



Containerboard Outlook Spurred By Box Data, but New Capacity a Worry

In late 2014 box shipments improved for three consecutive months during a typically slow period following several months of sluggish demand. While it may only be a short term blip if demand has improved it would be welcome news. New capacity continues to be a nagging worry that could pull down prices if producers don't manage supply but the overall outlook remains positive.

By Harold M. Cody

Until recently, discussions about the state of the containerboard market would often center on worries about a surge in new board capacity in North America. New tonnage from several conversions plus new capacity being added over a two-year period has cast doubt about the direction of the market this year. The concern obviously is that oversupply would tip the balance in the market away from producers over to buyers.

But at least for a while the discussion took a turn in direction following a surge in box shipments in late 2014 that brought a bit of excitement and hope to the sector. The uptick began in September as shipments surged 6.6% vs. the prior year and were up 1.5% on an average week basis. Thru the first nine months of the year shipments are up 0.4%. Total containerboard production jumped 4.7% and was up 0.7% for the year while containerboard inventories fell by 54,000 tons vs. the prior month.

The September surge was followed by consecutive gains in October and November. November shipments were down on an actual basis but up 3.6% on an average week basis bringing year to date shipments up 0.4% on an average week basis.



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Inventories fell and ended November at 3.6 weeks of supply.

Three consecutive months of growth in corrugated container shipments was unexpected, particularly given the time of year, and was welcome news to say the least. Leading up to this most observers had been focused on whether the market would slip over this seasonally slow period. Nevertheless, the jury is still out on the significance of these data as it may simply be a short term spike.

However, it's also possible that the surge is in line with recent strength in the economy and thus growth could continue. The economy appears to have stepped up a notch based on several factors such as growth in industrial production of nondurables, improved consumer confidence indicators, and a drastic drop in energy prices. GDP growth, at 5% in the third quarter of 2014, was the strongest gain posted in 11 years. It's possible in turn that box use could pick up from recent flat levels.

Other news also makes it clear not everything is on track for 2015. Prices were under some pressure through the fall and into early 2015 despite the improved box plant data in

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part because recycled board prices have fallen relative to virgin grades. As a result, the major integrated mills, i.e. Kraft mills, were under increasing pressure to lower prices to avoid losing market share. Kraft liner prices in the east are reported in the \$600/ton range. Lower energy and fiber costs are a key factor behind the decline.

New Capacity

The other factor, as noted, is a major surge underway in containerboard capacity. This is a particularly noteworthy since the predominant trend for years has been the shut-down of capacity. More than 925,000 tons of new capacity entered the North American containerboard market in 2013 via new capacity and conversions from grades such as newsprint. Another 750,000 tons of capacity or more was expected to hit the market in 2014 and an additional 360,000 tons of new capacity will come online during 2015.

A range of projects large and small that total over two million tpy have or will startup over the 2013 to 2015 period. This is a gain of over 5% and it is probably somewhat understated owing to swing capacity for paper. Major projects include the conversion of two newsprint machines to containerboard (SP Fiber and Atlantic Packaging), a new recycled linerboard mill by Norampac in New York and SP Fiber's ongoing conversion to linerboard in Newburg, OR. Pratt Industries is building a new 350,000 tpy recycled containerboard mill in Valparaiso, IN and PCA planned to startup its 350,000 tpy conversion at the DeRidder mill in late 2014.

And finally, IP said it would restart a liner machine at its Valliant, OK mill late this year adding about 360,000 tpy of containerboard although the net will be less as IP stated it will reduce capacity at other mills to offset about half of the new capacity.

Strong Export Market

In contrast to concerns about supply, other factors continue to support a solid market outlook including continued strength in the export market. Linerboard exports remain a key pressure release value for U.S. mills as producers are able to divert tonnage from domestic markets in order to

sustain a balanced market in North America. The strength in exports continued despite a recent uptick in the value of the U.S. dollar which rose to a two-year high last fall against the Euro.

Liner production for export in November jumped nearly 10% resulting in a gain of almost 9% year to date. Export prices have been a bit mixed but posted gains in Europe during the third quarter of last year. The price increase helped offset the drop in dollar return on sales to U.S. mills that had fallen due to the surge in the dollar.

The export market is fragmented, however. Kraft liner exports to Central America remains solid, up over 3% through July, including a surge of 10% to Mexico. Exports to Asia remain good while shipments to Europe were up 5.3%. However, new capacity coming on stream in Mexico could slow tonnage going over the border and shipments to South America were weak.

Cautious Optimism

The bottom line is that the 2015 outlook appears promising, but the range of possible outcomes seems to be wider than normal. If box demand has in fact shifted gears to a somewhat higher level following several years of flat growth following the recession it would certainly support the case for 2015 being a notable year. But at the same time the question of the impact of new capacity lingers and whether it might lead to a slip in prices. This is a particular concern during the early part of 2015 when prices often slip historically. Falling costs are also likely to continue to favor recycled grades, which may also maintain pricing pressures.

However, if exports remain solid and the U.S. economy keeps humming, the containerboard industry's track record of managing supply has been such that I wouldn't want to bet against them. Producers have shown the ability to sustain market balance either via selective downtime or capacity curtailments. It's shaping up to be a very interesting year no matter what. ■

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