

Tough Year Ahead for Newsprint as Demand Losses Accelerate



The drop in U.S. newsprint demand picked up speed in 2007 and prices have fallen for three straight quarters, effectively wiping out the gains posted in 2005 and early 2006. While the losses appear to be leveling out and prices are at cash cost levels—indicating they can't fall much further—chances of a recovery appear remote unless producers can find a way to cut their losses fast.

By Harold Cody

In last year's column I compared the newsprint market to a boxing match, where the two fighters (producers vs. market/consumers) beat each other up until only one is left standing in the ring. Each keeps looking for a knockout punch but it ends up a marathon to see who can last the longest. At the time, the producers were definitely winning because despite the fact that newsprint demand was shrinking, a wave of significant capacity withdrawals kept the market in balance and resulted in newsprint prices rising to new peak levels in early 2006.

However, it appears that while the producers may have won the early rounds, the opponent (the market) certainly has been pacing himself for a long tough fight. The critical structural problems plaguing the demand side of the

newsprint market in 2005 continued through all of 2006. Obviously the major problem has been that, despite the large capacity withdrawals of recent years, newsprint demand has fallen even faster than anticipated. In 2005, total North American demand dropped by over 6% to about 10.4 million metric tons, with U.S. daily consumption falling 5.4% to about 7.5 million metric tons. In 2006, this decline continued at an even faster rate, as total N.A. demand dropped to 9.7 million metric tons based on preliminary data, while consumption by U.S. dailies plummeted 7.1% to just 7.0 million metric tons.

In turn, the long rise in prices ended in the second half of 2006 and a steady fall in pricing commenced. Unfortunately, the bad news for mills has gotten even worse. First, the

NEWSPRINT STATISTICS - DECEMBER 2006

(000 metric tonnes) North America	Current month		Year-to-date	
	2006	% change 2006/2005	2006	% change 2006/2005
Operating rate, %	94	96 ¹	94	96 ¹
Shipments to North America	803	-6.7	9,623	-5.6
Shipments to U.S.	721	-5.6	8,542	-6.1
Shipments to Canada	81	-15.6	1,081	-1.3
Overseas exports	229	24.2	2,242	-9.8
Imports	6 (e)	-63.2	142 (p)	-25.2
Total demand	808 (p)	-7.7	9765 (p)	-6.0
Mill inventories	306	-1.0	-	-
U.S. dailies consumption	626 (p)	2.0	7026 (p)	-7.1
Other U.S. consumption	148	-9.3	1,760	-1.8
U.S. publisher inventories	749	-7.3	-	-

1. Actual figure, not a percentage change. (e) = estimate; (p) = provisional. Source: Pulp and Paper Products Council

underlying weakness in newsprint demand continues unabated in 2007, and through May prices had fallen for nine straight months according to industry sources and producer reports.

Weak First Half Set Bad Tone for Year

Another bad sign is that newspaper publishers report that first quarter advertising revenues were off 6.5% and advertising revenues continued to fall in the second quarter of 2007. With housing, the job market and auto sales weak, there is little likelihood of a major rebound in newspaper advertising during the second half of the year. Newspaper classified ads declined 1.9% to \$16.9 billion last year, while retail advertising was down 0.3% to \$22.1 billion, according to RISI.

Similarly, newsprint consumption data through May paints a scary story as demand is off about 10% from last year's depressed levels and consumption by dailies is even a bit worse off than that. Estimates are that with economic growth expected to be weak, particularly in sectors such as housing, publishers face a further fall-off in advertising and circulation. As publisher's scrape for ways to maintain their margins by cost cutting they look to further cut newsprint consumption. These factors, along with efforts to raise revenues by upping subscription rates, which further hurt circulation, will continue to undermine any significant demand improvement through the remainder of 2007. If North American demand and U.S. dailies consumption falls another 10% this year, dailies consumption would plummet to 6.3 million metric tons while overall demand would drop to about 8.8 million metric tons. This is a loss of over 840,000 metric tons from 2006 levels in just one year!

In addition to these market problems, mills in Canada are also at an even bigger disadvantage and under added pressure because they are paying an additional penalty on sales to U.S. customers due to the strong Canadian dollar. It reached the US\$ 0.94 level in June and many analysts forecast it to continue strengthening. And finally, costs for energy

remain high and a rise in ONP prices has been trimming margins even further.

Nevertheless, there are a few glimmers of hope. It's reported that prices have now fallen close to cash costs for higher-cost North American mills. This may lead producers to embark on an aggressive supply-side management track that is the only hope of restoring the North American market balance. In addition, recent consumption data indicate that losses are less severe than those posted during the first four months of 2007 and producers have also found some relief by increasing exports to areas outside North America.

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supply, the lower newsprint prices can fall, further driving high cost mills into the red. It also remains to be seen if the somewhat less negative May shipment data will tempt producers into further delays of the necessary and inevitable capacity reduction needed to balance the North American newsprint market. Some mar-

ket analysts have also dubbed down expectations of a supply reduction induced improvement in the market when they stated that the proposed Abitibi-Consolidated and Bowater merger may slow this capacity adjustment process. They note that it's unlikely major mill or machine closures will occur until the deal is done and that this may delay any major capacity withdrawals by these companies until late 2007.

In 2005, producers did a remarkable job of not only surviving what at the time was a crisis, but also actually coming out ahead and entering a period of strongly rising prices. Unfortunately, the North American newsprint market continues to be a very tough business and producers face a very hard and very long fight. Given the weakness in the U.S. economy in areas such as housing, which appear unlikely to improve much before next year, it's hard think of any way to slow this slide that doesn't involve some very painful mill and or company closures. ■

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