If you can come away with a positive from 2009, it would be that the pulp and paper producers now have a better understanding of what it’s going to take to operate their businesses in the years to come. Here we’ll take a brief look at the good and bad of the past year, and see where the current markets are headed as we enter 2010.

By John O’Brien, Managing Editor

As 2009 fades from view in the rearview mirror, the U.S. pulp and paper industry was left dinged-up and dented, and, in some cases, totaled beyond repair. Volumes for some producers hit all-time lows, while others saw wild, unpredictable swings in orders from month to month. Pricing wasn’t great, but did strengthen as the year bore on due to closures and downward capacity management.

Brutally tight credit markets didn’t help things either, leaving some companies unable to refinance credit facilities, resulting in a number of bankruptcies.

To be sure, 2009 was a furious fight for survival, and it may also prove to be a litmus test of sorts to determine who makes it through 2010 and who doesn’t.

The past year, however, wasn’t all bad. Input costs for energy, fiber, chemicals, and fuel remained reasonably low. Supplier-side discipline, which was needed prior to the economic meltdown, was substantial and swift and brought a much healthier balance to the supply/demand ratio. And a weak USD proved beneficial for US producers in the foreign exchange markets.

The 800-pound gorilla, of course, was the black liquor alternative fuel credit which proved a savior for some, what may be a stay of execution for others, or an outright injustice to those without kraft pulping operations. So it’s difficult to say whether or not it was a “good” thing for the industry, overall.

Finally, and somewhat surprisingly, many producers finished 2009 with better balance sheets — most likely the result of the not-all-bad list mentioned above.

THINGS HAVE TO GET BETTER, RIGHT?

The most common feeling from people in, and observers of, the industry is that we’re all “cautiously optimistic.” In other words, everyone is hoping for the best, but things could just as easily go the other way, and that really doesn’t help to paint much of a picture as to what’s going on.

Currently, the most clearly visible trend is upward pricing. This is especially true for market pulp. Prices are climbing and they’re climbing fast. Big international producers such as Botnia and Sodra have pushed the price of NBSK and softwood grades of pulp to $860/ton (for Feb. 1) — a $60 increase since the close of 2009.

In the U.S., NBSK list prices in January are up $20/mton to $850/mton, and with another round of hikes announced, NBSK would be $880/mton through February, according to Deutche Bank’s Mark Wilde, who covers the pulp and paper sector.

If implemented, NBSK would rise to a 16-month high and nearly match the August 2008 peak of $880-890/mton, Wilde pointed out.

What’s driving the price? Low inventories and strong demand, worldwide.

“The pulp market is tight,” said Ulf Edman, president of Sodra Cell International, whose company produces some two million tons per year of hardwood and softwood pulp.

“The demand keeps being strong and the stocks remain on a historically low level at both producers and buyers of pulp,” he said.

The country playing a huge role in pulp consumption is China. According to China’s General Administration of Customs, in December, China imported one million metric tons of pulp, a 45.5% increase compared to December 2008. For 2009, pulp imports to China totaled 13.68 million tons, up 44% year/year.

Although the pulp market is humming along nicely right now, it’s hard to see it sustaining this pace much beyond the first quarter. That’s not to say there’s a sharp decline on the horizon, but production has been ramped up and previously idled capacity has come back into the mix. The onslaught of “new” pulp capacity, which may become overcapacity in Q2, coupled with a still fragile world economy, should most likely stabilize, or even erode, the price gains of the first quarter.
Uncoated Freesheet

Volumes towards the end of 2009 and the first few weeks of 2010 in the UFS market appear to have stabilized. The volumes remain relatively low, but the downward spiral has reversed itself to some degree and reports point to an uptick in producers’ order books.

Lending a bit of evidence to the improved conditions, Domtar is out with a $40 per ton price hike for cutsize, effective Feb. 15. Other producers have been quiet as of this writing, but it would make sense for others to follow.

Further data from Deutsche Bank shows year/year UFS shipment comparisons improved in Q4 ’09 and preliminary data on December shows shipments +1.2% over Dec. 2008 — the first positive comparison since April 2007.

“While some of this improvement is simply the result of lapping very weak 08Q4 numbers, our discussions with merchants, importers, and other players in the trade suggest a healthier tone to the business, Wilde said.

“Inventories appear lean. Mill inventories are down 20% year-to-year and merchant inventories are also reportedly down in the same range,” he added.

In regards to future capacity management, it’s noteworthy to mention that International Paper and Domtar in late 2009 announced 800,000 tpy of permanent capacity closures by mid-2010, representing 7% of North American UFS capacity.

Coated Freesheet

Producers of CFS may have a tougher road ahead. Print advertising, the main ingredient to driving page counts in magazines, has yet to show any significant rebound — it is very early, though. With a question mark still hovering over the direction of the economy, marketing budgets for advertisers remain tight, a situation that will make it challenging for volumes and better pricing throughout the year.

CFS numbers from Deutsche Bank show prices in December were essentially flat, with No.3 60-lb rolls -$5/ton to $900-925/ton, while No.3 50-lb rolls were flat at $960-1000/ton range.

Nevertheless, Wilde notes that producers are trying to raise CFS prices in the US market on improved order books and higher operating rates. Appleton Coated joined NewPage and Verso in the $40/ton ($2/cwt) price hike on CFS grades, and others are following.

Newsprint

Pricing for newsprint makers gradually improved in 4Q09 and continues to move upward as producers aggressively manage capacity downward. From a low of about $450/mton at the end of Q309, the price of 30lb. newsprint closed the year at a bit over $510/mton. Currently (mid-Jan.), 30lb. newsprint stands at $530/mton.

Here again, the newsprint market relies heavily on advertising to drive volumes. In addition, circulation numbers continue to drop, falling victim to the abundance of news as it happens available through a dizzying array of electronic media sources.

It’s unfortunate, but apparent, that newsprint volumes will continue their slide and there’s not much the producers can do about that. It’s tough to find an optimistic ray of light here, but newspaper advertising won’t stay down forever and neither will the economy. Circulation numbers may not bounce back, but page counts of U.S. dailies should improve over time.

Containerboard/Paperboard

The packaging sector is pushing hard right now for price increases and industry reports say volumes are improving. A $50/ton price hike is out for January. How much, if not all, of the hike will go through is yet to be seen. The general consensus is that it will be fully implemented, but may have to work its way through in increments during the first quarter.

“On the volume side, we’re receiving a number of reports suggesting a solid [year-over-year] jump in box volumes in December,” Wilde said. “Some of the strong comps are driven by very weak numbers in late 2008, but some of the strength also reflects improvement in manufacturing sector,” he said.

“Reports suggest that most containerboard mills have strong order backlogs driven by strong export demand and some pre-buying before the price increase,” Wilde noted.

Virtually all paperboard makers — uncoated recycled board (URB) and coated recycled board (CRB) — are out with increases and here, again, order books are reported to be better.

Sonoco is out with a $50/ton hike on all uncoated recycled board grades effective Feb 1, with a 4.5% bump on converted products effective Feb 15. RockTenn and Caraustar have announced a $50/ton price hike on URB grades, while The Newark Group has a $40 hike in place, all effective Feb. 8. Additionally, Graphic Packaging has announced a $50/ton increase on all grades of its FaceSetter URB, effective Feb. 18.

For CRB, Rock-Tenn, Graphic Packaging, PaperWorks, Cascades, and Strathcona in late-November announced $40-45 per ton hikes for the first of this year. In addition, The Newark Group said it will initiate a $40/ton price hike effective Feb 1.

The price hikes are a result of rising input costs, especially OCC, well managed inventories and an uptick in orders.

The CRB initiative comes on the back of stronger demand (order backlogs = 155,000 tons, +60% y/y and +50% since mid-summer), higher input costs and lower inventories throughout the supply chain, Wilde said in his report.

CONCLUSION

Whether you see the glass for 2010 as half full or half empty depends on what you compare it to. The two primary health indicators in the pulp and paper industry, pricing and volume, in 2009 were terrible from a historical standpoint. But moving forward and comparing the fourth quarter of 2009 and the first few weeks of 2010, the downward trends for pricing and volume have either reversed, or at the very least, stabilized. And that’s a better situation than the one the industry faced a year ago.