TAYLOR DEVICES INC
Form 10-Q
January 12, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended November 30, 2011

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 0-3498

TAYLOR DEVICES, INC.

(Exact name of registrant as specified in its charter)

NEW YORK	16-0797789
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
90 Taylor Drive, North Tonawanda, New York	14120-0748
(Address of principal executive offices)	(Zip Code)

716-694-0800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of January 12, 2012, there were outstanding 3,263,948 shares of the registrant's common stock, par value $.025 per share.

TAYLOR DEVICES, INC.

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TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Balance Sheets	(Unaudited) November 30, 2011	May 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 1,928,455	$ 2,193,534
Accounts receivable, net	3,254,360	2,136,848
Inventory	7,285,556	5,352,424
Costs and estimated earnings in excess of billings	4,671,281	4,189,799
Other current assets	1,364,998	1,597,830
Total current assets	18,504,650	15,470,435
Maintenance and other inventory, net	802,921	846,177
Property and equipment, net	3,612,236	3,413,446
Other assets	150,915	147,970
	$ 23,070,722	$ 19,878,028
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 5,485	$ 5,485
Accounts payable	1,686,663	1,292,095
Accrued commissions	940,513	433,355
Billings in excess of costs and estimated earnings	1,274,176	152,505
Other current liabilities	1,559,703	1,329,341
Total current liabilities	5,466,540	3,212,781
Long-term liabilities	279,399	282,142
Stockholders' Equity:		
Common stock and additional paid-in capital	6,977,216	6,720,784
Retained earnings	12,745,881	11,924,023
	19,723,097	18,644,807
Treasury stock - at cost	(2,398,314)	(2,261,702)
Total stockholders' equity	17,324,783	16,383,105
	$ 23,070,722	$ 19,878,028

See notes to condensed consolidated financial statements.

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TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Income	(Unaudited) For the three months ended November 30, 2011	2010	(Unaudited) For the six months ended November 30, 2011	2010
Sales, net	$ 6,781,754	$ 4,525,002	$ 11,354,456	$ 8,801,825
Cost of goods sold	4,935,156	3,487,175	7,973,353	6,623,261
Gross profit	1,846,598	1,037,827	3,381,103	2,178,564
Selling, general and administrative expenses	1,232,035	877,872	2,214,322	1,756,808
Operating income	614,563	159,955	1,166,781	421,756
Other income, net	3,178	32,520	39,077	60,857
Income before provision for income taxes	617,741	192,475	1,205,858	482,613
Provision for income taxes	204,000	69,500	384,000	175,000
Net income	$ 413,741	$ 122,975	$ 821,858	$ 307,613
Basic and diluted earnings per common share	$ 0.13	$ 0.04	$ 0.25	$ 0.10

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

(Unaudited)

For the six months ended	November 30, 2011	2010
Operating activities:		
Net income	$ 821,858	$ 307,613
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	262,707	233,854
Stock options issued for services	26,502	30,463
Changes in other assets and liabilities:		
Accounts receivable	(1,117,512)	3,498,183
Inventory	(1,889,876)	188,342
Costs and estimated earnings in excess of billings	(481,482)	(1,256,341)
Other current assets	232,832	(5,693)
Accounts payables	394,568	(131,628)
Accrued commissions	507,158	(126,401)
Billings in excess of costs and estimated earnings	1,121,671	(27,526)
Other current liabilities	230,362	(597,202)
Net operating activities	108,788	2,113,664
Investing activities:		
Acquisition of property and equipment	(461,497)	(132,096)
Other investing activities	(2,945)	(2,965)
Net investing activities	(464,442)	(135,061)
Financing activities:		
Principal repayments on long-term debt	(2,743)	(2,742)
Proceeds from issuance of common stock, net	143,085	7,185
Acquisition of treasury stock	(49,767)	(8,040)
Net financing activities	90,575	(3,597)

Net change in cash and cash equivalents	(265,079)	1,975,006
Cash and cash equivalents - beginning	2,193,534	197,587
Cash and cash equivalents - ending	$ 1,928,455	$ 2,172,593

See notes to condensed consolidated financial statements.

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TAYLOR DEVICES, INC.

Notes to Condensed Consolidated Financial Statements

1 The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of November 30, 2011 and May 31, 2011, the results of operations for the three and six months ended November 30, 2011 and November 30, 2010, and cash flows for the three and six months ended November 30, 2011 and November 30, 2010. These financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company's Annual Report to Shareholders for the year ended May 31, 2011. There have been no updates or changes to our audited financial statements for the year ended May 31, 2011

2 The Company has evaluated events and transactions for potential recognition or disclosure in the financial statements through the date the financial statements were issued

3 There is no provision nor shall there be any provisions for profit sharing, dividends, or any other benefits of any nature at any time for this fiscal year

4 For the six month periods ended November 30, 2011 and November 30, 2010, the net income was divided by 3,237,093 and 3,230,965, respectively, which is net of the Treasury shares, to calculate the net income per share. For the three month periods ended November 30, 2011 and November 30, 2010, the net income was divided by 3,233,056 and 3,230,965, respectively, which is net of the Treasury shares, to calculate the net income per share.

5 The results of operations for the three and six month periods ended August 31, 2011 are not necessarily indicative of the results to be expected for the full year

6 Recently issued Financial Accounting Standards Board Accounting Standards Codification guidance has either been implemented or is not significant to the Company

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Information in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this 10-Q that does not consist of historical facts, are "forward-looking statements." Statements accompanied or qualified by, or containing, words such as "may," "will," "should," "believes," "expects," "intends," "plans," "projects," "estimates," "predicts," "potential," "outlook," "forecast," "anticipates," "presume," and "assume" constitute forward-looking statements and, as such, are not a guarantee of future performance. The statements involve factors, risks and uncertainties, the impact or occurrence of which can cause actual results to differ materially from the expected results described in such statements. Risks and uncertainties can include, among others, uncertainty regarding how long the worldwide economic recession will continue and whether the recession will deepen; reductions in capital budgets by our customers and potential customers; changing product demand and industry capacity; increased competition and pricing pressures; advances in technology that can reduce the demand for the Company's products; and other factors, many or all of which are beyond the Company's control. Consequently, investors should not place undue reliance on forward-looking statements as predictive of future results. The Company disclaims any obligation to release publicly any updates or revisions to the forward-looking statements herein to reflect any change in the Company's expectations with regard thereto, or any changes in events, conditions or circumstances on which any such statement is based.

Results of Operations

A summary of the period to period changes in the principal items included in the condensed consolidated statements of income is shown below:

Summary comparison of the six months ended November 30, 2011 and 2010

Increase /

	(Decrease)	
Sales, net	$	2,553,000
Cost of goods sold	$	1,350,000
Selling, general and administrative expenses	$	458,000
Income before provision for income taxes	$	723,000
Provision for income taxes	$	209,000
Net income	$	514,000

Sales under certain fixed-price contracts, requiring substantial performance over several periods prior to commencement of deliveries, are accounted for under the percentage-of-completion method of accounting whereby revenues are recognized based on estimates of completion prepared on a ratio of cost to total estimated cost basis. Costs include all material and direct and indirect charges related to specific contracts.

Adjustments to cost estimates are made periodically and any losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. However, any profits expected on contracts in progress are recognized over the life of the contract.

For financial statement presentation purposes, the Company nets progress billings against the total costs incurred on uncompleted contracts. The asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. The liability, "billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized.

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For the six months ended November 30, 2011 (All figures discussed are for the six months ended November 30, 2011 as compared to the six months ended November 30, 2010.)

	Six months ended	November 30	Change	
	2011	2010	Increase / (Decrease)	Percent Change
Net Revenue	$ 11,354,000	$ 8,802,000	$ 2,552,000	29%
Cost of sales	7,973,000	6,623,000	1,350,000	20%
Gross profit	$ 3,381,000	$ 2,179,000	$ 1,202,000	55%
... as a percentage of net revenues	30%	25%		

The Company's consolidated results of operations showed a 29% increase in net revenues and an increase in net income of 167%. Revenues recorded in the current period for long-term construction projects (“Project(s)”) were 64%

higher than the level recorded in the prior year. Revenues recorded in the current period for other-than long-term construction projects (non-projects) were lower by 16% from the level recorded in the prior year. The gross profit as a percentage of net revenues for the current and prior year periods was 30% and 25%. Similar to the same period last year, we have several Projects in process during the current period that are sold directly to representatives in two different Asian countries net of their normal commissions. These Projects tend to have lower gross margins because the selling price is reduced to compensate the representative for the lack of commission. While we have more of these Projects in the current period than we did last year, the aggregate gross margin recorded, as a percentage of the sales, on these Projects is eight percentage points higher in the current period compared with last year. We had 52 Projects in process during the current period compared with 23 during the same period last year.

Sales of the Company’s products are made to three general groups of customers: industrial, construction and aerospace / defense. As the construction market improves around the world, we are experiencing a greater increase in demand from our customers for products to provide protection to buildings and bridges from wind and seismic events. A breakdown of sales to the three general groups of customers is as follows:

	Six months ended November 30	
	2011	2010
Industrial	8%	9%
Construction	64%	58%
Aerospace / Defense	28%	33%

At November 30, 2010, we had 100 open sales orders in our backlog with a total sales value of $13 million. At November 30, 2011, we have 8% more open sales orders in our backlog (108 orders) and the total sales value is $25.5 million or almost double the prior year value.

The Company's backlog, revenues, commission expense, gross margins, gross profits, and net income fluctuate from period to period. The changes in the current period, compared to the prior period, are not necessarily representative of future results.

Net revenue by geographic region, as a percentage of total net revenue for six month periods ended November 30, 2011 and 2010 is as follows:

	Six months ended November 30	
	2011	2010
USA	41%	42%
Asia	50%	35%
Other	9%	23%

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Selling, General and Administrative Expenses

	Six months ended	November 30	Change	
	2011	2010	Increase / (Decrease)	Percent Change
Outside Commissions	$ 456,000	$ 284,000	$ 172,000	61%
Other SG&A	1,758,000	1,473,000	285,000	19%
Total SG&A	$ 2,214,000	$ 1,757,000	$ 457,000	26%
... as a percentage of net revenues	19%	20%		

Selling, general and administrative expenses increased by 26% from the prior year. Outside commission expense increased by 61% from last year's level. This fluctuation was primarily due to a.) the significant increase in the level of sales from last year to this, and b.) the lower value of Projects sold directly to two Asian representatives, net of commission, as a percentage of total Project sales. Other selling, general and administrative expenses increased 19% from last year to this. This increase is primarily due to an increase in estimated incentive compensation expense in the current period related to the higher level of sales and operating results.

The above factors resulted in operating income of $1,167,000 for the six months ended November 30, 2011, up 177% from the $422,000 in the same period of the prior year.

Comparison of the three months ended November 30, 2011 and 2010

	Increase / (Decrease)
Sales, net	$ 2,257,000
Cost of goods sold	$ 1,448,000
Selling, general and administrative expenses	$ 354,000
Income before provision for income taxes	$ 425,000
Provision for income taxes	$ 135,000
Net income	$ 291,000

For the three months ended November 30, 2011 (All figures discussed are for the three months ended November 30, 2011 as compared to the three months ended November 30, 2010.)

	Three months ended November 30		Change	
	2011	2010	Increase / (Decrease)	Percent Change
Net Revenue	$ 6,782,000	$ 4,525,000	$ 2,257,000	50%
Cost of sales	4,935,000	3,487,000	1,448,000	42%
Gross profit	$ 1,847,000	$ 1,038,000	$ 809,000	78%
... as a percentage of net revenues	27%	23%		

The Company's consolidated results of operations showed a 50% increase in net revenues and an increase in net income of 236%. Revenues recorded in the current period for long-term construction projects (“Project(s)”) were 81% higher than the level recorded in the prior year. Revenues recorded in the current period for other-than long-term construction projects (non-projects) were 1% higher than the level recorded in the prior year. The gross profit as a percentage of net revenues for the current and prior year periods was 27% and 23%. Similar to the same period last year, we have several Projects in process during the current period that are sold directly to representatives in two different Asian countries net of their normal commissions. These Projects tend to have lower gross margins because the selling price is reduced to compensate the representative for the lack of commission. While we have more of these Projects in the current period than we did last year,

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the aggregate gross margin recorded, as a percentage of the sales, on these Projects is 11 percentage points higher in the current period compared with last year. We had 44 Projects in process during the current period compared with 17 during the same period last year.

Sales of the Company’s products are made to three general groups of customers: industrial, construction and aerospace / defense. As the construction market improves around the world, we are experiencing a greater increase in demand from our customers for products to provide protection to buildings and bridges from wind and seismic events. A breakdown of sales to the three general groups of customers is as follows:

	Three months ended November 30	
	2011	2010
Industrial	6%	11%
Construction	71%	66%
Aerospace / Defense	23%	23%

Net revenue by geographic region, as a percentage of total net revenue for three month periods ended November 30, 2011 and 2010 is as follows:

	Three months ended November 30	
	2011	2010
USA	36%	35%
Asia	57%	34%
Other	7%	31%

Selling, General and Administrative Expenses

	Three months ended November 30		Change	
	2011	2010	Increase / (Decrease)	Percent Change
Outside Commissions	$ 326,000	$ 179,000	$ 147,000	82%
Other SG&A	906,000	699,000	207,000	30%
Total SG&A	$ 1,232,000	$ 878,000	$ 354,000	40%
... as a percentage of net revenues	18%	19%		

Selling, general and administrative expenses increased by 40% from the prior year. Outside commission expense increased by 82% from last year's level. This fluctuation was primarily due to the significant increase in commissionable sales. Other selling, general and administrative expenses increased 30% from last year to this. This increase is primarily due to an increase in estimated incentive compensation expense in the current period related to the higher level of operating results.

The above factors resulted in operating income of $615,000 for the three months ended November 30, 2011, up 284% from the $160,000 in the same period of the prior year.

Stock Options

The Company has a stock option plan which provides for the granting of nonqualified or incentive stock options to officers, key employees and non-employee directors. Options granted under the plan are exercisable over a ten year term. Options not exercised at the end of the term expire.

The Company expenses stock options using the fair value recognition provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). The Company recognized $27,000 and $30,000 of compensation cost for the six month periods ended November 30, 2011 and November 30, 2010.

The fair value of each stock option grant has been determined using the Black-Scholes model. The model considers assumptions related to exercise price, expected volatility, risk-free interest rate, and the weighted average expected term of the stock option grants. Expected volatility assumptions used in the model were based on volatility of the Company's stock price for the thirty month period ending on the date of grant. The risk-free interest rate is derived from the U.S. treasury yield. The Company used a weighted average expected term. The following assumptions were used in the Black-Scholes model in estimating the fair market value of the Company's stock option grants:

	2011	2010
Risk-free interest rate:	1.875%	2.75
Expected life of the options:	2.7 years	2.5 years
Expected share price volatility:	49.42%	60.27
Expected dividends:	zero	zero
These assumptions resulted in:		
Estimated fair-market value per stock option:	$1.74	$2.00

The ultimate value of the options will depend on the future price of the Company's common stock, which cannot be forecast with reasonable accuracy.

A summary of changes in the stock options outstanding during the six month period ended November 30, 2011 is presented below:

	Number of Options	Weighted-Average Exercise Price
Options outstanding and exercisable at May 31, 2011:	229,000	$5.21
Options granted:	15,250	$5.23
Options exercised:	51,500	$4.36
Options outstanding and exercisable at November 30, 2011:	192,750	$5.44
Closing value per share on NASDAQ at November 30, 2011:		$6.99

Capital Resources, Line of Credit and Long-Term Debt

The Company's primary liquidity is dependent upon the working capital needs. These are mainly inventory, accounts receivable, costs and estimated earnings in excess of billings, accounts payable, accrued commissions, billings in excess of costs and estimated earnings, and debt service. The Company's primary sources of liquidity have been operations and bank financing.

Capital expenditures for the six months ended November 30, 2011 were $461,000 compared to $132,000 in the same period of the prior year. As of November 30, 2011, the Company has commitments for capital expenditures of $303,000 during the next twelve months.

Subsequent to November 30, 2011, the Company closed on its purchase of three industrial buildings in the City of North Tonawanda, NY. The location of the site is 1.4 miles from Taylor Devices' existing facilities on Tonawanda Island. In addition, the Company has had its purchase offer accepted for vacant lots adjacent to the new facilities and expects to close on that purchase very soon. The combined real estate of the new parcel totals 9+ acres.

The additional manufacturing space is needed to address severe overcrowding of the Company's large parts machining and assembly areas due to increased sales of large seismic protection products. Total area of the three newly purchased buildings is 46,000 square feet, which will more than double the Company's current manufacturing space.

The three buildings require renovation and modification to house the production machinery that will be relocated from the Company's Tonawanda Island site, along with the addition of large overhead cranes to move large parts from machine to machine. It is the Company's intent to move all machining and metalworking operations to the new site. This will allow the former machining areas at the existing Tonawanda Island site to house greatly expanded assembly and product testing areas. All corporate and engineering offices will be unaffected by the change and will remain on Tonawanda Island.

Although the total purchase price was low, the renovations to the buildings are extensive, with a total project budget (including the initial purchase cost) of $2.5 million. The Company intends to have the first of the three buildings in service by summer 2012, with the remaining two buildings completed and in service by December 2013. The Company anticipates that its current cash and bank line of credit resources will be sufficient for that purpose.

The Company has a $6,000,000 bank demand line of credit, with interest payable at the Company's option of 30, 60, 90 or 180 day LIBOR rate plus 2.5%, or the bank's prime rate less .25%. The line is secured by accounts receivable, equipment, inventory, and general intangibles, and a negative pledge of the Company's real property. This line of credit is subject to the usual terms and conditions applied by the bank, was subject to renewal annually, and is not subject to an express requirement on the bank's part to lend. There was no balance outstanding as of November 30, 2011 or as of May 31, 2011. The outstanding balance on the line of credit fluctuates as the Company's various long-term projects progress. The Company is in compliance with restrictive covenants under the line of credit. In these covenants, the Company agrees to maintain the following minimum levels of the stated item:

Covenant	Minimum per Covenant	Current Actual	When Measured
Minimum level of working capital	$3,000,000	$13,038,000	Quarterly
Minimum debt service coverage ratio	1.5:1	n/a	Fiscal Year-end

All of the $6,000,000 unused portion of our line of credit is available without violating any of our debt covenants.

Principal maturities of long-term debt for the remainder of the current fiscal year and the subsequent years are as follows: 2012 - $2,000; 2013 - $4,000.

Inventory and Maintenance Inventory

	November 30, 2011		May 31, 2011		Increase /(Decrease)	
Raw materials	$ 619,000		$ 666,000		$ (47,000)	-7%
Work in process	5,906,000		4,083,000		1,823,000	45%
Finished goods	761,000		603,000		158,000	26%
Inventory	7,286,000	90%	5,352,000	86%	1,934,000	36%
Maintenance and other inventory	803,000	10%	846,000	14%	(43,000)	-5%
Total	$ 8,089,000	100%	$ 6,198,000	100%	$ 1,891,000	31%
Inventory turnover	2.2		2.3			

NOTE: Inventory turnover is annualized for the six month period ended November 30, 2011.

Inventory, at $7,286,000 as of November 30, 2011, is $1,934,000 or 36% higher than the prior year-end level of $5,352,000. Approximately 81% of the current inventory is work in process, 10% is finished goods, and 9% is raw materials.

Maintenance and other inventory represent stock that is estimated to have a product life cycle in excess of twelve months. This stock represents certain items the Company is required to maintain for service of products sold and items that are generally subject to spontaneous ordering. This inventory is particularly sensitive to technological obsolescence in the near term due to its use in industries characterized by the continuous introduction of new product lines, rapid technological advances and product obsolescence. The maintenance inventory decreased 5% since May 31, 2011. Management of the Company has recorded an allowance for potential inventory obsolescence. The provision for potential inventory obsolescence was $90,000 for each of the six month periods ended November 30, 2011 and November 30, 2010. The Company continues to rework slow-moving inventory, where applicable, to convert it to product to be used on customer orders.

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Accounts Receivable, Costs and Estimated Earnings in Excess of Billings (CIEB"), and Billings in Excess of Costs and Estimated Earnings ("BIEC")

	November 30, 2011	May 31, 2011	Increase /(Decrease)	
Accounts receivable	$ 3,254,000	$ 2,137,000	1,117,000	52%
CIEB	4,671,000	4,190,000	481,000	11%
Less: BIEC	1,274,000	153,000	1,121,000	733%
Net	$ 6,651,000	$ 6,174,000	$ 477,000	8%
Number of an average day’s sales outstanding in accounts receivable	43	27		

The Company combines the totals of accounts receivable, the current asset CIEB, and the current liability, BIEC, to determine how much cash the Company will eventually realize from revenue recorded to date. As the accounts receivable figure rises in relation to the other two figures, the Company can anticipate increased cash receipts within the ensuing 30-60 days.

Accounts receivable of $3,254,000 as of November 30, 2011 includes approximately $238,000 of amounts retained by customers on Projects. It also includes $42,000 of an allowance for doubtful accounts (“Allowance”). The accounts receivable balance as of May 31, 2011 of $2,137,000 included an Allowance of $42,000. The number of an average day's sales outstanding in accounts receivable (“DSO”) increased from 27 days at May 31, 2011 to 43 at November 30, 2011. The DSO is a function of 1.) the level of sales for an average day (for example, total sales for the past three months divided by 90 days) and 2.) the level of accounts receivable at the balance sheet date. The level of sales for an average day in the first quarter of the current year is only slightly less than in the fourth quarter of the prior year. The level of accounts receivable at the end of the current fiscal quarter is 52% more than at the end of the prior year. The combination of these two factors caused the DSO to increase from last year end to this. The Company expects to collect the net accounts receivable balance, including the retainage, during the next twelve months.

As noted above, CIEB represents revenues recognized in excess of amounts billed. Whenever possible, the Company negotiates a provision in sales contracts to allow the Company to bill, and collect from the customer, payments in advance of shipments. Unfortunately, provisions such as this are often not possible. The $4,671,000 balance in this account at November 30, 2011 is 11% more than the prior year-end. The Company expects to bill the entire amount during the next twelve months. 35% of the CIEB balance as of the end of the last fiscal quarter, August 31, 2011, was billed to those customers in the current fiscal quarter ended November 30, 2011. The remainder will be billed as the Projects progress, in accordance with the terms specified in the various contracts.

The balances in this account are comprised of the following components:

	November 30, 2011		May 31, 2011	
Costs	$	7,176,000	$	5,818,000
Estimated Earnings		1,887,000		1,388,000
Less: Billings to customers		4,392,000		3,016,000
CIEB	$	4,671,000	$	4,190,000
Number of Projects in progress	23		25	

As noted above, BIEC represents billings to customers in excess of revenues recognized. The $1,274,000 balance in this account at November 30, 2011 is up from the $153,000 balance at the end of the prior year. This significant increase is the result of a single sales order in which the Company received 67% of the order value upon receipt of the order. The balance in this account fluctuates in the same manner and for the same reasons as the account "costs and estimated earnings in excess of billings", discussed above. Final delivery of product under these contracts is expected to occur during the next twelve months.

The balances in this account are comprised of the following components:

	November 30, 2011		May 31, 2011	
Billings to customers	$	1,918,000	$	2,592,000
Less: Costs		477,000		1,645,000
Less: Estimated Earnings		167,000		794,000
BIEC	$	1,274,000	$	153,000
Number of Projects in progress	7		3	

Summary of factors affecting the balances in CIEB and BIEC:

	November 30, 2011	May 31, 2011
Number of Projects in progress	30	28
Aggregate percent complete	46%	67%
Average total sales value of Projects in progress	$701,000	$510,000
Percentage of total value invoiced to customer	30%	39%

The Company's backlog of sales orders at November 30, 2011 is $25.5 million, up from the $15 million it was at the end of the prior year. $11.3 million of the current backlog is on Projects already in progress.

Other Balance Sheet Items

Accounts payable, at $1,687,000 as of November 30, 2011, is 31% more than the prior year-end. There is no specific reason for this fluctuation other than the normal payment cycle of vendor invoices. Commission expense on applicable sales orders is recognized at the time revenue is recognized. The commission is paid following receipt of payment from the customers. Accrued commissions as of November 30, 2011 are $941,000, up 117% from the $433,000 accrued at the prior year-end. The Company expects the current accrued amount to be paid during the next twelve months. Other current liabilities increased 17% from the prior year-end, to $1,560,000 primarily due to taxes accrued in the current period. Payments on these liabilities will take place as scheduled within the next twelve months.

Management believes the Company's cash flows from operations and borrowing capacity under the bank line of credit is sufficient to fund ongoing operations, capital improvements and share repurchases for the next twelve months.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Smaller reporting companies are not required to provide the information called for by this item.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.*

The Company's principal executive officer and principal financial officer have evaluated the Company's disclosure controls and procedures as of August 31, 2011 and have concluded that as of the evaluation date, the disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms and that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer to allow timely decisions regarding required disclosure.

(b) *Changes in internal control over financial reporting.*

There have been no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter ended August 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's control over financial reporting.

Part II - Other Information

ITEM 1 Legal Proceedings

There are no other legal proceedings except for routine litigation incidental to the business

ITEM 1A Risk Factors

Smaller reporting companies are not required to provide the information called for by this item

ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

(a) The Company sold no equity securities during the fiscal quarter ended November 30, 2011 that were not registered under the Securities Act
(b) Use of proceeds following effectiveness of initial registration statement: Not Applicable
(c) Repurchases of Equity Securities – Quarter Ended November 30, 2011

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
September 1, 2011 - September 30, 2011	-	-	-	
October 1, 2011 - October 31, 2011	-	-	-	
November 1, 2011 -				

November 30, 2011	-		-	
Total	-	-	-	(1) $419,815.00

(1) On November 11, 2011, the Board of Directors of the Registrant voted unanimously to continiue the share repurchase agreement with Merrill Lynch, Pierce, Fenner & Smith Incorporated under which the Company repurchases shares of its common stock. Of the $500,000 of Registrant's cash on hand authorized by the Board last year to repurchase shares of its outstanding common stock, $419,815 remains available for open-market purchases. To date, a total of 15,600 shares have been purchased at an average price per share of $5.14

(d) Under the terms of the Company's credit arrangements with its primary lender, the Company is required to maintain net working capital of at least $3,000,000, as such term is defined in the credit documents. On November 30, 2011, under such definition the Company's net working capital was significantly in excess of such limit. Additional information regarding the Company’s line of credit and restrictive covenants appears under the caption “Capital Resources, Lines of Credit and Long-Term Debt” in the Management’s Discussion and Analysis of Financial Condition and Results of Operations

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ITEM 3 Defaults Upon Senior Securities

None

ITEM 4 (Removed and Reserved)

ITEM 5 Other Information

(a) Information required to be disclosed in a Report on Form 8-K, but not reported

None

(b) Material changes to the procedures by which Security

Holders may recommend nominees to the Registrant's Board of Directors

None

ITEM 6 Exhibits

20	News from Taylor Devices, Inc. Shareholder Letter, Winter 2011-2012
31(i)	Rule 13a-14(a) Certification of Chief Executive Officer
31(ii)	Rule 13a-14(a) Certification of Chief Financial Officer
32(i)	Section 1350 Certification of Chief Executive Officer
32(ii)	Section 1350 Certification of Chief Financial Officer

101.INS*	XBRL Instance Document30, 2011, formatted in XBRL, as follows:
101.SCH*	XBRL Taxonomy Extension

	Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

*Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Taylor Devices, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Taylor Devices, Inc. and Subsidiary as of November 30, 2011, the related condensed consolidated statements of income for the three and six months ended November 30, 2011 and November 30, 2010 and cash flows for the three and six months ended November 30, 2011 and November 30, 2010. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim condensed consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of May 31, 2011, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated August 5, 2011, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of May 31, 2011 is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

Lumsden & McCormick, LLP

Buffalo, New York

January 12, 2012

TAYLOR DEVICES, INC.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TAYLOR DEVICES, INC.
(Registrant)

Date: January 12, 2012 /s/Douglas P. Taylor

Douglas P. Taylor

President

Chairman of the Board of Directors

(Principal Executive Officer)

Date: January 12, 2012 /s/Mark V. McDonough

Mark V. McDonough

Chief Financial Officer

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2009

%

North America

22

21

21

24

27

22

22

24

Europe

54

54

55

54

46

46

48

48

Southern Africa

24

25

24

22

13

13

13

13

Far East and others

14

19

	17
	15
Total	
	100
	100
	100
	100
	100
	100
	100
	100

Principal Factors Impacting our Group Results

Our results of operations are affected by numerous factors. Given the high fixed cost base of pulp and paper manufacturers, industry profitability is highly sensitive to changes in sales volumes and prices. Sales volumes and prices are significantly affected by demand for our products, changes in industry capacity and output levels and customer inventory levels. Demand levels are highly dependent on cyclical and structural changes in the world economy. Industry profitability is also influenced by factors such as the level of raw material inventory, energy, chemicals, wood and other input costs, currency exchange rates, and operational efficiency.

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

(a) Cyclical nature of the industry and movement in market prices, raw materials and input costs;

(b) Sensitivity to currency movements and inflation rates;

(c) The additional week in the first quarter of fiscal 2011; and

(d) New acquisitions, expansions, restructurings, cost-reduction initiatives, capacity closures, our ability to maintain and continuously improve operational efficiencies and performance and other significant factors impacting costs.

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

Cyclical Nature of the Industry and Movement in Market Prices, Raw Materials and Input Costs

The markets for pulp and paper products are cyclical, with sales prices significantly affected by factors such as changes in industry capacity and output levels, customer inventory levels and changes in the world economy. The pulp and paper industry has often been characterized by periods of imbalances between supply and demand, causing prices to be volatile. Prices also vary significantly by geographic region and product. Coated woodfree paper, our core product used for many types of publications, is susceptible to the highly cyclical advertising market, a major driver in our business, and other factors such as increasing consumer preferences for digital media over print media. See Markets for a further discussion of the cyclical nature of the pulp and paper industry and movements in market prices. In addition, the purchase prices of many of the raw materials we use generally fluctuate in correlation with global commodity cycles. Other input costs, such as energy and fuel costs, vary depending on various factors, including local and global demand and seasonality. Worldwide economic conditions experienced a significant downturn during the latter half of 2008, continuing in fiscal 2009 and into fiscal 2010, resulting in significant recessionary pressures and lower business and consumer confidence. As worldwide economic conditions improved throughout 2010, demand for our products improved, and market prices increased in our major markets. Market prices for pulp increased significantly in fiscal 2010 and continued to do so during fiscal

2011 due to higher worldwide-demand, specifically demand from Asia. However, with the emergence of the sovereign debt crises in the European Union during the latter half of calendar 2011 and continuing into calendar 2012, the global economic recovery slowed which, together with competition from electronic media, caused pulp prices and demand for many of our major products to decline. Sales prices consequently decreased.

Currency Fluctuations

The principal currencies in which our subsidiaries conduct business are the US dollar (US$), the euro ( ) and the South African Rand (ZAR). Although our reporting currency is the US dollar, a significant portion of the Group s sales and purchases are made in currencies other than the US dollar. In Europe and North America, sales and expenses are generally denominated in euro and US dollars, respectively; however, pulp purchases in Europe are primarily denominated in US dollars. In South Africa, costs incurred are generally denominated in Rand, as are local sales. Exports from the South African businesses to other regions, which in local currency represented approximately 48% of net sales for Sappi Southern Africa in both the six months ended March 2012 and 2011 and 49% and 47%, respectively, of net sales of Sappi Southern Africa in fiscal 2011 and fiscal 2010, are denominated primarily in US dollar.

The appreciation of the Rand or the euro against the US dollar diminishes the value of exports from South Africa and Europe in local currencies, while depreciation of these currencies against the US dollar has the opposite impact. Since expenses are generally denominated in local currencies, the depreciation of the US dollar has a negative effect on gross margins of exports sales as well as those domestic sales which are priced relative to international US dollar prices. The appreciation of the US dollar has the opposite impact. In North America, the depreciation of the US dollar against the euro or Asian currencies has a positive effect on sales volumes and margins, due to high levels of imports of coated woodfree paper in the market, which are adversely affected by such depreciation, and the favorable impact on exports of coated woodfree paper and release paper. The Group s consolidated financial position, results of operations and cash flows may be materially affected by movements in the exchange rate between the US dollar and the respective local currencies to which subsidiaries are exposed. The principal currencies in which subsidiaries conduct business that are subject to the risks described in this paragraph are the euro and Rand. The following table depicts the average and year end exchange rates for the Rand and euro against the US dollar used in the preparation of our financial statements in the six months ended March 2012 and 2011 and in fiscal 2011, fiscal 2010 and fiscal 2009:

	Average rates					Closing rates				
Exchange rates	**March 2012**	**March 2011**	**2011**	**2010**	**2009**	**March 2012**	**March 2011**	**2011**	**2010**	**2009**
ZAR to one US$	7.9237	6.9476	6.9578	7.4917	9.0135	7.6725	6.6978	8.0963	7.0190	7.4112
US$ to one EUR	1.3299	1.3645	1.3947	1.3658	1.3657	1.3344	1.4231	1.3386	1.3491	1.4688

The profitability of certain of our South African operations is directly dependent on the Rand proceeds of their US dollar exports. Selling prices in the local South African market are significantly influenced by the pricing of competing imported products. The appreciation of the Rand against the US dollar leads to increased pressure from imports. This factor was evident in our 2011 fiscal year.

The translation of our annual results into our reporting currency (US dollar) from local currencies tends to distort comparisons between fiscal periods due to the volatility of currency exchange rates. In the six months ended March 2012, the euro was weaker against the US dollar with an average exchange rate of US$1.33/euro as compared to an average of US$1.36/euro in the six months ended March 2011, and the Rand was weaker against the US dollar with an average exchange rate of ZAR7.92/US$ as compared to an average of ZAR6.95/US$ in the six months ended March 2011. The impact of these currency movements decreased reported sales in US dollars by US$156 million for the six months ended March 2012 compared to the six months ended March 2011.

On average, the euro strengthened 2% against the US dollar in fiscal 2011 compared to fiscal 2010, but weakened towards the end of fiscal 2011 to close below its 2010 fiscal closing levels. The Rand strengthened in fiscal 2011 to an average level against the US dollar of ZAR6.96, 7% stronger than fiscal 2010 average levels, but weakened to a closing rate of ZAR8.10/US$ at the end of fiscal 2011, approximately 14% weaker than the closing rate of fiscal 2010. The impact of these currency movements increased reported sales in US dollars by US$210 million for fiscal 2011 and by US$263 million in fiscal 2010 and decreased reported sales by US$547 million in fiscal 2009.

The impact of currency translation effects on our results of operations is described below in Operating Results Sales and Operating Results Operating Expenses .

Inflation and Interest Rates

The graph below summarizes the South African inflation and interest rates (3 month JIBAR), as well as the South African Reserve Bank lending rate (repo rate) at the end of the relevant periods.

South African Inflation and Interest Rates

Source: Bloomberg

The Group is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates. The Group monitors market conditions and may utilize approved interest rate derivatives to alter the existing balance between fixed and variable interest rate loans in response to changes in the interest rate environment. As at March 2012, one fixed to floating interest rate swap was in place which swaps the fixed interest rate on the US$350 million 2021 Notes issued in April 2011 into a floating interest rate. In April 2012, Sappi Southern Africa entered into a new interest rate swap converting the floating rate on the new three-year ZAR750 million (US$98 million) bond into a fixed rate of 7.78%.

The Group has a current policy of not hedging translation risks. The South African and European operations use the Rand and the euro as their respective functional currencies. Any translation of the value of these operations into US dollars results in foreign exchange translation differences as the Rand and the euro exchange rates move against the US dollar. These changes are booked to the foreign currency translation reserve via other comprehensive income. 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. The Group has one interest rate and currency swap which swaps the principal of the US$300 million 2014 Notes into euros and the fixed USD interest rate on these Notes into a fixed euro interest rate.

Additional week in first quarter of fiscal 2011

Our normal reporting cycle comprises four quarters, each consisting of 13 seven-day weeks, which is equal to 364 days per year. As a result, after six years we have effectively lost a week (including the leap year). Accordingly, every six years we add an additional week to one of our quarters, which we did in the first quarter of fiscal 2011 thus fiscal 2011 consists of 53 weeks of operations instead of the usual 52 weeks and the six months ended March 2011 consists of 27 weeks of operations instead of the usual 26 weeks.

The main impacts of the additional week in the first quarter of fiscal 2011 are:

- an increase in Operating Profit excluding Special Items for fiscal 2011 and the six months ended March 2011 of approximately US$8 million and US$10 million, respectively (assuming a pro-rata accumulation of operating profit over the relevant period); and

- our accounting cut-off in all four quarters of fiscal 2011 and the two quarters in the six months ended March 2011 falling after the calendar month-end. Since most of our suppliers (particularly in Europe and South Africa) are paid on the calendar month-end, this resulted in a substantial cash outflow of between US$150 million and US$200 million just before our quarterly accounting cut-offs, which was not the case in fiscal 2010. Thus, when comparing our Net Cash Generated (cash retained from (utilized in) operating activities less cash utilized in investing activities) in fiscal 2011 to 2010, we believe it would be appropriate to add approximately US$150 million to Net Cash Generated in fiscal 2011 or to deduct the same amount in fiscal 2010. This impact was reflected through Working Capital and impacted Net Debt.

Acquisitions, Expansions, Restructurings and Cost-reduction Initiatives

We continually evaluate the performance of our assets by maintaining a focus on profitability and we actively manage our asset base on a regional basis, including closing non-performing assets and pursuing an investment policy that is focused on high-return projects. Some of these recent developments include the following:

Blackburn mill closure and cessation of production from PM 5 at Maastricht mill. During August 2008, we announced the possible closure of Blackburn mill in the United Kingdom and the possible cessation of production from our PM 5 at Maastricht mill in The Netherlands. We reached an agreement with labor representatives at our Blackburn mill during September 2008 and finally closed the facility on November 12, 2008. On December 19, 2008, we also ceased production from PM 5 at our Maastricht mill. As a result of the closure of our Blackburn mill and the cessation of production from PM 5 at our Maastricht mill, our coated woodfree paper capacity was reduced by 180,000 tons. Profitable products were moved to our other facilities in Europe.

Acquisition of M-real Corporation s coated graphic paper business. On December 31, 2008, we acquired the coated woodfree and coated mechanical paper business from M-real Corporation. See Mill Closures, Acquisitions, Dispositions, Impairment, Joint Venture and Broad Based Black Economic Empowerment .

Muskegon mill closure. During April 2009, we announced the suspension of production from our Muskegon mill in North America due to weak demand and prices for coated woodfree paper products in the North American market. We announced the final closure of our Muskegon mill on August 26, 2009. We continue to serve all our affected customers from our other operations in the United States. During August 2011, we sold the Muskegon mill site for US$2.2 million to a third party.

Kangas mill closure. Due to a reduction in the European consumption of coated magazine paper arising from the global recession, our Kangas mill in Finland had experienced a substantial amount of commercial downtime since the beginning of 2009. We announced the closure of the mill in January 2010. All our affected customers are now served from our other European operations. On July 7, 2010, we sold the Kangas mill land and buildings to M-real for 13 million.

Usutu mill closure. The Usutu mill was closed on January 31, 2010 in response to adverse market conditions in the pulp sector, as well as the cumulative severe impact of fire damage during August 2008, which destroyed 40% of the mill s timber crop. As a result, the mill was no longer self-sufficient with respect to timber supplies.

Biberist mill closure. On March 31, 2011, we announced that due to the persistent overcapacity in the European coated and uncoated fine paper market, we would be entering into a consultation process with employee representatives and social partners at our Biberist mill in Switzerland. Despite the combined efforts of mill employees and management, we were unable to identify a viable alternative to ensure the future existence of the mill. On July 20, 2011, we announced the closure of the Biberist mill and ceased operations at the mill during August 2011. As a result of this closure, we reduced our annual production capacity by 500,000 tons of coated and uncoated fine paper in the European market. All our affected customers are now served from our other European operations.

Adamas mill closure. We announced the possible closure of our Adamas mill in South Africa on May 23, 2011 and entered into a consultation process with employee representatives soon thereafter. Unable to find a viable alternative for the mill, we announced the final closure of the mill on August 3, 2011. We ceased operations at the mill later in August 2011 and transferred all products produced at the facility to other Sappi mills in South Africa to ensure an uninterrupted supply of products to our customers.

Expansion of chemical cellulose capacity. On May 19, 2011, we announced the approximately US$350 million expansion of our Ngodwana mill in South Africa. The expansion is expected to change the product portfolio of the mill to include the annual production of 210,000 tons of chemical cellulose. During November 2011, we also announced an additional investment of approximately US$170 million in our Cloquet mill in the United States, which is expected to enable the facility to produce 330,000 tons of chemical cellulose per annum. Together with our Saiccor mill in South Africa, these investments will increase our total annual chemical cellulose production capacity to approximately 1.3 million tons. Both projects have been initiated, are progressing well and we plan to commission both projects during 2013.

Forestry investment. In line with our strategy to secure a stable fiber supply for our southern African operations, we acquired 14,500 hectares of developed softwood plantations near Ngodwana mill during 2010. During fiscal 2011, we announced a joint proposal with AsgiSA (Accelerated and Shared Growth Initiative for South Africa) to accelerate the establishment and management of 30,000 hectares of commercial tree plantations by 2020 in the Eastern Cape province of South Africa.

European and southern African restructuring initiatives. During fiscal 2011, we embarked on restructuring initiatives in our European and southern African operations in an effort to streamline our operations further, to adapt to the changing needs of our customers and to match our assets to profitable markets for future growth. In Europe, we began realizing the benefits of these cost reduction initiatives in the six months ended March 2012 and we expect to start realizing the cost-saving benefits from the initiatives in southern Africa in the second half of fiscal 2012.

South African Operations

Sappi Limited is a public company incorporated in South Africa. We have significant operations in South Africa, which accounted for 24% of our net sales in both the six months ended March 2012 and 2011, respectively, and 25%, 24% and 22% of our net sales in fiscal 2011, 2010 and 2009, respectively. See Operating Results for the proportion of South African operating profit to total profit and South African Economic and Political Environment for a description of the South African economic and political environment.

Environmental Matters

We operate in an industry subject to extensive environmental regulations. Typically, we do not separately account for environmental operating expenses but do not anticipate any material expenditures related to such matters. We do separately account for environmental capital expenditures. See note 32 to our Group annual financial statements for a discussion of these matters.

Operating Results

Financial Condition and Results of Operations

The operations of the Group are organized into the following three reportable segments:

- Sappi Fine Paper North America;
- Sappi Fine Paper Europe; and
- Sappi Southern Africa.

The Sappi Fine Paper business comprises the two reportable segments, Sappi Fine Paper North America and Sappi Fine Paper Europe.

The Sappi Southern Africa reportable segment includes the following divisions: Sappi Paper and Paper Packaging, Sappi Chemical Cellulose, and Sappi Forests. Sappi Paper and Paper Packaging consists of two fine paper mills, three packaging paper mills and the Sappi ReFibre operation. The volume, revenue and cost relationship within the Sappi Forests business is substantially different to that of the paper and chemical cellulose businesses which form a part of this segment.

Profit or losses from investments in equity accounted associates and joint ventures are not accounted for in our reportable segments and costs related to our corporate head office, the Group s treasury operations and non-manufacturing entities which form part of the Sappi Group are not included in the reportable segments mentioned above, and are disclosed as Unallocated and eliminations in the segmental reporting.

The analysis and discussion which follows should be read in conjunction with our Group annual financial statements.

The key indicators of the Group s operating performance include sales, operating profit and operating profit excluding special items. Operating profit represents sales after operating expenses, which are comprised of cost of sales, selling, general and administrative expenses, other operating expenses or income and share of profit or loss from associates and joint ventures. As described in more detail in the discussion and analysis which follows, the key components of the Group s operating expenses can be characterized as variable costs (primarily variable manufacturing costs) or fixed costs (the fixed cost components of cost of sales and selling, general and administrative expenses).

Cost of sales is comprised of:

- variable costs, which include raw materials and other direct input costs, including:
- wood (which includes growth and felling adjustments);
- energy;
- chemicals;
- pulp;
- delivery charges; and
- other variable costs;
- fixed costs, which include:

- employment costs allocated to cost of sales;
- depreciation expense allocated to cost of sales; and
- maintenance;
- fair value adjustment on plantations, representing an accounting fair value adjustment of the timber assets of the Sappi Forests operation, which is mainly impacted by historical timber selling prices, costs associated with standing timber values, costs of harvesting and delivery, the estimated growth rate or annual volume changes in the plantations and discount rates applied; and
- other overheads.

Selling, general and administrative expenses are comprised of:

- employment costs not allocated to cost of sales;
- depreciation expense not allocated to cost of sales;
- marketing and selling expenses; and
- administrative and general expenses.

Other operating expenses (income) are comprised of:

- net asset impairment (reversal);
- (profit) loss on sale and write-off of property, plant and equipment;

- restructuring provisions raised (released) and closure costs; and

- alternative fuel mixture tax credits in the United States.

Comparison of the Six Months ended March 2012 and 2011

Overview

This overview of the Group s operating results is intended to provide context to the discussion and analysis which follow. General trends are being highlighted here, with a detailed discussion and analysis in separate sections below.

The key indicators of the Group s operating performance are:

Key figures	Six Months Ended March 2012	2011
	(US$ million)	
Sales	3,218	3,697
Operating profit	227	120
Special items (gains) losses	(2)	144
Operating profit excluding special items	225	264

The following table reconciles operating profit excluding special items to profit (loss) for the period.

	Six Months Ended March 2012	2011
	(US$ million)	
Profit (loss) for the period	103	(37)
Taxation charge	19	18
Net finance costs	105	139
Operating profit	227	120
Special items (gains) losses	(2)	144
Operating profit excluding special items	225	264
Plantation price fair value adjustment loss	4	14
Restructuring provisions raised	1	66
Profit on disposal of property, plant & equipment	(9)	
Asset impairments		69
BEE transaction charge	2	2
Insurance recoveries		(11)
Fire, flood, storm and related events		4
Total special items:	**(2)**	**144**

Movements in operating profit and operating profit excluding special items are explained below.

Segment contributions to operating profit were as follows:

Operating Profit (Loss)	**Six Months Ended March 2012**	**March 2012 vs. March 2011 (US$ million)**	**Six Months Ended March 2011**
Sappi Fine Paper North America	34	(30)	64
Sappi Fine Paper Europe	87	136	(49)
Sappi Southern Africa	107	2	105
Unallocated and eliminations	(1)	(1)	
Total	**227**	**107**	**120**

Special items (Gain) Loss	Six Months Ended March 2012	2011
Sappi Fine Paper North America		(1)
Sappi Fine Paper Europe	(9)	114
Sappi Southern Africa	7	27
Unallocated and eliminations		4
Total	**(2)**	**144**

Operating Profit (Loss) excluding special items	Six Months Ended March 2012	March 2012 vs. March 2011 (US$ million)	Six Months Ended March 2011
Sappi Fine Paper North America	34	(29)	63
Sappi Fine Paper Europe	78	13	65
Sappi Southern Africa	114	(18)	132
Unallocated and eliminations	(1)	(5)	4
Total	**225**	**(39)**	**264**

Special items for the Group in the six months ended March 2012 and the six months ended March 2011 are generally summarized below:

Plantation price fair value: This relates to an accounting fair value adjustment of the timber assets of Sappi Forests and Usutu Forests. This fair value adjustment is mainly impacted by timber selling prices, cost associated with standing timber values and harvesting and delivery, and discount rates applied. The parameters applied are all market related. The impact was a negative US$4 million in the six-month period ended March 2012 and a negative impact of US$14 million in the six-month period ended March 2011.

Impairment and restructuring charges: In the six-month period ended March 2011 operating profit was negatively impacted by asset impairments of US$69 million, which primarily related to the closure of our Biberist mill.

In the six-month period ended March 2011 operating profit was negatively impacted by restructuring charges of US$66 million which related mostly to the closure of our Biberist mill.

Sale of property, plant and equipment: In the six-month period ended March 2012 operating profit was positively impacted by profit on the sale of assets of US$9 million, mainly related to the sale of assets in Europe.

Fire, Flood and Storm damage: In the six-month period ended March 2011 operating profit was positively impacted by insurance recoveries of US$11 million related to the fire in the Stockstadt mill in Europe which occurred during fiscal 2010. The insurance recoveries were offset by costs incurred in the six-month period ended March 2011 related to the same fire.

BEE charges: Charges related to a BEE transaction completed during fiscal 2010 amounted to US$2 million in both the six months ended March 2012 and 2011.

Group

The operating profit of US$120 million in the six months ended March 2011 increased to operating profit of US$227 million in the six-month period ended March 2012. The six-month period ended March 2011 included an additional accounting week, which occurs every six years in our Group s accounting calendar.

Operating profit in the six months ended March 2012 was positively affected by net special items of US$2 million compared to a negative impact of net special items of US$144 million in the six months ended March 2011. Special items in the six months ended March 2011 included a negative plantation fair value price adjustment of US$14 million, restructuring charges of US$66 million and asset impairments of US$69 million.

Operating profit excluding special items decreased in the six months ended March 2012 to US$225 million from US$264 million in the six months ended March 2011. This significant decline was mainly due to decreased demand and sales volumes in the Group s major markets, a reduction in pulp prices and the inclusion of the additional accounting week in the six months ended March 2011.

Sappi Fine Paper North America

Key figures	2012	2011
	Six Months Ended March (US$ million)	
Operating profit	34	64
Restructuring provisions released		(1)
Operating profit excluding special items	**34**	**63**

Operating profit in the six months ended March 2012 decreased to US$34 million as compared to US$64 million for the corresponding period in 2011. The six-month period ended March 2011 included an additional accounting week.

There were no special items impacting operating profit in the six months ended March 2012.

Operating profit excluding special items in the six months ended March 2012 decreased to US$34 million as compared to US$63 million for the corresponding period in 2011. The decrease was mainly due to pulp production interruptions at Somerset mill, lower sales volumes, lower average selling prices and higher manufacturing costs.

Sappi Fine Paper Europe

Key figures	2012	2011
	Six Months Ended March (US$ million)	
Operating profit (loss)	87	(49)
Restructuring provisions raised		62
Profit on disposal of property, plant and equipment	(9)	
Asset impairments		59
Insurance recoveries		(11)
Fire, flood, storm and related events		4
Operating profit excluding special items	**78**	**65**

Operating profit in the six months ended March 2012 was US$87 million as compared to an operating loss of US$49 million for the comparative period in 2011.

The operating profit in the six months ended March 2012 included favorable net special items of US$9 million, relating to the profit on the sale of assets.

Operating profit excluding special items improved to US$78 million in the six months ended March 2012 from an operating profit excluding special items in the six months ended March 2011 of US$65 million. The improvement was due to the fixed and variable cost reduction actions and lower pulp prices compared to the same period in 2011.

Sappi Southern Africa

Key figures	Six Months Ended March 2012	2011
	(US$ million)	
Operating profit	107	105
Plantation price fair value adjustment loss	4	14
Restructuring provisions raised	1	1
Asset impairments		10
Black Economic Empowerment charge	2	2
Operating profit excluding special items	**114**	**132**

Operating profit for the six months ended March 2012 was US$107 million as compared to US$105 million for the comparative period in 2011.

The operating profit in the six months ended March 2012 included unfavorable net special items of US$7 million which mainly consisted of an unfavorable plantation price fair value adjustment (US$4 million) and BEE charges (US$2 million).

Operating profit excluding special items decreased to US$114 million in the six months ended March 2012 compared to an operating profit excluding special items in the six-month period ended March 2011 of US$132 million. The decrease was due to a decrease in pulp and paper sales volumes and increased variable input cost per ton in our pulp and paper operations, partly offset by a decrease in fixed costs for the Southern African business as a whole.

Sales

Group

An analysis of sales movements in the six months ended March 2012 and in the six months ended March 2011 is presented below:

Sales Volume	Six Months Ended March 2012	March 2012 vs. March 2011	Six Months Ended March 2011
		(000 tons)	
Sappi Fine Paper North America	680	(33)	713
Sappi Fine Paper Europe	1,768	(226)	1,994
Sappi Southern Africa			
Pulp & Paper	818	(48)	866
Forestry	536	100	436
Total Sappi Southern Africa	**1,354**	**52**	**1,302**

Total	**3,802**	**(207)**	**4,009**

Sales Value	**Six Months Ended March 2012**	**March 2012 vs. March 2011 (US$ million)**	**Six Months Ended March 2011**
Sappi Fine Paper North America	701	(53)	754
Sappi Fine Paper Europe	1,729	(315)	2,044
Sappi Southern Africa			
Pulp & Paper	747	(114)	861
Forestry	41	3	38
Total Sappi Southern Africa	**788**	**(111)**	**899**
Total	**3,218**	**(479)**	**3,697**

The main factors impacting sales are volume, price, product sales mix and currency exchange rate movements. The South African and European businesses transact in Rand and euro, respectively, but the results of their operations are translated into US dollars for reporting purposes. The movement in the exchange rates between local currency and the US dollar during periods of high volatility significantly impacts results reported in US dollars from one period to the next. Movements in exchange rates impacted sales negatively by US$156 million in the six months ended March 2012. An analysis of the drivers of sales movements is presented below:

Sales Variance Analysis	**Six Months Ended March 2012 vs. Six Months Ended March 2011 (US$ million)**
Exchange rate effects	(156)
Volume change effects	(191)
Price and product mix effects	(132)
Total	**(479)**

Sales for the six months ended March 2012 were US$3,218 million, a decrease of approximately 13% compared to the six months ended March 2011 (a decrease of approximately 8% excluding our Biberist mill). This decrease was driven by decreased sales volumes, driven partly by the closure of our Biberist mill, decreased average selling prices for some of our products and a less favorable product sales mix in the paper and pulp business. Sales in the six months ended March 2012 also included a negative currency translation impact of US$156 million.

Average selling prices realized by the Group in the six months ended March 2012 were approximately 8% lower in US dollar terms than the average selling prices realized in the six months ended March 2011, mainly as a result of a decrease in pulp selling prices. The average world benchmark NBSK pulp price was 10% lower in the six months ended March 2012 compared to the six-month period ended March 2011.

In the six months ended March 2012, sales volume for the Group was approximately 5% lower than in the six-month period ended March 2011.

Sappi Fine Paper North America

Sales decreased by approximately 7% from US$754 million in the six months ended March 2011 to US$701 million in the six months ended March 2012. Sappi Fine Paper North America s sales volumes decreased by 5% when compared to the six months ended March 2011. Average selling prices realized in the six months ended March 2012 of US$1,031/ton were lower than average selling prices of US$1,058/ton achieved in the corresponding period in 2011.

Sappi Fine Paper Europe

Uncertain market conditions experienced by Sappi Fine Paper Europe negatively impacted sales during the six months ended March 2012. In the six months ended March 2012, sales volumes were 11% lower than the sales volume in the corresponding period for 2011. Excluding the sales volume of our Biberist mill included in the six months ended 2011, the sales volume in the six months ended March 2012 declined by 2% compared to the sales volume in the six months ended March 2011.

Overall, average selling prices during the six months ended March 2012, in both euro and US dollar terms were lower than those achieved in the six months ended March 2011. Average realized prices in euro terms decreased from 751/ton in the six-month period ended March 2011 to 735/ton in the corresponding period for 2012. Average selling prices realized in US dollar terms in the six-month period ended March 2012 were US$978/ton compared to US$1,025/ton in the corresponding period for 2011.

Sappi Southern Africa

Sales from the southern African pulp and paper operations (Sappi Chemical Cellulose and Sappi Paper and Paper Packaging) decreased by approximately 13% in US dollar terms or 1% in Rand terms in the six months ended March 2012 (US$747 million; ZAR5,919 million) compared to the corresponding period in 2011 (US$861 million; ZAR5,982 million). Sales in US dollar terms decreased more than sales in Rand terms due to the difference in average exchange rates used to translate Rand sales to US dollar in the six months ended March 2011 (ZAR to one US$: 6.95) and the six months ended March 2012 (ZAR to one US$: 7.92).

Sales volumes for the southern African pulp and paper operations decreased by approximately 6% in the six months ended March 2012 compared to the six-month period ended March 2011. Demand for chemical cellulose products was slightly weaker in the six months ended March 2012 than during the corresponding period in 2011 and sales volume for the Sappi Chemical Cellulose business decreased by 5% compared to the six months ended March 2011. The sales volumes for the Sappi Paper and Paper Packaging business decreased by 5% compared to the six-month period ended March 2011 due to weak market conditions and strong competition from imported products.

A major determinant of sales pricing in the chemical cellulose business is the NBSK pulp market price. During the six months ended March 2012, the average NBSK pulp price decreased by 10% from an average of US$957/ton in the comparable period in 2011 to an average of US$860/ton in the six months ended March 2012. During the six months ended March 2012, our average chemical cellulose selling prices in US dollar terms decreased by 8% compared to the six months ended March 2011, but increased by 5% in Rand terms due to the weakening of the Rand to the US dollar during the same period.

Average selling prices realized in the Sappi Paper and Paper Packaging business decreased by 10% in US dollar terms and increased by 3% in Rand terms compared to the six-month period ended March 2011.

Sales of our Sappi Forests business increased by 8% in US dollar terms or 23% in Rand terms in the six months ended March 2012 (US$41 million; ZAR325 million) compared to the six months ended March 2011 (US$38 million; ZAR264 million). The sales volumes of the Sappi Forests business increased by 23% compared to the six-month period ended March 2011. Average selling prices of timber in Rand terms in the six-month period ended March 2012 were at the same levels as the corresponding period in 2011.

Operating expenses

In the analyses which follow, cost per ton has been based on sales tons. An analysis of the Group operating expenses is as follows:

Operating Costs	**Six Months Ended March 2012**	**March 2012 vs. March 2011 (US$ million)**	**Six Months Ended March 2011**
Variable Costs			
Delivery	267	(32)	299
Manufacturing	1,705	(286)	1,991
Total Variable Costs	**1,972**	**(318)**	**2,290**
Fixed costs	1,001	(128)	1,129
Plantation price fair value plantation loss (gain)	4	(10)	14
Impairment		(69)	69
Restructuring	1	(65)	66
Profit on disposal of property, plant and equipment	(9)	(9)	
Fire, flood, storm and related events		(4)	4
BEE charge	2		2

Insurance recoveries		11	(11)
Other operating costs	20	6	14
Total	**2,991**	**(586)**	**3,577**

Variable and fixed costs are analyzed in more detail below.

Variable manufacturing costs

Group

The table below sets out the major components of the Group s variable manufacturing costs.

Variable Manufacturing Costs	Six Months Ended March 2012 Costs (US$ million)	US$/Ton	Change 2012 vs. 2011 (US$ million)	Six Months Ended March 2011 Costs (US$ million)	US$/Ton
Wood	388	102	13	375	94
Energy	291	77	(42)	333	83
Pulp(1)	360	95	(188)	548	137
Chemicals	510	134	(25)	535	133
Other costs	156	41	(44)	200	50
Total	**1,705**	**449**	**(286)**	**1,991**	**497**

(1) Pulp includes only bought-in fully bleached hardwood and softwood.

Variable manufacturing costs relate to costs of inputs which vary directly with output. The line Other costs in the table above relates to inputs such as water, fillers, bought-in pulp (other than fully bleached hardwood and softwood) and consumables. The Group s variable costs are impacted by sales volume, exchange rate impacts on translation of our European and South African businesses into US dollars and the underlying costs of inputs. The major contributors to variable cost movements at a Group level have been the impact of the exchange rates on translation of the European and the South African operations into the US dollar presentation currency and actual input cost escalations. See Principal Factors Impacting on Group Results and Currency Fluctuations for a discussion of exchange rate movements. Cost increases are driven by international commodity price increases.

An analysis of variable cost developments by region is as follows:

Regional Variable Manufacturing Costs(1)	Six Months Ended March 2012 Costs (US$ million)	US$/Ton	Change 2012 vs. 2011 (US$ million)	Six Months Ended March 2011 Costs (US$ million)	US$/Ton
Sappi Fine Paper North America	364	535	(11)	375	526
Sappi Fine Paper Europe	995	563	(243)	1,238	621
Sappi Southern Africa	346	256	(32)	378	290

(1) Regional variable manufacturing costs are pre-consolidation adjustments.

Cost management is a major focus area for the Group. We have engaged in a number of cost reduction initiatives aimed at offsetting the impact of increases in input costs. These initiatives are aimed at improved procurement strategies and product re-engineering initiatives to reduce raw material input costs through substitution. Product design and raw material inputs are constantly reviewed to ensure product attributes and quality meet market specifications.

Sappi Fine Paper North America

During the six months ended March 2012, variable manufacturing costs per ton increased by 2% compared to the six-month period in 2011, due to increases in purchase prices of wood and chemicals, offset to some extent by decreases in the purchase prices of pulp.

Sappi Fine Paper Europe

As a result of cost reduction actions, Sappi Fine Paper Europe experienced a significant decrease in variable manufacturing costs during the six-month period ended March 2012. Variable manufacturing cost per ton in euro terms decreased by 7% compared to the six-month period ended March 2011, mainly due to a significant decrease in pulp and consumables input costs per ton. This decrease was offset by an increase in purchased wood and chemical prices. The decrease of 9% in variable manufacturing costs per ton in US dollar terms compared to the six-month period ended March 2011 reflects the different exchange rates used for translation in the six months ended March 2012 (US$ to one EUR: 1.3299) and in the six months ended March 2011 (US$ to one EUR: 1.3645).

Sappi Southern Africa

During the six months ended March 2012, variable manufacturing input costs per ton in Rand terms slightly increased by 1% compared to the six-month period ended March 2011 due to increased chemicals and wood input costs per ton, partly offset by a decrease in energy, pulp and consumables input costs per ton. The decrease in input costs per ton in US dollar terms stems from the change in average exchange rates used for translation in the six-month period ended March 2012 (ZAR to one US$: 7.9237) and in the six-month period ended March 2011 (ZAR to one US$: 6.9476).

Fixed costs

Group

A summary of the Group s major fixed cost components is as follows:

Fixed Costs	**Six Months Ended March 2012 Costs**	**Variance Value (US$ million)**	**Six Months Ended March 2011 Costs**
Personnel	563	(58)	621
Maintenance	126	(24)	150
Depreciation	185	(23)	208
Other	127	(23)	150
Total	**1,001**	**(128)**	**1,129**

The regional analysis which follows excludes corporate fixed costs and consolidation adjustments, the sum of which is not material.

Fixed Costs	**Six Months Ended March 2012 Costs**	**Variance Value (US$ million)**	**Six Months Ended March 2011 Costs**
Sappi Fine Paper North America	229	(11)	240
Sappi Fine Paper Europe	509	(74)	583
Sappi Southern Africa	263	(43)	306

Sappi Fine Paper North America

Fixed costs decreased by US$11 million or 5% in the six months ended March 2012 compared to the six months ended March 2011. This decrease was mainly due to a decrease in inventory during the six months ended March 2011 compared to an increase in inventory during the six months ended March 2012.

Sappi Fine Paper Europe

Fixed costs decreased by 45 million or 10% in the six months ended March 2012 compared to the six months ended March 2011. This decrease was the result of cost reduction and restructuring actions implemented in the European business, including the closure of our Biberist mill. In US Dollar terms fixed costs decreased by 13% in the six months ended March 2012 compared to the same period in 2011.

Sappi Southern Africa

Fixed costs decreased in Rand terms by 2% from ZAR2,126 million to ZAR2,084 million, in the six months ended March 2012 compared to the six months ended March 2011. This decrease reflects some of the benefits from the restructuring of the Southern African paper business announced in fiscal 2011. The restructuring includes streamlining sales and marketing and other central administration functions and services. The 14% decrease in fixed costs in US Dollar terms also reflects the different average exchange rates used for translation in the six-month period ended March 2012 (ZAR to one US$: 7.9237) and in the six-month period ended March 2011 (ZAR to one US$: 6.9476).

Net Finance Costs

Finance costs for the six-month periods ended March 2012 and March 2011 may be analyzed as follows:

Finance Costs	**Six Months Ended March 2012**	**2011**
	(US$ million)	
Finance costs	117	161
Finance revenue	(6)	(6)
Net interest	**111**	**155**
Finance cost capitalized	(2)	
Net foreign exchange gains	(2)	(7)
Net fair value gain on financial instruments	(2)	(9)
Net finance costs	**105**	**139**

Net interest (finance costs less finance revenue) in the six months ended March 2012 of US$111 million was significantly lower compared to US$155 million in the six months ended March 2011 following the refinancing concluded in fiscal 2011 and the use of cash to repay higher cost debt.

Finance cost capitalized relates to our chemical cellulose expansion project in South Africa.

The US$2 million net foreign exchange gain in the six-month period ended March 2012 and the US$7 million net foreign exchange gain in the corresponding period in 2011 were mainly due to the unwinding or Rand/US dollar foreign exchange positions to cover exports from the South African business denominated in US dollars. The Group s policy is to identify foreign exchange risks immediately when they arise and to cover these risks to the functional currency of the operation where the risk lies. The majority of the Group s foreign exchange exposures are covered centrally by the Group Treasury which nets the internal exposures and hedges the residual exposure with third party banks.

The US$2 million net fair value gain on financial instruments in the six-month period ended March 2012 and the US$9 million net fair value gain on financial instruments in the corresponding period in 2011 were mainly due to the net impact of currency and interest rate movements after hedge accounting for certain interest rate and currency swaps the Group has entered into in order to manage the interest and currency exposure on internal and external loans.

Taxation

	Six Months Ended March 2012	2011
	(US$ million)	
Profit (loss) before taxation	122	(19)
Taxation at the average statutory tax rates	37	4
Net exempt income and non-tax deductible expenditure	(16)	(14)
Deferred tax asset not recognized	17	55
Utilization of previously unrecognized tax assets	(18)	(25)
Prior year adjustments	(1)	(3)
Other taxes		1
Taxation charge	**19**	**18**
Effective tax rate	**16%**	**(95)%**

With a profit before taxation of US$122 million, the total taxation charge to the income statement of US$19 million corresponds to an effective tax rate of 16% for the six-month period ended March 2012.

Profit (loss)

Profit for the period of US$103 million for the six months ended March 2012 compared to a net loss for the period of US$37 million for the six months ended March 2011. The main reason for the change in the first half of fiscal 2012 compared to the first half of fiscal 2011 was the adverse impact on profit of the unfavorable special items of US$144 million in the six months ended March 2011 and the lower net finance costs in the six months ended March 2012 compared to the same period in 2011.

Comparison of Fiscal 2011, 2010 and 2009

Overview

This overview of the Group s operating results is intended to provide context to the discussion and analysis which follow. General trends are highlighted below, with a detailed discussion and analysis in separate sections that follow. The Group s results for fiscal 2009 reflect the Acquired Business from December 31, 2008, the date of the closing of the Acquisition.

The key indicators of the Group s operating performance are:

Key figures	**2011**	**2010** (US$ million)	**2009**
Sales	7,286	6,572	5,369
Operating profit (loss)	86	341	(73)
Special items losses (gains)	318	(2)	106
Operating profit excluding special items	404	339	33

The following table reconciles operating profit excluding special items to profit (loss) for the period.

	2011	**Year Ended September 2010** (US$ million)	**2009**
Profit (loss) for the period	**(232)**	**66**	**(177)**
Taxation charge (benefit)	11	20	(41)
Net finance costs	307	255	145
Operating profit (loss)	**86**	**341**	**(73)**
Special items losses (gains)	318	(2)	106

Operating profit excluding special items	**404**	**339**	**33**
Plantation price fair value adjustment loss (gain)	16	(31)	67
Restructuring charges	135	46	34
Profit on disposal of property, plant & equipment	(1)	(5)	(1)
Asset impairments (impairment reversals)	167	(10)	79
Alternative fuel mixture tax credits		(51)	(87)
Integration costs			3
Insurance recoveries	(10)	(1)	
BEE transaction charge	5	23	
Fire, flood, storm and related events	6	27	11
Total special items	**318**	**(2)**	**106**

Movements in operating profit and operating profit excluding special items are explained below.

Segment contributions to operating profit were as follows:

Operating Profit (Loss)	2011	2011 vs. 2010	2010	2010 vs. 2009	2009
			(US$ million)		
Sappi Fine Paper North America	136	(44)	180	127	53
Sappi Fine Paper Europe	(71)	(143)	72	139	(67)
Sappi Southern Africa	63	(49)	112	166	(54)
Unallocated and eliminations	(42)	(19)	(23)	(18)	(5)
Total	**86**	**(255)**	**341**	**414**	**(73)**

Special items (Gain) Loss	2011	2010	2009
		(US$ million)	
Sappi Fine Paper North America	(7)	(56)	(55)
Sappi Fine Paper Europe	139	4	79
Sappi Southern Africa	136	22	72
Unallocated and eliminations	50	28	10
Total	**318**	**(2)**	**106**

Operating Profit (Loss) excluding special items	2011	2011 vs. 2010	2010	2010 vs. 2009	2009
			(US$ million)		
Sappi Fine Paper North America	129	5	124	126	(2)
Sappi Fine Paper Europe	68	(8)	76	64	12
Sappi Southern Africa	199	65	134	116	18
Unallocated and eliminations	8	3	5		5
Total	**404**	**65**	**339**	**306**	**33**

Special items for the Group in fiscal 2011, fiscal 2010 and fiscal 2009 are generally summarized below:

Plantation price fair value: The impact was a negative US$16 million in fiscal 2011, a positive US$31 million in fiscal 2010 and a negative US$67 million in fiscal 2009.

Impairment and restructuring charges: In fiscal 2011 operating profit was negatively impacted by asset and investment impairments of US$167 million. The asset and investment impairments included US$57 million related to the closure of our Biberist Mill in Europe, US$10 million related to the closure of our Adamas Mill in South Africa, US$49 million related to asset impairments in our Southern African Paper and Paper Packaging business, where production was curtailed, and US$45 million impairment of part of our investment in equity accounted associates and joint ventures. In fiscal 2010 operating profit was positively impacted by asset impairment reversals of US$10 million, which comprised the reversal of a portion of the fiscal 2009 impairment of the coated mechanical paper business in Europe that had negatively impacted operating profit in that year (US$74 million). Fiscal 2009 operating profit was further negatively impacted by the impairment of the Usutu Mill in southern Africa (US$5 million).

In fiscal 2011 operating profit was negatively affected by restructuring charges of US$135 million. These restructuring charges related to mill closures and other restructuring actions mainly in our European business (US$89 million) and our Southern African business (US$44 million). In fiscal 2010 operating profit was negatively impacted by restructuring charges of US$46 million, which related to the closure of the Usutu Mill in southern Africa and the Kangas Mill in Europe. In fiscal 2009 operating profit was negatively impacted by restructuring charges of

US$34 million which related mostly to the closure of the Muskegon Mill in the United States.

Alternative fuel mixture tax credits: During fiscal 2010, the Company filed claims for alternative fuel mixture credits covering eligible periods subsequent to February 2009 totaling US$51 million and US$87 million, net of fees and expenses and has reflected such amounts in the accompanying Group income statement in Other operating expenses (income) . Cash received, net of fees and expenses paid by the Company during fiscal 2010 and 2009 totaled US$73 million and US$65 million, respectively. No receivables related to alternative fuel mixture credits were outstanding at the end of fiscal 2010. The Company considers the tax credits earned in fiscal 2010 and fiscal 2009 as fully taxable and treated them as such in the calculation of its tax provision in the consolidated financial statements.

On October 15, 2010, the Internal Revenue Service (IRS) issued additional guidance on this topic, indicating that a taxpayer who received cash refunds under the alternative fuel tax program, can also receive the tax credit under the Cellulosic Biofuels Producer Credit (CBPC) on those black liquor volumes for which it had not previously collected the cash refund. The company can make this election to file for the CBPC tax credits through fiscal 2013, with respect to eligible biofuels produced in 2009.

BEE charges: Charges related to a BEE transaction completed during fiscal 2010 amounted to US$5 million in fiscal 2011 and US$23 million in fiscal 2010.

Fire, Flood and Storm Damage: During fiscal 2011 operating profit was positively impacted by insurance recoveries of US$10 million related to the fire in the Stockstadt mill in Europe which occurred during fiscal 2010. The insurance recoveries were offset by costs incurred in fiscal 2011 related to the same fire.

During fiscal 2010 operating profit was negatively impacted by a fire in our Stockstadt mill in Europe (US$21 million) and storm damage to various southern African business units (US$5 million).

During fiscal 2009 the southern African business experienced devastating fires across a wide area of afforested land and some flooding at the Saiccor mill. The cost of these damages was US$10 million in fiscal 2009.

Group

Comparing fiscal 2011 with fiscal 2010

Our operating profit declined to US$86 million in fiscal 2011 from US$341 million in fiscal 2010.

Operating profit in fiscal 2011 was negatively affected by net special items of US$318 million compared to a positive impact of net special items in fiscal 2010 of US$2 million. Special items in fiscal 2011 included an unfavorable plantation fair value price adjustment (US$16 million), restructuring charges (US$135 million) and asset impairments (US$167 million).

Operating profit excluding special items increased in fiscal 2011 to US$404 million from US$339 million in fiscal 2010. This significant improvement was mainly due to increased demand in sales volumes and increased average selling prices for some of our major products.

Comparing fiscal 2010 with fiscal 2009

The operating loss of US$73 million recorded in fiscal 2009 improved to an Operating profit of US$341 million in fiscal 2010.

Operating profit in fiscal 2010 was positively affected by net special items of US$2 million compared to a negative impact of net special items in fiscal 2009 of US$106 million. Special items in fiscal 2010 included a favorable plantation fair value price adjustment (US$31 million), asset impairment reversals (US$10 million) and alternative fuel mixture tax credits earned in North America (US$51 million). These positive special items were offset by restructuring charges (US$46 million), BEE charges (US$23 million) and fire and flood damage (US$27 million).

Operating profit excluding special items increased in fiscal 2010 to US$339 million from US$33 million in fiscal 2009. This significant improvement was mainly due to increased demand and sales volumes in the Group s major markets and increased average selling prices for some of our major products.

Sappi Fine Paper North America

Key figures	2011	2010 (US$ million)	2009
Operating profit	136	180	53
Profit on disposal of property, plant & equipment	(2)	(3)	
Asset impairment reversals	(3)	(2)	
Alternative fuel mixture tax credits		(51)	(87)
Restructuring provisions (released) raised	(2)		31
Fire, flood, storm and related events			1
Operating profit (loss) excluding special items	**129**	**124**	**(2)**

Comparing fiscal 2011 with fiscal 2010

Operating profit decreased from US$180 million in fiscal 2010 to US$136 million in fiscal 2011.

The operating profit for fiscal 2011 included favorable net special items of US$7 million as shown in the table above.

Operating profit excluding special items improved to US$129 million in fiscal 2011 from US$124 million in fiscal 2010. This improvement was mainly due to increased sales volumes and increased average selling prices partially offset by increased manufacturing costs.

Comparing fiscal 2010 with fiscal 2009

Operating profit increased from US$53 million in fiscal 2009 to US$180 million in fiscal 2010.

The operating profit for fiscal 2010 included favorable net special items of US$56 million and consisted mainly of alternative fuel mixture tax credits earned (US$51 million).

Operating profit excluding special items improved to US$124 million in fiscal 2010 from an operating loss excluding special items in fiscal 2009 of US$2 million. This significant improvement was mainly due to increased sales volumes, a reduction in variable cost per ton and a reduction in fixed costs.

Sappi Fine Paper Europe

Key figures	2011	2010	2009
		(US$ million)	
Operating (loss) profit	(71)	72	(67)
(Profit) loss on disposal of property, plant & equipment		(2)	1
Asset impairments (impairment reversals)	57	(10)	74
Insurance recoveries	(11)	(22)	
Restructuring provisions raised	89	17	1
Fire, flood, storm and related events	4	21	
Integration costs			3
Operating profit excluding special items	**68**	**76**	**12**

Comparing fiscal 2011 with fiscal 2010

Operating profit declined from an operating profit of US$72 million in fiscal 2010 to an operating loss of US$71 million in fiscal 2011.

The operating loss for fiscal 2011 included unfavorable net special items of US$139 million which included asset impairments related to the closure of the Biberist Mill and restructuring charges (US$89 million) which were partially offset by insurance recoveries (US$11 million).

Operating profit excluding special items decreased to US$68 million in fiscal 2011 from an operating profit excluding special items in fiscal 2010 of US$76 million. This decline was due to increased input cost pressure and competition in all our major markets.

Comparing fiscal 2010 with fiscal 2009

Operating profit improved from a loss of US$67 million in fiscal 2009 to an operating profit of US$72 million in fiscal 2010.

The operating profit for fiscal 2010 included unfavorable net special items of US$4 million which included restructuring charges for the closure of the Kangas mill (US$17 million), costs related to fire damage at our Stockstadt mill (US$21 million) which were partially offset by insurance recoveries (US$22 million) and the reversal of asset impairment charges (US$10 million).

Operating profit excluding special items improved to US$76 million in fiscal 2010 from an operating profit excluding special items in fiscal 2009 of US$12 million. This significant improvement was mainly due to improved market demand for our products which lead to increased sales volumes, partially offset by increases in variable costs and fixed costs.

Sappi Southern Africa

Key figures	**2011**	**2010**	**2009**
		(US$ million)	
Operating profit (loss)	63	112	(54)
Plantation price fair value adjustment	16	(31)	67
Loss (profit) on disposal of property, plant & equipment	1		(2)
Asset impairments	68	2	5
Insurance recoveries			(10)
Restructuring provisions raised	45	23	2
Fire, flood, storm and related events	1	5	10
BEE transaction charge	5	23	
Operating profit excluding special items	**199**	**134**	**18**

Comparing fiscal 2011 with fiscal 2010

Operating profit decreased from an operating profit of US$112 million in fiscal 2010 to an operating profit of US$63 million in fiscal 2011.

The operating profit for fiscal 2011 included unfavorable net special items of US$136 million which consisted mainly of an unfavorable plantation price fair value adjustment (US$16 million), asset impairments (US$68 million) and restructuring charges (US$45 million). The asset impairments included US$10 million related to the closure of our Adamas Mill and US$49 million related to impairments of assets in our paper and paper packaging business where we have decided to cease production of certain products. The restructuring charges relate to our revised strategy for our South African paper and paper packaging business.

Operating profit excluding special items improved to US$199 million in fiscal 2011 from an operating profit excluding special items in fiscal 2010 of US$134 million. This significant improvement was mainly due to increased sales volumes and average selling prices in our chemical cellulose business partially offset by increased variable input cost per ton and increased fixed costs for the Southern African business as a whole. In fiscal 2011, all of the operating profits excluding special items of Sappi Southern Africa were generated by our Saiccor Mill, with the paper and paper packaging business making a loss.

Comparing fiscal 2010 with fiscal 2009

Operating profit improved from a loss of US$54 million in fiscal 2009 to an operating profit of US$112 million in fiscal 2010.

The operating profit for fiscal 2010 included unfavorable net special items of US$22 million which consisted mainly of a favorable plantation price fair value adjustment (US$31 million), offset by BEE charges (US$23 million) and restructuring charges for the closure of the Usutu Mill (US$23 million).

Operating profit excluding special items improved to US$134 million in fiscal 2010 from an operating profit excluding special items in fiscal 2009 of US$18 million. This significant improvement was mainly due to increased sales volumes in our chemical cellulose business, increased average selling prices for our pulp and paper operations and a decrease in variable input cost per ton, which were partially offset by an increase in fixed costs.

Movements in the sales, variable cost and fixed cost components of operating profit are explained below.

Sales

Group

An analysis of sales movements in fiscal 2011, 2010 and 2009 is presented below:

Sales Volume	2011	Change 2011 vs. 2010	2010	Change 2010 vs. 2009	2009
			(000 tons)		
Sappi Fine Paper North America	1,436	82	1,354	80	1,274
Sappi Fine Paper Europe(1)	3,845	49	3,796	840	2,956
Sappi Southern Africa					
Pulp & Paper	1,700				