Capacity Bulge, Sluggish Demand Remain Challenges for Containerboard Market

2013 wasn't a bad year for containerboard mills but results were decidedly mixed. Price increases were enacted on board and corrugated boxes in early 2013 that boosted margins, but underlying box demand was stagnant. 2014 offers hope that improved economic growth can propel box demand to stronger gains, but the impact of new containerboard capacity remains a nagging concern.

By Harold M. Cody

Over the course of the last 12 months the containerboard industry was characterized by relatively weak fundamental demand for corrugated containers and rising capacity. However, despite these negative trends, the overall business benefitted from an approximate $100/ton price increase in major containerboard grades and an increase in box prices as well. The biggest concern entering 2014, other than the basic strength of the global economy, is the impact of a surge in new capacity, which could throw a monkey wrench into the works.

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The rise in prices and a muting of input costs — at least for a while as OCC prices fell to very low levels earlier in 2013 — were certainly noteworthy developments last year in the containerboard market. In April, a $50/ton increase was successfully passed on to converters that raised linerboard prices to about the $650/ton range. This was the second successful increase in an eight-month period, following a $50/ton increase that was enacted in September 2012. These increases significantly improved operating margins for the major producers.

Containerboard mills were able to push through the increases despite several important indicators that wouldn't seem to support an upward movement in prices, i.e. weak domestic demand for corrugated boxes, a steady decline on OCC costs and a long term over supply situation in the box market. The increase was successful mainly due to the sweat and hard work on the part of board producers who took significant market-related downtime to keep inventories under control and the market balanced. At the end of the year and into early 2014, prices are reported to have held mainly steady despite somewhat weak box cut ups during the seasonally slow months of the year again due to downtime that sustained operating rates.

As noted, OCC costs fell steadily from a peak almost $180/ton in late 2011 before bottoming out at about $100/ton in early 2013. Since then, prices have posted a modest rebound but remain low. Many observers believe that as global containerboard demand accelerates in 2014, OCC prices will surge and this may provide the impetus for prices to also rise further on liner and medium grades this year.

U.S. box and containerboard data through November 2013 clearly demonstrate the impact of sluggish economic, job and personal income growth on the box market. For the first 11 months of 2013, box shipments were down 0.5% vs. the prior year at 331.2 billion square feet year-to-date, and down 2.5% vs. November 2012 levels. On an average week basis, which accounts for a different number of shipping days month to month, November box shipments were up 2.6%, according to FBA and AFPA data. Total containerboard production, at 31.9 million tons, was up 1.6% over the first eleven months vs. the prior year level, but down 4.5% in November vs. last year.

Export Markets Cooled in 2013

The export market continues to be an important market for U.S. mills, with linerboard exports through November at 3.5 million tons according to AF&PA. However, this is down 0.6% vs. 2012 levels. While demand in some export markets has weakened the drop is also partly due to mills in North America diverting tonnage to domestic markets. The export market has appeared to be weak in recent months, with export prices reported to be down in Europe and weak in Latin America. The weaker pricing is a result of a slowdown in demand plus an excess of supply in several regions including North America and Europe.

U.S. Bureau of Census data through the first three quarters of 2013 showed U.S. Kraft linerboard exports down 6.3% at 2.8 million tons vs. the same period in 2012. Exports to the largest U.S. export market, Western Europe, were off nearly 20% at 585,000 tons. Exports were also down significantly to Canada, while smaller drops were posted for Mexico, the Middle East and Africa. In contrast, exports to Central America and South America, at 438,000 tons and 439,000, were up by 3.6% and 11%, respectively, vs. 2012 levels. In turn, export prices are reported to have slipped as well in Europe and were under pressure in the fourth quarter in Latin America.

New Capacity a Concern

As noted, significant new capacity came online in the second half of 2013 that is a cause for concern, but reportedly, so far, it hasn't had a severe impact on the market. This includes tonnage from the startup of Norampac's new 330-inch, 525,000 tpy recycled linerboard machine at the Greenpac mill in Niagara Falls, New York and the conversion of two newsprint machines to containerboard. This includes the addition of 150,000 tpy of linerboard by SP Fiber in Dublin, Georgia, and 300,000 tpy by Atlantic Packaging in Whitby, Ontario.

The converted paper machine in Dublin has a 390,000 tpy capacity, but the net gain is 150,000 tpy because of switching another machine at the mill from board to newsprint. Combined, the new machine and conversions added nearly one million tons of new capacity. All three machines came online in the 2nd and 3rd quarter of 2103. The impact of this tonnage, much of which was just beginning to hit the market late in 2013, is a major concern in 2014. Pratt also announced plans to build a 360,000 tpy containerboard mill by its box plant in Valparaiso, Indiana.

Box Demand and Consumer Spending

Probably the biggest unknown in the outlook for containerboard is box demand. The reasons behind the relatively poor performance recently in box demand is fairly obvious: a sluggish U.S. economy in combination with weak job growth and poor growth in personal income resulted in weak growth in consumer spending. This is particularly true for key markets that consume a lot of corrugated board such as food and beverage. With sluggish or no growth in disposable income over the last few years, consumers spent less on packaged food and beverages. These uses are critical for box plants as they account for just under half of total U.S. box shipments. Major food companies also reported lackluster results, mirroring the poor performance of corrugated boxes.

Looking Ahead

Looking forward into 2014, there is hope that the U.S. and European economies will perform better than they did in 2013, and this could provide a modest boost in box demand. Many economists believe that the U.S. economy could expand at closer to a 4% rate this year vs. weaker growth pegged at about 3% in 2013, which is coming on the heels of 2.8% and 1.8% growth in GDP in 2011 and 2012, respectively. Similarly, Europe's GDP fell in 2012 and was expected to post little or no gain in 2013. However, projections call for modest growth in the Euro area economy in 2014.

Notable structural changes in the containerboard market in recent years, and which continued in 2013, will also likely impact the market's supply and demand balance as well as the direction of pricing. Major mergers and acquisitions, including two major ones in 2013, have resulted in the top five containerboard producers now accounting for 75% of U.S. capacity. The most recent deals closed last year include Kapstone's $1 billion acquisition of Longview Fibre and PCA's $2 billion acquisition of Boise. Kapstone's deal moved the company into the No. 5 position in North American containerboard capacity, behind International Paper, RockTenn, Georgia-Pacific and PCA.

A rebound in the U.S. economy and thus improved box demand would be of great benefit to producers, who wouldn't have to continue to take downtime and also would result in higher operating rates. It would also go a long way in accommodating the recent capacity that has been added and allow producers to maintain a more balanced market. Given the recent weakness and new capacity it's unlikely any major movement in prices can be expected early this year.

However, if the U.S. and global economy improves, and input costs such as for OCC begin rising, producers are likely to seek additional increases later in 2014. ■

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