



Tissue Markets Remain Healthy as Global Trade Grows

Cost pressures on tissue mills should ease in 2007, while demand and prices post modest gains.

By Harold Cody

Tissue markets remain competitive but growing as the big three—Georgia-Pacific, Kimberly-Clark and Procter & Gamble—fight for market share in the U.S. while having their margins pinched a bit during 2006 by surging energy and fiber costs.

In response, producers implemented price increases that took effect during the third quarter in the retail sector and announced further price gains that will be implemented during 2007. In addition, the time-tested game of lowering sheet counts in an effort to improve margins/unit are underway. Pulp prices continued to rise during 2006, but gains appear to be ending and the drop in oil prices has lowered manufacturing and distribution costs somewhat.

Nevertheless, despite these cost and competitive pressures, overall tissue demand and supply fundamentals remain generally positive. Overall North American demand remains healthy, although growth is expected to slow a bit from the more rapid growth of 3% annually in 2004-2005 to rates near 2% annually over the next couple of years. Demand has risen steadily since the downturn in 2001-2002.

Surge in New Machines Lowering Industry Costs

On the capacity side, while a spate of new machines have come on-line in the last three years, the shutdown of high-cost older capacity and a number of mills, in conjunction with demand growth, appears to be offsetting any net capacity gains. Capacity only rose modestly in 2006, under 1%,

but larger gains of about 2% are expected in 2007 and 2008. A good example of this is Georgia-Pacific's revamp of its Camas, Washington mill. A new 70,000 tpy tissue machine will come online this year, but three existing machines will be shutdown that largely offset this gain. GP is considerably improving its competitive cost position with the new machine, which is also a key to improving margins in its core tissue business.



The top three producers control about 65% of North American capacity, or about 9 million tons. They are: Koch/GP (33%), Kimberly-Clark (17%), and P&G (15%). Following these three are Cascades (7%), and SCA (6%). A major wave of consolidation on the consumer side in industrial markets is also occurring and this is likely to make the away-from-home market more competitive for producers.

Outside of North America, big international players, such as Kimberly-Clark, also continue to benefit from more rapid growth in emerging markets overseas, where demand is growing much more rapidly than the steady, but modest gains typical of the large but mature U.S. market. Gains of over 10% annually are possible in these markets.

Expanded Trade Routes

International trade, not something usually considered when talking about the tissue business, has also become a topic of discussion for tissue mills. For years, trade in tissue was

largely limited with the exception of countries in close proximity. For example, trade between the U.S. with Canada and Mexico has always occurred. However, a recent surge of trade between the U.S. and countries such as China have led to a tripling of imports in the last 5-10 years from a level of 200,000 tons annually to 600,000 tons annually.

Similarly, according to market forecasting firm RISI, world tissue imports also doubled over the last ten years. It's not likely that U.S. markets will feel the impact of low cost imports of tissue to anywhere near the extent it has in grades such as printing and writing papers, but it bears watching.

Outlook

Going forward, the outlook on the demand side continues to be good, as tissue markets remain the most steady and predictable pulp and paper market in the industry. The key

thing to watch is whether producers manage the growth in capacity to match demand. Four new machines were

brought online in 2006 (a fifth in early 2007). Several are smaller machines, but bigger units are also being added by the major producers. If there is a continued surge in new machines in the U.S. over the 2008-2009 periods as mills work to lower their manufacturing

cost structures in order to remain competitive with lower cost tonnage coming off the new machines, supply will run ahead of demand and producers will lose their pricing leverage. But capacity can be managed to match demand—just look at what containerboard mills have been able to do in recent years by matching capacity to falling or stagnant demand. ■

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