed discussion of this impairment is contained in the section Mill Closures, Acquisitions, Dispositions and Impairment; and Joint Venture , elsewhere in this Operating and Financial Review and Prospects. As a result of improved pulp prices a weakening of the ZAR against the US$ and improved operational performances the Usutu mill, has seen an improved performance to a level where impairment was reversed under IFRS, in terms of IAS 36. This resulted in a write back of the impairment provision in fiscal 2006 of US$40 million.

A major cost reduction and restructuring project was undertaken in Europe, during fiscal 2006, which will result in a head count reduction of approximately 650 employees mainly throughout 2007. This project resulted in a restructuring charge of US$47 million in 2006.

For further information see note 23 to our Group annual financial statements included elsewhere in this Annual Report.

South African Economic and Political Environment

South Africa features a highly developed sophisticated first world infrastructure at the core of its economy. The South African economy is expected to grow at approximately 4.7% in calendar 2007. South Africa s long-term foreign currency investment ratings have remained constant over the last year at Baa1 from Moody s Investor Services Inc. and BBB+ from Standard & Poor s Rating Service (S&P). While exchange controls have been relaxed in recent years and are continuing to be relaxed, South African companies remain subject to restrictions on their ability to raise and deploy capital outside of the Southern African Common Monetary Area (See Liquidity and Capital Resources Financing).

South Africa celebrated 12 years of democracy in calendar 2006; however the country continues to face challenges in overcoming substantial differences in levels of economic and social development among its people. Access to land, poverty, unemployment, crime and a growing prevalence of HIV/AIDS are some of the social and economic factors that affect businesses operating in this country.

The Restitution of Land Rights Act (Act 22 of 1994), as amended, provides for the restoration of rights in land or other equitable redress to persons or communities dispossessed of their land rights after June 19, 1913 as a result of old laws or practices discriminating on the basis of race. The legislation empowers the Minister of Land Affairs to expropriate land in order to restore it to a successful claimant provided that there is just and equitable compensation to the owner of the land. Claims under the Act were required to be filed on or before December 31, 1998 and are presently being processed by the Commission on Restitution of Land Rights and adjudicated upon by the Land Court. This process is expected to continue for many years. As one of the largest land owners in South Africa, we anticipate that a substantial number of claims may affect land we own. The process of determining the extent of claims filed in respect of our land and the potential impact of these claims on our South African operations continues. To date, we have been notified of twenty-four formal Land Claims made in respect of portions of Sappi plantations in the Mpumalanga area, and twenty-eight others made in respect of portions of Sappi plantations in KwaZulu Natal. These claims have not been finalized and are still under investigation by the Regional Land Claims Commissioner.

The southern African region has one of the highest infection rates of HIV/AIDS in the world. In 1992, Sappi started a programme to address the effects of HIV/Aids and its impact on our employees and our business. Our aim is to ensure that our programme prevents new infections and to treat the HIV positive employees. Each operating unit has an elected HIV/AIDS committee and a workplace HIV/AIDS prevention programme which are adapted to suit the needs of each particular business unit and to ensure that they are active owners and managers of their programmes. Each Sappi operation in southern Africa has also identified the relevant role players in their geographical area and is working with them on the implementation of a comprehensive HIV/AIDS programme, eliminating duplication and making optimum use of relevant resources.

Following an initial anonymous, voluntary prevalence test in 2003, a second comprehensive voluntary study was conducted in 2006 in all of our southern African operations. Based on a participation rate of greater than 80%, at the locations tested, we estimate that the overall infection rate in our southern African operations is approximately 14%. With the information of the prevalence testing and the Knowledge, Attitude and Practices study (KAP) we planned a comprehensive programme for 2007. We are planning interventions to focus on the stigma surrounding HIV and on wellness and healthy living.

Our HIV/AIDS response strategy places special emphasis on testing and counselling to ensure the staff knows their HIV status to enable them to make informed decisions as to their life choices. Since August 2002, our medical care for employees has included treatment to prevent mother to child transmission. Anti-retroviral treatment has been offered to HIV-infected permanent employees from the beginning of 2003. We estimate that 40% of HIV positive employees participate in our HIV/AIDS management programme, which is an improvement on the prior year s participation rate. To ensure that our programme remains current, we became a member of the Global Business Coalition (GBC) on HIV/AIDS in 2005, a global partnership focused on developing an integrated strategy for dealing with the disease.

The government and organised business have taken a number of steps in recent years to increase the participation of black people in the South African economy. To this end, the Employment Equity Act (No 55 of 1998), the Skills Development Act (No 97 of 1998) and the Preferential Procurement Policy Framework Act (No 5 of 2000) were promulgated. More recently, the Broad-Based Black Economic Empowerment Act (No. 53 of 2003) has formalised the country s approach to distributing skills, employment and wealth more equitably between races and genders. Broad-Based Black Economic Empowerment (BBBEE) focuses on increasing equity in ownership, management and control of businesses, and improving Black representation in all levels of employment. It also promotes the development of skills within a business, the nurturing of Black entrepreneurship through preferential procurement and enterprise development, and the uplifting of communities through social investment.

Our South African businesses have formulated a BBBEE scorecard, based on guidelines set out by the Codes of Good Practice from the government Department of Trade and Industry. The scorecard set out in the following table was verified by Empowerdex, a leading BBBEE rating agent and reflects our significant achievements in the categories of empowerment, equity, skills development, preferential procurement, enterprise development and social development. The decline from a rating of C to D in the employment equity category results from the application of our new 5 year empowerment plan within which White females are excluded for the purposes of economic empowerment reporting. This has resulted in significantly more challenging targets as the benchmark. White females are however included in employment equity statistics for all other statutory equity reporting requirements. The shortage of experience and developed skills continues to pose challenges in meeting targets at the higher levels in our operations, contributing to the current employment equity rating. In general, targets for improvement in the various categories in the scorecard are set to be achieved by 2015.

Sappi s rating

	2006	2005
BBBEE factor status*		
Overall Rating	BBB	BB
Equity in ownership	E	E
Equity in management	D	D
Employment equity	D	C
Skills development	A	B
Preferential procurement	B	C
Enterprise development	A	B
Social development	A	A

* A is the highest score.

The shares of Sappi are widely held by South African and international investors. The company does not currently intend to undertake an empowerment transaction in respect of these shares. We will consider and are pursuing empowerment transactions related to specific southern African assets or business units where they add to the value of our business and meet our empowerment criteria.

The representation of Black people, particularly Black women, in management and all levels of employment within the company is a focus within the organisation, driven by employment equity targets set in each occupational category. Skills development initiatives, particularly programmes aimed at improving management and leadership skills, are geared to meet these targets. Where practical, Sappi purchases goods and services from Black-owned businesses and seeks opportunities to develop future Black vendors. Sappi is committed to the support of its Project Grow initiative through financial and technical input, as well as by providing a secure market during the start-up phase of these small tree farming enterprises. This initiative has been extended to encourage aspirant tree farmers who wish to undertake forestry activities on a larger scale. We have a number of enterprise development initiatives and have established programmes to train new entrepreneurs. These initiatives involve the transfer of business skills, technical assistance, financial support and preferential payment terms to assist new enterprises to enter the market. Sappi has a history of investment in the communities in which it operates. Initiatives to promote education, health and welfare, arts and culture, and rural and community development, amongst others, are regularly undertaken.

The South African constitution guarantees ownership rights of assets, and it is the stated intent of the Bill that transfer of ownership will occur at market prices. It should be noted that BBBEE equity participation need not necessarily occur at the corporate level, and can be effected at divisional, business unit or lower levels. Because the BBBEE Bill sets forth a framework for plans rather than specific requirements or goals, it is not possible to predict whether or how our business or assets may be impacted.

For further information, see Item 4 Information on History and Development of the Company

Inflation and Interest Rates

The following table sets forth South African inflation for fiscal 2006 and fiscal 2005:

	2006	**2005**
Inflation(1)	5.4 %	4.4 %

(1) South African Consumer Price Index (CPI). The CPI is for the Sappi fiscal years.

South African prime overdraft interest rates continued to declined in 2005 to reach a new low of 10.5% in April 2005. The rates remained at these levels until April 2006 when they increased to 11%. They increased in August 2006 to 11.5%. The ZAR strengthened to ZAR 5.61 against the US$ on 31 December 2004 and started fiscal 2006 at ZAR 6.34 on 3 October 2005. Partly due to the stronger ZAR during fiscal 2005 and fiscal 2004, the South African inflation rate decreased significantly to 1.3% at the end of fiscal 2004, but increased to 4.4% as at the end of fiscal 2005 and 5.4% at the end of fiscal 2006, within the target range of 3-6% as set by the South African Reserve Bank (the SARB). This increase is largely the effect of the impact of higher oil prices on the South African economy. The SARB reduced its repurchase rate to 7.0% in April 2005. In June 2006 it increased to 7.5% and to 8% in August 2006. The rate at the end of fiscal 2006 was 8%. The repurchase rate is the rate at which the SARB lends assistance to the banking sector and therefore represents the cost of credit to the banking sector. When the repurchase rate is changed, the interest rates on overdrafts and other loans extended by the banks also change. In this way the SARB indirectly affects interest rates in the economy. Although South African interest rates impact the cost of our South African borrowings, the majority of our borrowings have been incurred by subsidiaries outside southern Africa, denominated in either US$ or Euro.

In the US and Europe inflation rates were relatively stable in recent years, and accordingly had a lesser impact on our North American and European businesses. The three-month LIBOR interest rate for the US$ reached 6.8%, in May 2000 and remained unchanged through to the end of fiscal 2000. Fiscal 2001 saw a period of significant rate reductions to 2.6% at the end of fiscal 2001. The rate reduced further to 1.14% at the end of fiscal 2003. Since then it increased to 1.96% by the end of fiscal 2004 and increased further to 4.06% by the end of fiscal 2005. On 28 September, 2006 it was 4.37%.

The three-month EURIBOR interest rate in Europe decreased sharply from 4.9% at the end of fiscal 2000 and was 2.13% at the end of fiscal 2003 and 2.12% at the end of fiscal 2004. It increased slightly to 2.17% at the end of fiscal 2005 and on 28 September 2006 it was 3.38%. The relatively low interest rates in the United States and Europe continue to represent a significant interest rate differential when compared to South Africa s 8.0% repurchase rate as determined by the SARB, and could result in further short-term strengthening of the ZAR.

We borrow in the currencies of the countries in which we invest. As a result, finance costs are related to the location of our activities and not our domicile.

Our foreign exchange policy consists of the following principal elements:

- External borrowings are taken up in the functional currency of the operating company concerned and, if not, then the exposure is hedged. Where appropriate we aim, in accordance with IFRS, to apply hedge accounting treatment to avoid volatility in our results due to mark-to-market effects of such hedging instruments.

- Any debtors or creditors not in the operating currency of the mill are hedged. Sales are hedged from the time of invoicing, purchases from the time of capex approval in the case of capex, and all other purchases are hedged in most instances at the time the order is placed.

- These exposures are hedged through our central treasury, where external hedging instruments are contracted after netting the various exposures.

- Variations in this policy are considered from time to time, but any deviations from the central treasury policy are always subject to prior board approval.

- No speculative positions are permitted.

Translation risks are not hedged. As a general rule we manage our relative debt and equity ratios by financing our investments in different currencies with similar debt to asset ratios.

External dollar borrowings for our North American operations (with the exception of US$107 million public long-term bonds) were replaced during fiscal 2002 by inter-group financing from Sappi Papier Holding GmbH (SPH), our European holding company. Accordingly, there is a larger proportion of external borrowings in our European operations when compared to the position before fiscal 2002. We have a current policy of not hedging translation risks. Our South African and European operations use the South African ZAR and the Euro as their respective functional currencies. Any translation of the value of these operations into US$ results in foreign exchange translation differences as the ZAR and the Euro exchange rates move against the US$. These changes are booked to the foreign currency translation reserve account. We prefer not to hedge this exposure with financial instruments, as these result in cash settlements which impact our results on a permanent basis. Borrowings taken up in a currency other than the functional currency of the borrowing entity are specifically hedged with financial instruments, such as currency swaps and forward exchange contracts. With regard to interest rate swaps, hedge accounting is permitted when the hedging relationship between the hedge and the underlying debt meets the requirements of the relevant IFRS. For example, on our public bonds we have fixed to variable swaps. The terms of the swaps match the terms of the bonds exactly in respect of interest settlements and capital repayments etc. With regard to maturity, the 10-year bond is hedged to full maturity, the 30-year bond for the first ten years. If the relationship between the hedge and the debt is not matched, hedge accounting cannot be applied. We only enter interest rate swaps when hedge accounting can be applied or any volatility due to the mark-to-market movements of the swaps to the income statement avoided. For a description of hedge accounting with regard to interest rate swaps in accordance with United States GAAP, see note 35 to our Group annual financial statements included elsewhere in this Annual Report. For a description of our interest and exchange rate risks, see note 31 to our Group annual financial statements included elsewhere in this Annual Report.

Financial Condition and Results of Operations

Our operations are organised into two business units:

I. *Sappi Fine Paper, which consists of Sappi Fine Paper North America, Sappi Fine Paper Europe and Sappi Fine Paper South Africa; and*

II. *Sappi Forest Products, which consists of Sappi Kraft, Sappi Saiccor and Sappi Forests.*

The following table sets forth sales and operating profit for Sappi, Sappi Fine Paper by region, and Sappi Forest Products, in US$, and as a percentage of sales for fiscal 2006 and fiscal 2005. Operating profit percentages are expressed as a percentage of sales of the applicable business unit.

	2006		2005	
	Amount (US$ millions)	% of Sales	Amount	% of Sales
Sales:				
Sappi Fine Paper				
Sappi Fine Paper North America	1,439	29.1	1,458	29.1
Sappi Fine Paper Europe	2,194	44.4	2,239	44.6
Sappi Fine Paper South Africa	325	6.6	323	6.4
Total	3 958	80.1	4,020	80.1
Sappi Forest Products	983	19.9	998	19.9
Group Sales	4,941	100.0	5,018	100.0
Operating (Loss) Profit:				
Sappi Fine Paper				
Sappi Fine Paper North America	(16)	(1.1)	(259)	(17.8)
Sappi Fine Paper Europe	(27)	(1.2)	84	3.8
Sappi Fine Paper South Africa	(6)	(1.9)	(11)	(3.4)
Total	(49)	(1.2)	(186)	(4.6)
Sappi Forest Products	175	17.8	83	8.3
Corporate	(1)		(6)	
Group Operating Profit (Loss)	125	2.5	(109)	(2.2)

Our 2006 financial year included 52 accounting weeks, compared to 53 accounting weeks last year. Our financial years operate on a 52 accounting week cycle, except every 6th year which includes an additional accounting week (additional accounting week). The impact of the additional accounting week, based on the average of 53 accounting weeks, (average sales) for example, accounted for a sales volume decrease of 141,000 tons and US$95 million decrease in total sales.

Group volumes sold in fiscal 2006 decreased by 280,000 metric tonnes (3.7%). Consolidated group sales decreased by US$77 million (1.5%) over fiscal 2005. The additional accounting week in fiscal 2005 accounted for additional sales volume of approximately 141,000 metric tonnes. The decrease was attributable to, the one less accounting week and decreased timber and timber product volumes of 217 000 tonnes, partly offset by volume growth in other pulp and paper volumes. The additional accounting week in fiscal 2005 contributed additional sales of US$95 million.

The impact of the additional accounting week on expenses in fiscal 2005 was US$97 million, based on the average weekly expenses of the 53 accounting weeks, or average expenses .

A more detailed discussion and explanation of the material factors that affect our results of operations described below, is contained in the sections Markets , Principal Factors Impacting our Results , Currency Fluctuations , Raw Material and Other Input Costs of Manufacturing , Restructuring , Inflation and Interest Rates and Mill Closures, Acquisitions, Dispositions and Impairment; and Joint Venture , elsewhere in this Operating and Financial Review and Prospects. These factors include market fluctuations, exchange rates, taxation, net finance costs, impairment costs and significant cost factors, including raw material and other input costs of manufacturing as well as restructuring and cost reduction initiatives.

Year Ended September 2006 Compared to Year Ended September 2005

North American coated fine paper apparent demand growth was significantly better in fiscal 2006 in comparison to fiscal 2005. Demand for coated woodfree paper grades grew 4.3% in comparison to 1% growth in fiscal 2005. Sappi Fine Paper North America s average price realised decreased by 0.6% to US$1,009 per metric tonne in fiscal 2006, mainly due to competitive import price pressure and mix. In Europe, demand for coated woodfree paper grew by 7.3% in fiscal 2006, compared to growth of 4.3% in fiscal 2005. Despite sharp input costs increases and significant temporary capacity closures during fiscal 2005, prices in Europe were flat.

Due to weak market conditions in fiscal 2005 and 2006 and to contain rising costs, the company continued its restructuring initiatives as described in the Company and Business Overview section. This gave rise to a US$47 million restructuring charge at Sappi Fine Paper Europe.

The translation of our annual results, from local currencies to US$ for reporting purposes, tends to distort comparisons between financial periods when currencies are volatile. During 2006 the US$ strengthened by 2.7% on average against the Euro, and by 5.8% on average against the South African Rand (ZAR). For example, as a result of the strengthening of the average US$ rate against the Euro and the ZAR during 2006, a 1.1% decrease in average selling price realised in Euro translates to a 3.8% decrease in US$, and a 12.4% increase in average selling price realised in ZAR translates to a 5.9% increase in US$. We refer to this as the currency translation effect in the following discussion of our financial condition and results of operations.

Sales

Sales represent the net sales value of all products sold to outside parties. For a full description see our revenue recognition policy in note 2 of our Group annual financial statements included elsewhere in this Annual Report.

Sappi Group:

	Fiscal 2006	**2005**	**Variance Value**	**%**
	Tonnes 000			
Sales Volume				
Sales Volume	7,199	7,479	(280)	(3.7)
Impact of Additional Accounting Week		141	(141)	
	US$ Millions			
Sales Value				
Sales Value	4,941	5,018	(77)	(1.5)
Impact of Additional Accounting Week		95	(95)	

The total volume of product (including pulp) sold by the Group in fiscal 2006 decreased by 280,000 metric tonnes from fiscal 2005. The impact of additional accounting week in fiscal 2005 was 141,000 metric tonnes. Sales volumes in fiscal 2006 were impacted by a reduction in timber and timber product volumes of 212,000 metric tonnes, partly offset by a 72,000 metric tonne volume growth in other core pulp and paper volumes, and the impact of the additional accounting week in fiscal 2005. The increase of 72,000 metric tonnes in volume of products sold consisted of increased volume sold for Sappi Fine Paper Europe (69,000 metric tonnes), Sappi Fine Paper North America (20,000 metric tonnes) and Sappi Fine Paper South Africa (17,000 metric tonnes), partly offset by reduced volumes sold at Forest Products (34,000 metric tonnes), excluding the impact of the additional accounting week in fiscal 2005.

Consolidated sales decreased by US$77 million to US$4,941 million in 2006 from US$5,018 million in 2005 (1.5%). The impact of additional volume sold, due to the additional accounting week in 2005, was US$95 million, based on average weekly sales. The US$77 million decrease is primarily due to a currency translation effect of US$133 million and lower volumes sold of US$39 million, partly offset by higher selling prices of US$95 million. The sales of our Fine Paper division decreased by US$62 million and Forest Products by US$15 million. The total volume of products sold, in metric tons, in 2006 decreased by 0.3 million tons to 7.2 million tons. Volumes sold increased for Sappi Fine Paper (27,000 metric tonnes), despite 79,000 metric tonnes of additional volume in fiscal 2005 due to the additional accounting week, and decreased for Forest Products (307,000 metric tonnes), with 62,000 metric tonnes attributable to the additional accounting week in fiscal 2005. The increase in volumes for Fine Paper was largely at our European operations (23,000 metric tonnes), while the decrease for Forest Products is primarily due to lower volumes of timber products (212,000 metric tonnes) and paper pulp (95,000 metric tonnes).

An analysis by business unit is as follows:

Sappi Fine Paper:

	Fiscal 2006	2005	Variance Value	%
	Tonnes 000			
Sales Volume				
Sales Volume	4,204	4,177	27	0.7
Impact of Additional Accounting Week		79	(79)	
	US$ Millions			
Sales Value				
Sales Value	3,958	4,020	(62)	(1.5)
Impact of Additional Accounting Week		76	(76)	

The total volume sold by Sappi Fine Paper (including pulp) in 2006 increased by 27,000 (0.7%) metric tonnes to 4.2 million metric tonnes, even taking into account the impact of the additional accounting week in 2005 of 79,000 metric tonnes additional volume, based on average weekly sales. For Sappi Fine Paper North America, volumes sold decreased by 7,000 metric tonnes (0.5%), to 1.4 million metric tonnes, the impact of the additional accounting week in 2005 was 27,000 metric tonnes, based on average sales. Industry demand for coated fine paper in North America increased at an annualised rate of 4.3% in fiscal 2006. Sappi Fine Paper North America saw a decline in market share due mainly to increased imports. Sappi Fine Paper Europe s volumes increased by 23,000 metric tonnes to 2.5 million tons (1.0%), compared with industry-wide coated fine paper growth of 7.3% for 2006, compared to 1.6% in 2005. The impact of the additional accounting week in fiscal 2005 was 46,000 metric tonnes, based on average sales. The market share lost in Europe in the second and third quarters of fiscal 2005 was regained by Sappi Fine Paper Europe in the last fiscal quarter of fiscal 2005. Sappi Fine Paper South Africa maintained market share in 2006 with volumes flat at 0.3 million tons.

Total sales for Sappi Fine Paper (including pulp) decreased by only US$62 million (1.5%) to US$3,958 million in fiscal 2006 despite the impact of the additional accounting week in fiscal 2005 of US$76 million additional sales. The US$62 million decrease is due primarily to the currency translation effect (US$79 million) and lower average selling prices realised in local currencies (US$7 million), partly offset by increased volume (US$24 million). Average prices realised in US$ terms in fiscal 2006 decreased by US$21 per metric tonne (2.2%) to US$941 per metric tonne, down from US$962 per metric tonne in fiscal 2005.

Sales for Sappi Fine Paper North America decreased by US$19 million (1.3%) to US$1,439 million in fiscal 2006, based on average sales, the impact of the additional accounting week in fiscal 2005 was

US$28 million. Decreased selling prices reduced sales by US$12 million, and lower volumes contributed to a decrease of US$7 million in sales. The decrease in volume was impacted by the additional accounting week in fiscal 2005. The average price realised decreased by 0.8% to US$1,009 per metric tonne in fiscal 2006, from US$1,017 per metric tonne in 2005.

Sales for Sappi Fine Paper Europe decreased by US$45 million (2%) to US$2,194 million in fiscal 2006. Based on average sales, the impact of the additional accounting week in fiscal 2005 was US$42 million. The US$45 million decrease is due to the currency translation effect (US$61 million) and reduced selling prices in Euro terms (US$5 million), partly offset by increased volume, (US$21 million). The increase in volume was impacted by the additional accounting week in fiscal 2005. The increase in volume, excluding the impact of the additional accounting week in 2005, was mainly the effect of our improved market share as from the final quarter of fiscal 2005. Average prices realised in US$ terms were US$896 per metric tonne in fiscal 2006, US$27 per metric tonne (2.9%) down from the US$923 per metric tonne in fiscal 2005. In Euro terms average prices per metric tonne were 1.1% lower.

For Sappi Fine Paper South Africa, sales increased by US$2 million (0.6%) to US$325 million in fiscal 2006. Based on average sales, the impact of the additional accounting week in fiscal 2005 was US$6 million additional sales in fiscal 2005. The increase is primarily attributable to higher average selling prices realised in ZAR terms (US$9 million) and increased volumes (US$11 million), being partly offset by the decrease due to currency translation effect (US$18 million). The average price realised for fine paper products in South Africa in US$ terms decreased by 2.8% to US$991 per metric tonne in fiscal 2006 as a result of the currency translation effect, while in ZAR terms, the average price realised in fiscal 2006 increased by 2.9% as a result of reduced pressure from imports into South Africa and by the ZAR weakening against the US$. The weakening of the currency also resulted in better margins in ZAR terms on export sales in fiscal 2006.

Sappi Forest Products:.

	Fiscal 2006	2005	Variance Value	%
	Tonnes 000			
Sales Volume				
Pulp and Paper	1,470	1,565	(95)	(6.1)
Timber and Timber Products	1,525	1,737	(212)	(12.2)
Total Volume	**2,995**	**3,302**	**(307)**	**(9.3)**
Impact of Additional Accounting Week		**62**	**(62)**	
	US$ Millions			
Sales Value				
Pulp and Paper	896	908	(12)	(1.3)
Timber and Timber Products	87	90	(3)	(3.3)
Total Value	**983**	**998**	**(15)**	**(1.5)**
Impact of Additional Accounting Week		19	(19)	

Total sales volumes, for Sappi Forest Products, decreased 9.3% to 3.0 million tons in 2006. The volume of timber sold decreased by 212,000 metric tonnes (12.2%) and the volume of paper pulp sold decreased by 27.6%, due to the additional accounting week in fiscal 2005 as well as operational performance issues in 2006, while chemical cellulose volumes were 3.5% higher, despite the additional accounting week in fiscal 2005. The impact of the additional accounting week in fiscal 2005 was 62,000 metric tonnes (US$19 million), based on average sales. Sappi Forest Product s total sales decreased by US$15 million (1.5%), to US$983 million in fiscal 2006, from US$998 million in fiscal 2005. This decrease is attributable mainly to the currency effect (US$55 million) and decreased volumes (US$63 million), partly reduced by increased selling prices in ZAR terms and mix (US$103 million). The average price for chemical cellulose increased by 3.0% in fiscal 2006, mainly due to higher international pulp prices. The higher average prices at Sappi Forest Products, are mainly attributable to improved product mix and higher international pulp prices in 2006. The product mix improvement mainly reflects the decrease in timber product sales (212,000 metric tonnes) and increase in chemical cellulose sales. Chemical cellulose sales increased 16.2% in fiscal 2005 of total Sappi Forest Products sales volume to 18.5% in fiscal 2006. Timber and timber product sales volume decreased from 52.6% in fiscal 2005 to 51.0% in fiscal 2006. In fiscal 2006 the average selling price of chemical cellulose was US$692 per metric tonne and that of timber and timber products US$56 per metric tonne. International pulp prices (NBSK: US$583 per metric tonnes) were US$128 per metric tonne higher than at the end of 2005, which benefited both chemical cellulose and paper pulp sales. Export sales margins in local currency, especially chemical cellulose sales which are all exported, benefited from the weakening of the ZAR against the US$.

Operating Expenses

Group operating expenses (comprising cost of goods sold, SG&A expenses and other expenses) decreased by US$311 million (6.1%) to US$4,816 million in fiscal 2006. An analysis of group operating expenses is as follows:

	2006 US$ million	%	2005 US$ million	%	Variance US$ million	%
Total Operating Costs						
Delivery	441	9.2	451	8.8	(10)	(2.2)
Material Costs	2,516	52.2	2,426	47.3	91	3.7
Manufacturing Costs	1,428	29.7	1,602	31.2	(174)	(10.9)
Silvicultural Costs	43	0.9	45	0.9	4	10.3
SG&A	366	7.6	363	7.1	3	0.8
Inventory Revaluation			13	0.3	(13)	(100.0)
Impairment	9	0.2	229	4.5	(220)	(96.1)
Restructuring	43	0.9	22	0.4	21	95.5
Other	(30)	(0.7)	(24)	(0.5)	(13)	71.9
	4,816	**100**	**5,127**	**100**	**(311)**	**(6.1)**

Cost of goods sold decreased by US$87 million, reflecting the positive impact of the US$114 million currency effect and US$74 million volume decrease impact being partly offset by the negative impact of US$79 million raw material and energy cost increases and US$22 million adverse fair value pricing adjustment. Major cost drivers during 2006 were price increases of wood (US$32 million), energy (US$83 million) and pulp (US$38 million), partly offset by volume reductions. Selling, general and administrative expenses (SG&A) increased by US$3 million. The impact of the additional accounting week in 2005 was an additional US$85 million cost of goods sold and US$7 million additional SG&A costs, based on the average weekly costs in fiscal 2005. We have been vigilant in controlling costs and offsetting cost increases where possible.

Group fixed costs for the year decreased US$194 million (10%) compared to the previous year. The decrease in fixed costs was mainly due to the one less accounting week, decreased personnel costs (US$93 million), decreased maintenance costs (US$25 million) and decreased depreciation (US$28 million). The impact of the additional accounting week in fiscal 2005, based on average weekly expense, was US$37 million.

Other expenses decreased US$229 million mainly due to the non-reoccurrence of fiscal 2005 impairment charges of US$229 million, impairment charges in fiscal 2006 were US$9 million. In 2006 the benefit of the reversal of the Usutu Mill impairment (US$40 million), in terms of IAS 36, was offset by restructuring charges in Europe (US$40 million).

Operating expenses for Sappi Fine Paper North America decreased by US$262 million, primarily as a result of decreased other expenses (US$207 million) and partly as a result of decreased raw material costs (US$32 million) for chemicals, energy and wood costs and decreased SG&A costs (US$21 million). The reduction in other expenses relates mainly to a reduction in impairment and restructuring charges (US$203 million) and SG&A costs decreased mainly due to a release of a pension fund provision (US$18 million). The impact of the additional accounting week in fiscal 2005 was US$32 million, based on average weekly costs.

Operating expenses for Sappi Fine Paper Europe increased US$66 million (3.1%). The benefit of the currency translation (US$53 million) and one less accounting week (US$37 million) was offset by increased volumes (US$18 million), raw material (US$40 million) and energy (US$52 million) cost increases and restructuring charges (US$40 million). Raw material cost increases were due to timber (US$15 million) and pulp (US$32 million).

Operating expenses for Sappi Fine Paper South Africa remained flat in US$, but increased 6.0% in ZAR. The currency translation benefit (US$17 million) was offset by increased volumes (US$10 million) and increased costs (US$8 million).

Operating expenses for Sappi Forest Products decreased US$107 million (11.7%) The benefit of the currency translation (US$43 million), volume decrease (US$95 million), decreased SG&A (US$5 million) and decreased other expenses (US$87 million) was partly offset by operating cost increases (US$102 million) and fair value pricing adjustment (US$22 million). Other expenses reduced mainly as a result of the Usutu mill impairment charge (US$50 million) in fiscal 2005 being partially reversed in fiscal 2006 (US$40 million).

SG&A, which is included in the group operating expenses discussed above, increased by US$3 million (0.8%) to US$366 million in 2006. SG&A costs were favourably impacted by sales of emission credits at Sappi Fine Paper Europe (US$7 million), reversal of a Pension Fund Provision in Sappi Fine Paper North America (US$18 million), the result of the currency effect (US$16 million) and US$6 million impact due to the extra accounting week in 2005, based on average weekly expenses.

Other expenses which are included in the group operating expenses described above represent all profit and expenditure relating to activities outside what is regarded as normal trading. Other expenses of US$30 million in 2006 (US$259 million in 2005) relates mainly to significantly lower asset impairment charges of US$9 million (US$229 million in 2005) and increased restructuring charges of US$43 million (US$22 million in 2005), partly offset by the reversal of a impairment of Usutu mill at Sappi Forest Products (US$40 million). The US$229 million asset impairment charges in 2005 related mainly to our North American Muskegon Mill (US$183 million) and our Southern African Usutu Mill (US$50 million). The restructuring charges of US$43 million in 2006 relate mainly to a specific operating expense reduction and efficiency improvement project in Sappi Fine Paper Europe (US$47 million), partly offset by the reversal of a provision (US$4 million) in Sappi Fine Paper North America, no longer required.

Group operating expenses per metric tonne decreased by US$17 (2.5%) to US$669 in fiscal 2006 from US$686 per metric tonne in fiscal 2005. The decrease of 2.9% was largely the result of the non-reoccurrence of the Muskegon and Usutu impairment charges (US$32 per metric tonne or 4.7%), the currency translation effect (US$16 per metric tonne or 2.6%) as well as lower raw materials and energy costs (US$2 per metric tonne or 0.3%).

At our North American operations the operating expense were US$1,198 per metric tonne in 2006 compared to US$1,020 in 2005, with the impact of the impairment charges in 2005 were US$128 per metric tonne. At our European operations the operating expenses were US$907 per metric tonne in 2006 compared to US$888 in 2005, mainly due to restructuring charges and increased material costs. At our Fine Paper Southern Africa operations the operating expenses were US$1,009 per metric tonne in 2006 compared to US$1,054 in 2005. At our Forest Products operations the operating expenses were US$270 per metric tonne in 2006 compared to US$277 in 2005, the impact of the Usutu mill impairment charge in 2005 accounting for US$14 per metric tonne.

Operating Loss/Profit

Group operating income amounted to US$125 million in 2006, compared to an operating loss of US$109 million in 2005. The operating loss of our Fine Paper division decreased by US$137 million; and Forest Products operating profit increased by US$92 million.

The group operating margin was positive 2.5% compared to negative 2.2% in 2005. This reflects the effect of the non-reoccurrence of the impairment charges (US$233 million) in 2005 and the reversal of the Usutu mill impairment of US$40 million in 2006.

Sappi Fine Paper. Operating loss for Sappi Fine Paper decreased by US$137 million to a loss of US$49 million in 2006 primarily due to decreased operating losses at Sappi Fine Paper North America (US$243 million) and Sappi Southern Africa (US$5 million), partly offset by a US$111 million decrease in operating income to a loss of US$27 million at Sappi Fine Paper Europe in 2006. Operating margin was for Sappi Fine Paper negative 1.2% in 2006 as compared to negative 4.6% in 2005.

Sappi Fine Paper North America incurred operating losses of US$16 million in 2006 and US$259 million in 2005. This improvement in 2006 is mainly due to the non-reoccurrence of the Muskegon impairment charge (US$183 million) and restructuring charges (US$22 million) in 2005 and the pension provision release (US$18 million) in fiscal 2006, partly offset by the impact of lower selling prices (US$18 million) and higher raw material and energy costs (US$32 million) in 2006.

Sappi Fine Paper Europe operating profit decreased by US$111 million to a loss of US$27 million in 2006. Operating margin decreased to negative 1.2% in 2006 from positive 3.8% in 2005. The decrease was mainly attributable to increased raw material and energy cost (US$47 million), reduced sales due to currency and pricing (US$66 million) and increased restructuring charges (US$40 million), partly offset by the benefit of increased sales volumes (US$21 million).

Sappi Fine Paper South Africa operating loss decreased US$5 million to a loss of US$6 million; in 2006. The improvement was mainly attributable to pricing (US$9 million), partly offset by increased costs.

Sappi Forest Products. Sappi Forest Products operating profit increased by US$92 million to US$175 million in 2006. The increase was mainly due to improved volume, pricing and mix (US$135 million), reduced SG&A costs (US$14 million), reduced other expenses (US$87 million), mainly impairment reversal, partly offset by increased operating costs (US$102 million), adverse fair value pricing adjustment (US$22 million) and the impact of currency translation (US$12 million). US$40 million of the Usutu impairment charge (US$50 million) in 2005 was reversed in 2006. Operating margin was 17.7% in 2006, compared to 8.3% in 2005.

Corporate. Corporate operating expenses decreased by US$5 million.

Net Finance Costs

Net finance costs consists of gross interest and other finance costs net of interest received, interest capitalised, foreign exchange gains and losses and change in fair value of financial instruments. Net finance costs were US$130 million in 2006 compared to US$80 million in 2005. Gross interest cost remained largely unchanged from 2005, increasing by US$1 million to US$162 million. Net interest-bearing debt of US$2,113 million in 2006 increased by US$105 million compared to US$2,008 million in 2005. Net finance costs also included fair value adjustments for which 2005 included gains of US$13 million due to an accounting mismatch, as a result of our inability to apply hedge accounting in respect of interest rate swaps during the third quarter in 2005. As a result of IFRS adoption, the prior year was restated by a US$22 million gain due to cash flow hedges, previously accounted for in equity no longer qualifying for hedge accounting under IAS 39. These instruments are now recognized at fair value through profit and loss.

Cash interest cover (cash generated by operations divided by net finance costs (before capitalised interest)) decreased to 3.6 times in 2006 compared to 7.1 times for 2005. The decrease in 2006 is mainly due to lower cash generated by operations as well as higher net finance costs as a result of the fair value adjustments, which were gains in 2005.

Finance costs capitalised were US$2 million in 2006 and US$1 million in 2005. Finance costs capitalised relate primarily to the capitalised interest on major projects under construction.

Taxation

The 2006 taxation credit was taxation credit of US$1 million in fiscal 2006, compared to a credit of US$5 million in fiscal 2005. The effective taxation rate this year was 14.9% (2.8% in 2005). Despite the loss in fiscal 2006, the decrease in the taxation benefit and the increase in the effective taxation rate in fiscal 2006 were primarily as a result of taxation losses carried forward, arising in North America and Austria, not being recognized under applicable accounting rules. Our North American operations, where the nominal taxation rate is 39.5%, reported a net loss before taxation of US$79 million, with the Austrian operations reporting a loss of US$87 million. In addition a provision for Secondary Tax on Companies (STC) of US$9 million, being 12.5% of dividends declared, was provided. Tax risk provisions to the value of US$13 million have been raised in Europe. Offsetting the negative consequences of losses not being tax relieved and the risk provisions raised was the release of risk provisions against matters which have now been finalised and settled, the recognition of taxation assets in Belgium and the effect of the Usutu impairment reversal not being tax effected, due to the prior non-recognition of the deferred tax asset.

The effective taxation rate of 2.8% in fiscal 2005 was primarily affected by the net loss before taxation of US$327 million for Sappi Fine Paper North America not being fully recognized and the non-relief of the impairment charges relating to the Usutu mill. This was, however, partially offset by tax rate reductions in the Netherlands and South Africa.

Taxation 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 taxation liabilities of legal entities trading in such jurisdictions are calculated in accordance with group taxation principles. In certain cases entities are subject to taxation in more than one jurisdiction. Where the entity is entitled to a corresponding taxation credit in the country of fiscal residence, this entitlement is reflected in the taxation charge. Should there not be any entitlement to a taxation credit, the foreign taxation paid is included as part of the taxation 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 24.4 to our Group annual financial statements included elsewhere in this Annual Report.

Sappi International S.A. (SISA) our group treasury, operates in Belgium under a co-ordination centre license granted by the Belgium government that includes an alternative method of calculating the taxation liability of the co-ordination centre. This license was renewed in July 2003 and it is our current understanding that this license will be renewed until the end of 2010. The Belgian government 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. This will apply to Sappi once the co-ordination centre status expires and will result in similar benefits.

Sappi accounts for taxation using the undistributed taxation rate for IFRS and using the distributed rate for US GAAP. This is reflected as a reconciling item in the annual financial statements (refer note 35 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 US$18 million (fiscal 2005 US$31 million). Deferred tax assets are recognised for unused STC credits to the extent that they will be utilised in the future. 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%. 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 Secondary Tax on Companies (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 IFRS 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 20% of the total equity shares and voting rights) in the foreign company declaring the dividend, however certain dividends are excluded from this exemption in terms of 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 R2,500 of such income (the exemption is firstly to be applied to foreign dividends and only if they do not exceed R2,500, the excess is to be applied to foreign interest). There is also an exemption applicable to the first R16,500 of the aggregate of any interest received from local sources and any dividends which are not exempt from tax (other than foreign dividends), however, this exemption will be reduced by the amount of the exemption which may be applicable to foreign interest or dividends referred to above.

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. 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

Net loss decreased to US$4 million in 2006 from a net loss of US$184 million in 2005, primarily due to the non-reoccurrence of the Muskegon and Usutu impairment charges of US$233 million pre-tax. Lower selling prices, higher raw material and energy costs, especially in our North American and European operations continue to place margins under pressure. A weakening of the Euro and ZAR against the US$ impacts margins of our European and southern African businesses favourably. Restructuring charges in Europe were partly offset, in fiscal 2006, by the reversal of impairment of our Usutu Mill at Sappi Forest Products.

Basic loss per share decreased to a loss of 2 US cents per share in 2006, from a loss per share of 81 US cents per share in 2005.

Liquidity and Capital Resources

Operations

Cash retained from operating activities amounted to US$228 million in 2006 compared to US$301 million in 2005.

During 2006 we generated cash from operations of US$464 million compared to US$569 million in 2005, a reduction of US$105 million in cash generated compared to 2005. Although operating profit (US$125 million) improved by US$234 million as against 2005 operating loss (US$109 million), the improvement in operating profit relates mainly to, non-cash, impairment charges of US$229 million in 2005 becoming a reversal of US$31 million in 2006. Cash generated was reduced by finance costs paid (net of interest income) of US$138 million (US$11 million more than 2005), taxation paid of US$13 million (US$30 million less than 2005) and also by US$17 million cash being utilised by working capital (2005 utilised US$30 million).

Total non-cash items in 2006 amounted to US$339 million, which was US$339 million lower than the US$678 million in 2005, and included:

	2006	**2005**
	US$ million	
Depreciation	390	422
Fellings & Amortisation	76	68
Asset Impairments, Mill Closure & Non-cash items	(127)	188
	339	678

The changes in other non-cash items were as follows:

	2006	**2005**	**Variance**
	US$ million		
Fair Value Pricing adjustment	(104)	(118)	14
Asset (Reversals)/Impairments	(31)	236	(267)
Other	8	70	(62)
Other Non-Cash Items	**(127)**	**188**	**(315)**

- The fair value pricing adjustment was lower because of the impact of cost escalations in fiscal 2006, mainly due to the impact of the oil price.

- The 2005 impairment charges related mainly to the Sappi North American Muskegon and Forest Products Usutu mills. The Usutu impairment was partially reversed in 2006 (US$40 million).

- Depreciation and felling charges were lower due to the effect of one less accounting week (US$9 million), currency translation effect (US$14 million).

The increase in 2006 in working capital of US$17 million compared to a US$30 million increase in 2005, consisted of:

- A decrease in accounts payable (US$12 million). The decrease in payables consisted mainly of a decrease in payables at Sappi Fine Paper Europe (US$20 million), partly offset by an increase at Sappi Fine Paper Southern Africa (US$5 million).

- A minimal increase in receivables (US$3 million).

- A US$3 million increase in inventories related mainly to increases at our Sappi Fine Paper Europe (US$8 million) and Sappi Fine Paper South African (US$15 million) operations, partly offset by decreases at our North American (US$15 million) and Forest Products (US$2 million) operations.

The increase of US$11 million in finance costs paid in 2006 was primarily due to increased levels of average borrowings and higher interest rates paid on borrowings.

Taxation paid of US$13 million in 2006 was US$30 million lower than 2005.

Investing

Cash utilised in investing activities was US$355 million in 2006 and US$379 million in 2005. Cash utilised in investing activities in 2006 related primarily to capital expenditure on non-current assets of US$303 million, increased pension and other post retirement payments (US$68 million), partly offset by proceeds on non-current asset disposals (US$4 million) and a decrease (US$12 million) in investments and loans. Increased pension and other post retirement payments were mainly at Sappi Fine Paper Europe (US$13 million) and Sappi Fine Paper North America (US$43 million).

Cash capital expenditure increased to US$303 million in 2006 from US$294 million in 2005. The lower cash capital expenditure of US$9 million in 2005 was impacted by currency movements of US$11 million. The US$303 million spent in 2006 consisted of US$160 million (US$183 million in 2005) relating to expenditure to maintain operations and US$143 million (US$111 million in 2005) of expenditure to expand operations.

The capital expenditure of US$143 million in 2006 to expand operations primarily consisted of:

- Expenditure of US$81 million at our Sappi Fine Paper Europe operations, relating mainly to process improvements, particularly at the Ehingen mill (US$65 million). The purpose of the Ehingen investment was to enable the mill to move from a single to a multi-coated product.

- Expenditure of US$61 million at our Sappi Forest Product operations, relating mainly to process de-bottlenecking at Saiccor (US$17 million), initial expenditure on the major capacity increase project at Saiccor (US$32 million), a product improvement project at Usutu mill (US$3 million) and various other process improvement projects.

- Expenditure of US$1 million at our Sappi Fine Paper Southern Africa operations.

Our capital expenditure programme varies from year to year, and expenditure in one year is not necessarily indicative of future capital expenditure.

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

- Projects at our European operations amounting to US$58 million, including the replacement of operating equipment and finishing house automation of US$14 million at our Gratkorn mill and US$11 million on the rebuild of our Ehingen mill.

- US$27 million at our Forest Product division, including US$18 million on de-bottlenecking at Saiccor mill.

- Expenditure of US$26 million at our North American operations, including US$17 million at the Cloquet mill on product improvements and cost reductions.

Financing

At September 2006 our gross debt, which is all interest-bearing borrowings plus overdraft, decreased to US$2,337 million, from US$2,375 million last year. Cash and cash equivalents of US$224 million in 2006 decreased by US$143 million from last year, primarily due to the dividend payment (US$68 million) and the repayment of loans in 2006. Our net debt, which is gross debt less cash and cash equivalents, at September 2006 increased by US$105 million to US$2,113 million from US$2,008 million last year, of

which US$28 million was a result of currency movements and fair value adjustments. At the end of 2006, the ratio of net debt to total capitalization was 46%, up from 41% at the end of 2005.

The currency profile of our gross debt at the end of 2006 and 2005 is detailed below:

	September 2006 US$ million	**% of total**	**September 2005 US$ million**	**% of total**
US Dollar	1,125	48.1	1,012	42.6
Euro & Swiss Franc	933	39.9	1,105	46.5
South African ZAR	279	12.0	258	10.9
Total	2,337	100.0	2,375	100.0

Debt is preferably taken up in the functional currency of the borrowing entity. Where external loans are raised in currencies other than the domestic operating currency of the entity to which the funds are applied, the currency exposure is covered by forward exchange contracts or currency swaps.

The increased proportion of South African debt in 2006 is mainly the result of increased capital expenditure.

The maturity profile of our gross debt at the end of 2006 and 2005 is detailed below:

	September 2006 US$ million	**% of total**	**September 2005 US$ million**	**% of total**
2006			775	32.6
2007*	703	30.1	141	5.9
2008	66	2.8	65	2.7
2009	10	0.4	11	0.6
2010	62	2.7	67	2.8
2011(2005 Thereafter)	553	23.7	1,316	55.4
Thereafter	943	40.3		
Total	2,337	100.0	2,375	100.0

* Included in the US$703 million reflected as payable in 2007 is US$347 million debt relating to securitisation funding which has the character of a revolving facility.

The maturity profile of our debt with an average time to maturity of 7.6 years reflects the long-term nature of our assets (2005: 8.4 years).

We have a policy of maintaining a balance between fixed 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 by currency to reflect more accurately the relevant interest rate environments. 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 market. At the end of 2006, 40.2% of our gross debt was at fixed rates compared to 35.3% in 2005. See note 31 to our Group annual financial statements.

In June 2002, SPH issued US$500 million 6.75% Guaranteed Notes due 2012 and US$250 million 7.50% Guaranteed Notes due 2032 (the Notes), both fully and unconditionally guaranteed on an unsecured basis by each of Sappi Ltd and SISA. The interest on the Notes is payable semi-annually on June 15 and December 15 of each year, which commenced on December 15, 2002.

In August 2005, Sappi Papier Holding GmbH (SPH) raised a facility of US$54 million from OeKB, repayable in two tranches. Tranche A (OeKB A tranche) of US$16 million is repayable in a single repayment in March 2007 and Tranche B (OeKB B tranche) of US$38 million in a single repayment in

June 2010. The OeKB A tranche and the OeKB B tranche attract interest at an agreed fixed rate of 4.53%. Interest is payable quarterly in arrears on both tranches. The proceeds were used to pay for Sappi s equity participation in the Jiangxi Chenming joint venture.

In June 2005 SPH raised a new revolving credit facility of 600 million, with a maturity date of June 2010. The previous syndicated loan facility of 562.5 million raised in 2001, at our disposal until July 2006, was replaced with this new facility. The early replacement of the syndicated loan facility, 12 months prior to maturity, was undertaken to improve the terms and conditions of the replacement facility, specifically pricing of the margin and the commitment fee, and also to ensure continuity in the long-term nature of this facility. The funding margin under the new revolving credit facility is determined by a rating grid and based on our current credit rating attracts a margin between 60 and 67.5 basis points over EURIBOR, depending on the level of utilisation. This new revolving credit facility is to be used for general corporate purposes and was utilized to the extent of US$131.9 million at the end of 2006 (unutilised at the end of 2005).

Sappi Manufacturing took up a public bond of ZAR1 billion (approximately US$129 million) during fiscal 2006, at a fixed rate of 9.34%, repayable in June 2013. The bond was raised primarily to replace other maturing debt.

In previous years our banking covenants were calculated at the combined level of SPH and Sappi International S.A. During 2005 this was changed to measure the covenants at the consolidated Sappi Limited level, following the issuance in 2005 of a Sappi Limited guarantee for the long-term borrowings of the SPH/Sappi International S.A. 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 and covenants that apply to our major credit agreements. The covenants are not subject to any rating triggers, however ratings impact our interest rates.

The Group has adequate cash on hand and short and long-term banking facilities to meet its short-term commitments. At the end of 2006, Sappi s divisions had aggregate unused borrowing facilities available of US$1,069 million (US$134 million in South Africa, US$935 million in Europe) (2005: US$1,229 million) of which US$654 million is committed (2005: US$753 million). In addition, at the end of September 2006 the group had cash and cash equivalents on hand of US$224 million (2005: US$367 million).

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 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 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 mainly to finance working capital.

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Off-Balance Sheet Arrangements

We have entered into certain asset-related finance arrangements for which various obligations, which are significant, and related assets are not included in our Group annual financial statements under IFRS. These Off-Balance Sheet Arrangements include lease arrangements described in note 26, securitisation facilities described in note 17 and an equity accounted investment described in note 14, 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 US$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 January 29, 2008 for the original purchase price multiplied by a factor of 50.1%. 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 in note 26 to the group annual financial statements.

In 1982 a cogeneration facility was installed adjacent to our Westbrook mill at a cost of US$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 in note 26 to the group annual financial statements.

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. Following our first-time adoption of IFRS in 2006, the majority of these receivables are now reflected on our balance sheet with the exception of the southern Africa receivables. The funds received are reflected as interest-bearing borrowings (refer note 21). This accounting treatment is in-line with the strict derecognition criteria introduced through amendments to IAS 39 Financial Instruments .

In the southern African region the sale of receivables to iNdwa Investments Limited is not reflected on-balance sheet. The key difference in the securitisation programme in this region is that there are no first tier loss provisions which reduce the bank s credit risk. In this region 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. The total amount of trade receivables sold and derecognised at the end of fiscal 2006 amounted to US$107 million (fiscal 2005: US$129 million).

If this securitisation facility was to be terminated, we would discontinue further sales of trade receivables and would not incur any losses in respect of receivables previously sold. 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. 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 impairment of accounts receivable has been recorded for any receivables which may be un-collectable. The determination of this allowance is restricted to the 15% risk retained by Sappi.

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 Timberlands LLP, in exchange for cash of US$3 million and three promissory notes receivable in the aggregate amount of US$171 million. In 1999, the Company contributed these promissory notes to a special purpose entity (SPE). The promissory notes were pledged as collateral for the SPE to issue bonds to investors in the amount of US$156 million. In 2001, the Company contributed its interest in the SPE to a limited liability company in exchange for 90% of the outstanding limited liability membership interest. All voting control of the limited liability company is controlled by an unrelated investor that has significant capital at risk and therefore has not been consolidated by the Company in its financial statements. 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 Company s investment in the SPE is US$19 million as of October 1, 2006.

The SPE may not be liquidated prior to repayment of the bonds it issued, which mature in three tranches on February 11, 2007, February 11, 2009, and February 11, 2011. The Company may not redeem its investment in the SPE (via its ownership interest in the limited liability company) prior to complete repayment of the bonds issued by the SPE and our investment has a subordinate interest to the payment of the outstanding bonds. 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 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 Timberlands LLP notes being reflected on 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.

Capital Expenditures

Capital expenditures in 2006 and 2005 consisted of the following:

	September 2006 US$ million	**September 2005 US$ million**
Sappi Fine Paper		
Sappi Fine Paper North America	**48**	**90**
Sappi Fine Paper Europe	**136**	**124**
Sappi Fine Paper South Africa	**19**	**27**
Total	**203**	**241**
Sappi Forest Products	**99**	**101**
Corporate	**1**	**3**
Consolidated Total	**303**	**345**

Of the US$303 million of capital expenditure in 2006 (2005: US$345 million), approximately US$160 million were investments to maintain operations (2005: US$183 million) and US$143 million were investments to expand operations. The capital expenditure to expand operations during 2006 included major projects at Sappi Fine Paper Europe US$81 million, Sappi Forest Products US$61 million, and

Sappi Fine Paper North America US$1 million. Total capital expenditure amounted to 77% of depreciation in 2006. Capital expenditure to expand operations in fiscal 2006 was US$143 million (US$111 million in 2005). Capital expenditure to expand operations primarily consisted of investments at Sappi Fine Paper Europe related mainly to process improvements, particularly at the Ehingen mill (US$65 million). The purpose of the Ehingen investment was to enable the mill to move from a single to a multi-coated product. The investments at Sappi Forest Products related mainly to process de-bottlenecking at Saiccor (US$17 million), initial expenditure on the major capacity increase project at Saiccor (US$32 million) and various other process improvement projects. 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. Due to cash flow restrictions during fiscal 2006 capital expenditure was intentionally curtailed. Capital spending for the Sappi Group during 2007 is not expected to exceed depreciation, including the proposed expansion of the Sappi Forest Products Saiccor mill. Capital spending is expected to be funded primarily through internally generated funds. For further details about our capital commitments, see note 26 to our Group annual financial statements included elsewhere in this Annual Report.

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 2006 and fiscal 2005 amounted to approximately US$160 million and US$183 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 US$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 US$525 million on the Cloquet mill during the period 1993 to 2000, resulting in a substantially new pulp mill.

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 2006 that can be quantified.

	Payments Due by Period				
	Total	**Less than 1 year**	**1 - 3 years**	**3 5 years**	**More than 5 years**
	(US$ millions)				
Long-Term Debt Obligations(1)	2,286	687	61	612	926
Capital Lease Obligations(1)	42	7	14	4	17
Operating Lease Obligations(2)	235	54	77	45	59
Purchase Obligations(3)	56	24	27	5	
Other Long-term Liabilities Reflected on Balance Sheet(4)	472				
Group Total	3,091	772	179	666	1,002

(1) Refer to note 21 of our Group annual financial statements included elsewhere in this Annual Report.

(2) Operating leases are future minimum obligations under operating leases. Refer to note 26.

(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) The Other Long-Term Liabilities of US$472 million (fiscal 2005 US$577 million) on balance sheet, relate mainly to post-employment benefits, post-retirement benefits other than pensions obligations, workmen s compensation, and other items which do not have a payment profile. Refer to note 22 of our Group annual financial statements included elsewhere in this Annual Report.

Share Buy Back

Following an initial approval of our shareholders, on December 15, 2000, of purchases by our subsidiaries of Sappi ordinary shares, further approval to purchase was obtained at the annual general meeting of shareholders held on 6 March 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 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 2005, is approximately 19.4 million shares (or approximately 8.1% of our issued shares) at an average price of US$9.61 (ZAR74.55) per share, of which 7.0 million shares had been utilised by the Sappi Limited Share Incentive Trust to meet its obligations. During 2005 we acquired approximately 1.3 million shares for a total consideration of approximately US$15.9 million. We held approximately 13.2 million treasury shares (or approximately 5.5% of our issued shares) at the end of 2005. On December 6, 2006, the closing price for our shares on the JSE was 11,425 SA cents per share and the closing price of the ADSs on the NYSE was US$16.09 per ADS. No shares were acquired during 2006.

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

In 2006, Sappi Limited declared dividends in respect of ordinary shares of 30 US cents per share (2005: 30 US cents per share).

We aim to declare annual dividends, which, over time, incorporate real growth for shareholders. To this end, dividend cover in each year will vary in line with changes in the business cycle, but our current intention is to maintain a long-term average of three times net profit. Notwithstanding our inability to meet this target in recent years, we remain committed to this policy in the longer term.

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

Usutu impairment reversal. During the first quarter of 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 an impairment charge of US$50 million in 2005. During the fourth quarter of 2006 the impairment of Usutu mill was reversed, in terms of IAS 36, because, as a result of improved pulp prices, weakening of the ZAR against the US$, improved economic conditions and improved operational performance, profitability has improved. Demand for the mills product has improved as international pulp prices improved as the differential between bleached and unbleached pulp prices widens resulting in unbleached capacity reverting back to bleached pulp production. The improved international pricing and improved product quality have resulted in improved pricing and the weakening of the local currency against the US$ is improving margins in local currency as costs are mainly local currency denominated. The impairment reversal for the year was US$40 million.

Nash Mill Closure. In May 2006 paper production at our Nash mill was stopped. The mill had been suffering from escalating costs, especially energy, which made it uncompetitive. The plant and equipment has been scrapped or transferred within the Group. The product previously manufactured at the mill is now produced elsewhere in the Group. The land and buildings are currently available for sale and are expected to be sold by the end of the next financial year. The assets are held in the Sappi Fine Paper Europe. The closure resulted in an impairment charge of US$2 million. An initial impairment charge of US$3 million was taken during fiscal 2005.

Restructuring. During 2006 Sappi Fine Paper Europe undertook a major cost reduction and productivity improvement project which will result in a headcount reduction of 650 employees mainly throughout 2007. This project resulted in a restructuring charge of US$40 million in quarter four of 2006.

Muskegon impairment. During the third quarter of fiscal 2005 we announced the impairment of our North American Muskegon mill, and recorded impairment charges of US$183 million in fiscal 2005. During fiscal 2006 impairment charges of US$4 million were incurred. 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 2004 we acquired 34% of Jiangxi Chenming Paper Company Limited (Jiangxi Chenming) in a joint venture with Shandong Chenming Paper Holdings Limited (Shandong Chenming) (51%), Moorim Paper Manufacturing Company Limited of South Korea (7.5%), and the International Finance Corporation (IFC) (7.5%). Our equity contribution was approximately US$60 million.

The mill has an annual capacity of 350,000 metric tons 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 US$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 US$50 million in long-term debt for its own account.

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 under funded status of the Company s pension plans decreased by US$139 million from the deficit of US$367 million as of September 2005 to a deficit of US$228 million as of September 2006. Post-retirement benefit liabilities (other than pension) decreased US$14 million to US$164 million from US$178 million as at September 2005.

Benefit obligations and fair value of plan assets across the regions are as follows:

	September 2006 Benefit Obligation (US$ in million)	Fair value of plan Assets	September 2005 Benefit Obligation	Fair value of plan assets
Pensions	**1,513**	**1,285**	**1,589**	**1,222**
The South African Surplus Recognition Restriction	**41**		**(6)**	
Post-retirement Benefits Other than Pensions	**164**		**178**	

Actual returns for the various regional pension funds during 2006 were significantly better than actuarial projections, which improved asset levels as of September 2006. Discount rates in funds have been adjusted upwards, reflecting higher prevailing interest rates. The higher discount rates across the regions decreased liabilities by US$76 million, thereby having a positive effect on the funded status of the Group s plans from September 2005 to September 2006.

The key assumptions used to compile plan assets and liabilities at September 2006 were as follows:

	Europe 2006 %	2005 %	North America 2006 %	2005 %	United Kingdom 2006 %	2005 %	South Africa 2006 %	2005 %
Discount rate	4.50	3.68	5.75	5.50	5.00	5.00	8.50	8.10
Return on assets	5.50	5.19	8.25	8.25	5.75	5.75	10.50	9.71
Salary increase	3.04	2.99	3.50	3.50	4.00	4.00	6.00	5.49

A 1% increase in discount rates would decrease the pension liability by approximately US$220 million and the related pension expense by approximately US$16 million per annum.

A 1% increase in the healthcare cost trend rates would increase the accumulated other post-retirement benefit obligation by US$13 million and the aggregate of the service and interest cost components of net periodic other post-retirement benefit expense by US$2 million after tax per annum.

The South African pension fund is, from 2005, closed to new employees. Due to uncertainties in interpretation of the South African pensions legislation, the surplus in the South African fund cannot be recognized.

For further information see notes 28 and 29 to our Group annual financial statements.

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 subject to regular risk assessments, the results of which receive the attention of senior management. The risk assessment and mitigation programmes are co-ordinated at Group level in order to achieve a harmonisation of methodology.

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 bulk of the insurance is placed with its own captive insurance company, Lignin Insurance Company Limited, which in turn reinsures the vast majority of the risk with third-party insurance companies.

Sappi has successfully placed the renewal of its 2007 insurance cover at rates lower than 2006. Self-insured retention for any one property damage occurrence has remained at US$25 million, with an unchanged annual aggregate limit of US$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 US$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

Our Group financial statements have been prepared in accordance with IFRS. The preparation of financial statements in conformity with IFRS 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 judgment 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 and/or the potential material impact they may have on the groups financial position and performance.

Asset impairments. The group periodically evaluates its long-lived assets for impairment, including identifiable intangibles and goodwill, whenever events or changes in circumstance indicate that the carrying amount of the asset may not be recoverable. Our judgements regarding the existence of 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, changes in the planned use of machinery or equipment or closing of facilities. The calculation of appropriate pre-tax discount rates (weighted average cost of capital) is another sensitive input to the valuation. While every effort is made to make use of independent information and apply consistent methodology, 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 judgments described in the preceding paragraph that are necessary in estimating future cash flows, significant judgments in estimating discounted cash flows also include the selection of the pre-tax 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.

Property, plant and equipment. Property, plant and equipment represents tangible items and intangible items that are integrated with tangible items that are held-for-use in the production or supply of goods or services, for rental to others, or for administrative purposes and are expected to be used during more than one period.

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Cost includes the estimated cost of dismantling and removing the assets, where specifically required in terms of legislative requirements or a constructive obligation exists.

Owner-occupied investment properties and properties in the course of construction are carried at cost, less any impairment loss where the recoverable amount of the asset is estimated to be lower than its carrying value. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group s accounting policy. Depreciation commences, on the same basis as other property assets, when the assets are ready for their intended use. The Group currently does not hold any investment properties.

Subsequent expenditure is capitalised when it is measurable and will result in probable future economic benefits. Expenditure incurred to replace a component of an item of owner-occupied property or equipment is capitalised to the cost of the item of owner-occupied property and equipment and the part replaced is derecognised. All other expenditure is recognised in profit or loss as an expense when incurred.

Depreciation is charged so as to write off the depreciable amount of the assets, other than land, over their estimated useful lives to estimated residual values, using a method that reflects the pattern in which the asset s future economic benefits are expected to be consumed by the entity.

Where significant parts of an item have different useful lives to the item itself, these parts are depreciated over their estimated useful lives. The methods of depreciation, useful lives and residual values are reviewed annually.

The following methods and rates were used during the year to depreciate property, plant and equipment to estimated residual values:

Buildings straight line 40 years

Plant straight line 5 to 20 years

Vehicles straight line 5 to 10 years

Furniture and equipment straight line 3 to 6 years

Assets held under finance leases are depreciated over their expected useful lives or the term of the relevant lease, where shorter. Previously the cost of assets was written-off over the assets expected useful life, depending on the class of asset. Under IFRS these useful lives have to be reassessed annually and the depreciation charge adjusted accordingly. This process is, by its nature, dependant on certain key assumptions. Management believes that the assigned values and useful lives, including the underlying assumptions have been adequately considered and consistently applied. Different assumptions and assigned useful lives could have an impact on the reported amounts.

The gain or loss arising on the disposal or scrapping of property, plant and equipment is recognised in profit or loss.

For material items of property, plant and equipment an internal engineer is used to assist in determining the remaining useful lives and residual values. Management believes that the assigned values and useful lives, including the underlying assumptions have been adequately considered and consistently applied. Different assumptions and assigned useful lives could have an impact on the reported amounts.

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. Deferred tax assets have been recognised where management believes there are sufficient taxable temporary differences or convincing other evidence that sufficient taxable profits will be available in to realise deferred tax assets. 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 and for firm commitments to hedge 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. Any residual ineffectiveness related to fair value hedges 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. Any residual ineffectiveness related to cash flow hedges can 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 group does not currently have any cash flow hedges.

Refer to note 31.5 of the Group Annual Financial Statements contained elsewhere in this Annual Report for details of the fair value hedging relationships.

The group has the following fair value hedges which qualify for hedge accounting:

Bonds at fixed interest rates with a total principle amount of US$856 million are hedged by seven external interest rate swaps (IRS), with a negative fair value of US$23 million which convert the US$ fixed interest rates into floating 6-month LIBOR in arrears.

In fiscal 2005 the hedge was de-designated at the end of March 2005 and was only re-designated three months later. During this period hedge accounting was interrupted. The changes in fair value of the bonds until the moment of de-designation are amortised over the remaining life of the hedge.

The following is an analysis of the impact on pre-tax profit and loss for the period

	2006 US$ million	**2005 US$ million**
(without brackets favourable)		
De/re designation		12.9
Amortisation	(1.6)	(1.2)
Residual ineffectiveness	3.5	10.5
Total	1.9	22.2

During 2006, Sappi s firm commitments for the purchase of equipment in foreign currency were hedged for foreign exchange risk by forward exchange contracts and were designated as a fair value hedge. The value of the firm commitments hedge accounted for was EUR15.4 million and US$1.1 million. These foreign currency forward exchange contracts had a negative fair value of US$0.3 million. Since the critical terms perfectly match, there was no residual ineffectiveness affecting profit and loss for the period.

Plantations. We state our plantations at their fair value, less estimated costs to sell at the harvesting stage. 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 fi