

# Falloff in Exports Poses Challenge to Stability in North American Newsprint Market



Strong export demand has been a crutch holding up the North American newsprint market. As exports have eased in recent months it is raising concerns about the future direction of the market. Producers will have to work hard to maintain market stability if shipments continue to slide as expected.

By Harold M. Cody

Over the last year, or actually even longer than that, the North American newsprint market has maintained a surprising degree of stability despite the bleak news that continues about the customer side of the business. While newspapers have continued to look like an endangered species as they fight steadily eroding revenues, the overall market for newsprint has been fairly stable, with prices holding steady for almost two years, one of the longest such streaks on record. It appears, however, that to sustain this stability will require additional realignment on the capacity side as some holes have started to appear in the armor that has been protecting the market, i.e. the strong exports that had until recently gone a long way in offsetting the decline in domestic shipments.

As has been the case for some time, the fundamental challenge facing newsprint mills is a continued decline in newsprint demand. Through the first five months of the year, North American shipments have plummeted and are down 9.4% in the January to May period compared to 2011. May shipments were off by 11% vs. year earlier levels.

The current decline comes on the heels of an annual decline in North American newsprint shipments of 6.4% in 2011 to 4.987 million metric tonnes according to the Pulp and Paper Products Council. Shipments finished the year in a steep downward direction, falling 13.1% in December compared to 2010. North American demand fell 7.4% in 2011 to 5.0 million metric tons. This followed a 6% decline in 2010 as shipments slipped to 5.4 million metric tonnes according to PPPC.

## Dilemma of Advertising Weakness

The culprit behind the decline of course is the continued loss of advertising revenues to other media. The loss in revenues is



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coupled with and caused by a continued decline in daily newspaper readership as more consumers get their news on the internet. The shift has been enabled by strong growth in smart phones and more recently by the explosion in use of tablets such as the iPad.

During the first quarter of 2012 newspaper advertising revenues fell 6.9% compared to year earlier levels according to the Newspaper Association of America. Newspaper print ad sales fell 10.5% in 2011, following a more muted 4.6% decline in 2010. As noted in last year's column, it was hoped that the lower rate of decline in 2010 might indicate a slowing of loss in print ad

sales. However, while digital ad revenues posted a 6.8% gain to \$3.2 billion last year, total print ad revenues fell 9.2% to \$20.7 billion. All major categories declined including national, retail and classified, which fell by 10.5%, 8.0% and 11%, respectively.

The biggest drop in classified ads in 2011 was registered by the real estate category, as the housing market continues to struggle. Automotive ads fell by 10.7% and the other category by 10%. If there was any good news in the data it was that employment advertising fell just 1.6%. However, the job ad category has fallen so far due to weak employment and continued losses to electronic job wanted services it's now a minor category. Classified job ad revenue in 2011 was \$0.7 billion compared to a level of \$5 billion in the early 2000's and \$2.1 billion as recently as 2008.

The erosion of newspaper's basic advertising business has led to continued structural change in the publishing business and all of the changes have been geared to minimize costs. These include downsizing sheet size and more recently the move by many papers to cut back the numbers of days published. All of these reduce newsprint demand.

On the bright side, when including digital editions, newspaper circulation data has shown surprising signs of resilience. According to the Audit Bureau of Circulations (ABC), total circulation for the 618 US daily newspapers tracked by ABC was flat for the six month period ending Mar. 31, 2012 due in part to the inclusion of digital subscriptions with print editions. Circulation among the 532 Sunday newspapers that reported was up 5%, ABC said.

### Dip in Exports Could Weaken Market

While newsprint consumption by the key daily newspaper segment continues to contract, the main culprit causing more noticeable and worrisome problems recently has been the dismal performance of exports. Offshore shipments in May 2012 were down 28% compared to a year ago and off 26% year-to-date for the January to May period. The decline comes on the heels of a 6% drop in exports in 2011. Offshore volumes have accounted for 27% of total shipments in 2012 vs. 32% of total shipments in 2011.

The key role played by exports was highlighted in last year's column on newsprint, where it was noted that a surge in exports literally saved the day for North America's newsprint mills. In 2010, overseas shipments by North American mills rose 44% to 2.5 million metric tons. At the time, exports to Latin America rose 27%, and more than doubled to Asia, with shipments to each reaching nearly one million tonnes.

At the present time, newsprint supply exceeds demand in these export markets, due in part to the lower Euro and a weaker Indian rupee, and which have resulted in US\$-based North American newsprint being less competitive. Asian shipments, not including those to Japan, are 39% lower in 2012 compared to the same period of 2011.

It should be noted that the drop in exports in 2011 is partly due to the shuttering of capacity by White Birch and SP. These capacity withdrawals late last year went a long way in supporting operating rates into early 2012 and were a big aid in sustaining prices even as exports fell and domestic demand dropped.

It's also of interest that the drop in exports has completely overshadowed what is a surprisingly solid year in domestic newsprint demand. North American total newsprint demand was only off 2.3% in May 2012 vs. year earlier levels and 1.7% lower for the January to May period compared to 2011. However, according to various sources, these numbers don't tell the whole story, as strong gains in the commercial printing segment, where demand was up almost 30%, have masked the decline from newspapers.

### Can Price Stability Continue?

While the demand side has been ugly, with the help of exports and timely capacity shuts, producers have been able to maintain operating rates. In turn, one striking facet of the current market is that prices have been stable at about \$640/metric ton where they've remained since late summer 2010.

But the overall outlook isn't pretty. North American shipments will continue to slip and while exports remain high in absolute tonnage terms they will be lower than last year as the depreciation of key export currencies in Asia and the financial crisis in Europe make the export market a challenge. European newsprint demand continues to decline and is expected to shrink about 4% to 5% this year. This will continue to require significant capacity reductions there as well.

It appears that further capacity reductions will be needed to maintain any semblance of a balance of supply and demand and any hope for a much needed price increase since newsprint mills are also only marginally profitable. At a rate of decline of 7% annually on a base of 5 million m/tons, capacity would have to be reduced 350,000 tpy annually just to maintain the status quo. With the drop in exports that number increases substantially.

Capacity shutdowns are old news in the turbulent newsprint business but the situation going forward is even harder to predict than normal and may resemble a game of musical chairs. Someone may just be left without a seat depending on timing and will have to drop out of the game.

The uncertainty on the supply side is due to the fact that several major producers are in bankruptcy or headed that way including No. 2 producer White Birch and No. 4 SP. White Birch closed the 400,000 mtpy Stadacona mill in late 2011 and SP cut capacity 225,000 mtpy when it converted 40% of the Dublin, Georgia mill to kraft paper and board. With the Canadian dollar continuing to remain strong, other Canadian producers are also feeling the pain. A recent example was when Resolute indefinitely shut down newsprint capacity at Mersey (250k m/t) largely targeted at export.

Mills could also face major cost pressures and this could impact the need to raise prices as well as determine what mills are forced to shut down. Recycled fiber costs have slipped recently but ONP prices may head to higher levels according to industry sources who predict ONP will move back to 2011 average levels of about \$145/short ton sometime this year. This could force some downtime or capacity withdrawals at recycled newsprint mills in North America. However, on a global basis, much more ONP is used by mills outside N.A. and thus this may actually benefit the many N.A. mills that predominantly use virgin fiber.

The bottom line is it appears it will be difficult for the market to be tight enough to support any major price increase without further capacity withdrawals. In fact, prices fell slightly by \$10/mton in June on the west coast indicating how the market has eased. If the downward spiral of both demand and exports continues, significant cuts will be the only path available for producers to maintain a tight enough market to allow them to avoid a price decline, let alone achieve a much needed price increase. ■

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