



Capacity Closures and Supply Shifts Bring Some Relief to Battered Newsprint Market

By Harold M. Cody

The implosion in U.S. newsprint demand in 2009, driven by an unprecedented collapse in newspaper advertising, is moderating although demand remains weak. However, driven by strong export growth, mill shipments have recovered and allowed for significant price gains over the lows reached in mid-2009. Can the momentum be sustained despite lackluster domestic demand?

The North American newsprint business — or at least what's left of it — has survived last year's epic downturn. The combined impact of self-imposed tough medicine in the form of significant mill and machine shutdowns, external factors (e.g. the earthquake in Chile) and an easing to the freefall in U.S. newsprint demand have led to a re-balancing in supply and demand. The outlook isn't all rosy, but without question it's an amazing recovery from conditions in place a year ago. The question is whether the recent gains are temporary or sustainable.

The road to improvement hasn't been easy. The unprecedented contraction in newspaper advertising in 2009, which resulted in a huge fall off in newsprint demand, has led to the continuation and in fact an intensification of a huge restructuring of newsprint production not only in North America but around the globe. It's a restructuring that began when demand plummeted in 2008 as the global economic malaise intensified. The contraction in advertising also led to seismic shifts in traditional newspaper publishing that continue to be felt.



Photo courtesy Catalyst Paper.

If newsprint producers can continue their masterful management of supply, and not get into a fight for market share at all costs to keep mills running, they might just be able to sustain recent gains even if U.S. demand continues to contract.

since 2006. All major categories — national, retail and classified — fell drastically in 2009.

In response, newspaper page counts were drastically cut, circulation trimmed and several publishers closed their doors, leading to the huge drop in demand and in turn shipments. To put it in perspective, in 2007 North American shipments and demand were 11.1 and 8.7 million tonnes, respectively. This slipped to 10.2 and 7.8 million tonnes, respectively, in 2008 as the economic downturn intensified. The full impact of the downturn hit the industry in 2009

Make no mistake; the drop in demand last year was to put it mildly, devastating. North American newsprint shipments dropped by nearly one-third in just one year. As noted, it was precipitated by a 27% plunge in newspaper advertising revenues which fell to the lowest level since the mid-1980s. According to the Newspaper Association of America, ad revenue was \$27.6 billion in 2009, down from \$38 billion in 2008. Print ad revenues have fallen for five straight years: down 17% in 2008, 9% in 2007 and about 2% in 2006. Ad revenues are down by nearly \$22 billion, or 44%,

when shipments and demand fell to 7.4 and 5.8 million tonnes, respectively.

Exports Save the Day

However, beginning later in 2009 and into 2010, market conditions improved to the point that producers have been able to not only push through price increases but are considering more. The improvement was driven by a rise in overall shipments and major capacity reductions and combined to bring some semblance of balance to supply and demand. By early 2010 prices had been successfully raised and reached \$575/tonne early in the second quarter.

Shipments in the first five months of 2010 rebounded by about 10% over the prior years tepid levels. Domestic demand remains weak as evidenced by a 1% year-to-date drop in domestic shipments, but this has been countered by a surge in export shipments, which are up by over 50%, or 325,000 tons, compared to 2009 levels.

The largest gains in newsprint exports were for Asian destinations, where North American mill shipments jumped by almost 250,000 tons in the first five months. One reason behind this surge was reduced competition from Chinese mills, who responded to the collapse in the newsprint market by shifting to other grades. High prices for secondary fiber have also tended to limit them from switching back. Shipments to Latin America also rebounded strong, partly due to supply disruptions in areas such as Chile. Shipments from U.S. and Canadian mills to the region rose about 40%, or 115,000 tons, over the prior year level through May.

In contrast, shipments to Europe remain depressed, down 22% from last year, due to excess local capacity in the region caused by weak demand as well as a sharp drop in prices and unfavorable exchange rates due to the falling Euro. European mills are trying to jump on the same bandwagon as their North American counterparts, as their export shipments advanced 24% in the first four months of 2010.

The key improvement for mills though is in pricing. Newsprint prices plunged in 2009 from a peak of over \$800/tonne down to under \$500/tonne and to a low point in August 2009 of about \$450/tonne. Prices since then have rebounded for ten straight months following two increases implemented last year with the most recent gains reported to bring prices up to \$615/tonne in the east. Pricing is fragmented and remains lower in the west. The increases moved prices up about \$165/tonne over their lows. However, various estimates indicate that current pricing remains well below what Canadian mills need to make a profit, particularly in light of the near parity of the Canadian and U.S. dollars. This will be one factor supporting the recent price

gains and in fact spurring on efforts by mills for further price gains if the market remains in their favor.

The outlook for 2010 and beyond remains challenging as the market is currently balanced on a knife edge. In order to sustain recent price gains mills have to continue to ship product offshore, as it's believed by many observers that not only will the loss in demand in the U.S. never recover but newsprint demand in the U.S. market will continue to shrink. The decline in demand has in fact moderated this year. For example, in May demand fell 8% vs. May 2009 and, while poor, it's an improvement over the double digit declines posted in 2009.

Another problem facing the industry is that newspaper advertising remains mired in a downturn although it too is stabilizing or at least the freefall has slowed. Gannett, for example, reported first quarter U.S. advertising revenues were down 8.5% from first quarter 2009, with circulation revenues off 9%. The New York Times first quarter print ad revenues fell 12% from last year's level. However, the NYT also reported that online ad revenues rose 18% and circulation revenues gains 4%, but that was due to higher newsstand prices for the New York Times and Boston Globe.

Therefore, the challenge facing mills as they seek to maintain the gains made to pricing and shipments will depend on two key factors — export levels and operating rates. The effort to pump tons offshore has worked but it remains to be seen whether Asian tonnage returns to the market as prices increase. Regarding shipments to Latin America, it appears demand in the region will continue to be solid, but again the question is what happens when the tonnage that has been down in the region comes back online as it may.

As noted, major capacity reductions have been a key factor in a return to a balanced supply and demand situation. However, it appears additional shuts may be necessary, or at the very least the capacity that is idle needs to stay idle. North American demand is expected to continue to shrink and even if exports remain good, it's likely that overall shipments will shrink going forward. It's plausible that shipments could fall to the 7 to 7.5 million tonne level annually over the next 2-3 years and that level will require additional closures to sustain operating rates.

If producers can continue their masterful management of supply, and not get into a fight for market share at all costs to keep mills running, they might just be able to sustain recent gains even if U.S. demand continues to contract. ■

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