



Newsprint Markets Have Stabilized, But Weak Newspaper Business Remains a Big Challenge

Strong export tonnage and crafty supply management continues to sustain North American shipments and operating rates. But U.S. newspapers are struggling as print ad revenues continue to shrink despite an economic recovery that led to growth in other forms of advertising. If domestic demand remains weak the question becomes how well producers can stay ahead on the supply side and the strength of exports.

By Harold M. Cody

Newsprint producers must wonder sometimes what can possibly go wrong next. First producers worldwide took a well deserved deep breath last year as they for the most part survived the worst downturn in history. The three year plunge in global newsprint demand, which was particularly acute in North America, finally ended as the market regained a semblance of normalcy in mid-2009 and finally turned the corner last year.

They may have survived but it hasn't been easy or pretty, and to top it off the outlook isn't all rosy. Mills around the world survived in part by closing additional and significant capacity to closely match supply with demand. I'm sure producers hoped that with the worst of the downturn behind them that things would at least begin to show some sense of a return to normal. The problem is that in North America, at least, that hasn't really happened.

You Call This a Recovery?

Half way through 2011 the overall situation isn't all bad, but several serious problems continue to plague the newsprint sector. Producers still don't have a clear path forward despite the fact that the economy has been improving for some time. Normally, as the economy improves demand recovers and the market enters into a new business or market cycle. Unfortunately some problems won't seem to go away and thus a "normal cycle" has yet to materialize. The most challenging problem is a nagging downturn in U.S. demand that never seems to end. In addition, rising costs are pinching margins and, finally, the outlook for exports remains a question.

In order to assess where things stand let's recap the last year. First, without doubt newsprint markets staged

a solid recovery in 2010 when compared with the prior three years which were characterized by unprecedented problems. The market finally and at last stabilized during 2009 and this was followed by a modest recovery last year. Operating rates improved and overall North American production posted a modest increase. North American operating rates were 91% for the year, vs. 76% in 2009, one of the worst levels ever recorded.

However, the bad news is that domestic demand stabilized at a very low volume level. In fact, if one were to look at some key newsprint market data in isolation it could easily be concluded that last year was actually a recession. As an example, while the tone of the market was markedly improved compared to the depths of the recession, total North American demand last year fell 6% compared to 2009 to a level of 5.4 million metric tonnes, according to PPPC. Shipments to N.A. were 5.3 million metric tonnes, a 5.8% drop, mainly driven by a 6.9% drop in shipments to the U.S., which fell to 4.5 million metric tons. The decrease was the result of an 8% drop in US daily newspaper consumption which ended the year at 3.7 million metric tonnes.

What literally saved the day was a huge gain in overseas newsprint exports, which rose 44% to 2.5 million metric tonnes. Exports accounted for about one-third of shipments last year, vs. just under one quarter in 2009. For the full year, exports to Latin America were up 27% and exports to Asia (excluding Japan) more than doubled, with shipments to both regions falling just shy of a million tonnes. Exports have weakened a bit in early 2011 but remain solid. A good portion of Japan's newsprint industry was shut down by the tsunami and this is one factor currently influencing global trade.

The world newsprint market also posted a recovery in 2010, however, growth remains modest and it varies widely by region. In the developed economies of North America and Europe, newsprint markets remain mired in a downturn where capacity withdrawals and capacity management are facts of life. Growth in other areas of the world such as Asia and South America continue although at reduced rates, and these remain key markets for producers worldwide. Capacity growth around the world remains modest but is something to closely monitor because growth in domestic capacity can have a far ranging, and negative, impact in imports from mills such as those in the U.S., Canada and Europe.

During the three-year downturn, global demand dropped 15% or about 7 million tonnes according to estimates. Demand in the developed regions such as North America is falling at a rate of about 3% annually on average.

Nevertheless, as a result of these developments and despite some bad news and underwhelming market indicators, the current market is in much better shape than it was. With the improvement in operating rates producers have been able to keep prices stable at about \$640/metric ton, where they've remained since late summer 2010. Prices rose about \$100/metric ton in 2010.

Dilemma of Advertising Weakness

The question now is where we go from here. It's a big unknown because of a huge problem facing newsprint producers: their biggest customer is suffering. Nearly two years after the overall economy began to pull out of the worst downturn since the 1930s, U.S. newspaper print advertising revenues not only haven't recovered, they don't appear to have stopped falling. Almost all other media, including magazines which posted a small improvement, posted some gain in 2010 over extremely weak 2009 levels. The gains may be small by historical measures and advertising remains well below pre-recession levels, but they were gains nonetheless.

After falling about 6% last year, and dropping on a quarterly basis since early 2006, it was hoped that newspaper ad sales might rebound this year. Unfortunately, the news so far in 2011 hasn't been much better. According to the Newspaper Association of America print ad sales fell by a steep 9.5% in the first quarter of 2011. This will inevitably lead to further shrinking in daily newspaper consumption.

The cause of this lingering problem is essentially what we reported in last year's newsprint column. Classified ad revenues are shrinking due to an unfortunate confluence of factors including stubborn high unemployment, a housing market on life support that has yet to recover and continued shifts/losses to electronic media.

One important newspaper advertising market, automotive, has rebounded. However, while vehicle sales bounced by 11% in 2010 after three years of successive decreases, newspaper automotive advertising did not rebound. In fact, auto advertising revenues fell almost 20% last year. Classified ads from autos are now only about 20% of what they were in the mid-2000s. In first quarter 2011, real estate classified fell 19%, auto was down 4.7% and retail fell 9.5%. Employment ads did post a modest 4% increase. As noted, this fundamental weakness resulted in an 8.0% decline in consumption by US daily newspapers last year, according to the Newspaper Assn. of America.

An ongoing concern was that even if advertising recovers, the gains would only be modest. In fact, unfortunately it now appears that revenues from print simply may not recover. Newspapers are working frantically to leverage the strengths of their businesses — a wide range of information gathering resources and a solid sales network — into a new business model based on electronic/online formats. Online advertising and readership continue to grow, but they remain minor and they certainly aren't growing fast enough to offset losses in traditional advertising.

So where does this leave us? Operating rates in May were 92% indicating that for now markets remain fairly stable. But signs of weakness continue to crop up and are a cause for concern. The continued weakness in domestic demand is in fact one key reason that prices have remained flat. Producers attempted to raise prices \$35/metric tonne for July shipments to offset rising costs and to improve margins, but this attempt failed as market fundamentals (shipments, inventories, etc.) weakened during early 2011.

Mills would like to attempt another increase later in the year despite the continued decline in North American demand for newsprint. With the Canadian dollar rising and with costs for fiber, energy and chemicals going up, Canadian mills will be under particularly extreme pressure. Industry observers note that the chances of any price increase this year, or next, likely depend on additional capacity curtailments, so further painful adjustments will be forthcoming unless domestic consumption posts a remarkable recovery — or unless exports remain an area of growth, which appears unlikely.

One thing does seem clear. Producers must continue to play the same hand they've been playing. They have to stay ahead of demand by cutting capacity as required and continue to ship a lot of tonnage to offshore markets. If they play the hand well, another price increase later this year may be possible. Keep watching. ■

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