



Shrinking Uncoated Freesheet Demand Continues To Pose a Key Challenge

The slide in uncoated freesheet demand continued in 2011. The decline wasn't a surprise as sluggish economic growth and high unemployment, combined with technology-driven consumption shifts, undermined the market. An end to the slide doesn't appear to be in sight, which places pressure squarely on producers to control supply.

By Harold M. Cody

The North American market for printing and writing grades continues to move through a very unstable period. Demand for most grades continues to shrink due to fundamental changes in paper consumption in the developed economies of North America. This includes uncoated freesheet grades, where demand continued to decline last year.

Back in 2010, a recovery in the U.S. economy resulted in a slowing of the fall in uncoated freesheet demand from the rapid rate of descent that occurred during the recession. Thus there was some hope that as economic growth continued paper demand might post a modest recovery. However, even as U.S. economic growth actually accelerated through 2011 and GDP rose each quarter (0.4%, 1.3%, 1.8% and 3.3%, respectively), paper demand continued to fall.

It is clear that the long term relationships between paper demand and the general economy, advertising and other paper usage factors, have fundamentally shifted. The decrease in demand continues to be driven by a combination of factors, including continued high unemployment and a combination of technological elements that are working together to reduce the use of paper.

The result of all of this was that North American (U.S. and Canada) uncoated freesheet demand fell 3.4% in 2011, finishing the year at 10.1 million tons, according to the Pulp and Paper Products Council (PPPC). Production was down 3.1% to 9.7 million tons and industry operating rates were poor, averaging 88% for the year vs. 89% in 2010.

U.S. uncoated freesheet production fell 3.0% to 9.26 million tons in 2011, according to AF&PA. It's worth noting that this is the smallest decrease among major grades, as U.S. production fell by 11.5% and 6.2% for uncoated mechanical and coated paper grades, respectively. In addition, U.S. newsprint production dropped 4.7% from 2010 levels.

U.S. trade helped the market somewhat in 2011 as U.S. imports through 11 months were reported at 930,000 tons — a decrease of 2.6% compared to 2010. Imports of uncoated

freesheet are modest accounting for only 6.4% of N.A. demand. As a result of a new paper machine at the Portucel mill, which is now at full capacity, imports from Portugal increased 10% last year. Exports rose 4% last year owing to a strong surge in December.

The decline in demand was widespread across all major uncoated freesheet grades. Bond and writing, offset and envelope grades are the three largest segments and account for 75% of total shipments. Shipments of bond and writing papers, the largest at about 4 million tons, fell 3%. The largest decline was posed in offset grades, where shipments fell just over 6%, followed by a decline in carbonless papers of 3.9% and bond grades of 3.5%. Envelope paper shipments fell just under 3%. In contrast, form bond posted a modest increase while tablet grades shipments jumped 14%.

One broad measure that can be used to track paper use is mail delivered by the USPS. For the fiscal year ending Sept. 30, 2011, total USPS mail volume for all classes was down 1.8% in number of pieces while overall weight was down 1.3% vs. the prior year. It should be stressed that this occurred during a modest economic expansion.

The problems facing uncoated freesheet grades are particularly troublesome since they are the largest segment of the printing and writing papers market and encompass a wide array of grades that the average person encounters every day. These include many brands and types of cut-size papers used in business and home office printers and copy machines, carbonless papers used in multipart forms, offset and envelope grades used for direct mail as well as first class business mail, and paper used for hardcover and soft cover books (this excludes paperbacks which are groundwood papers). In 2011, uncoated freesheet grades accounted for 41.2% of North American demand of 24.2 million tons of printing and writing papers. Uncoated groundwood, coated freesheet and coated groundwood accounted for 21.2%, 20.3% and 16.8%, respectively, of total demand.

Price Stability Despite Downturn

Despite relatively poor operating rates that averaged under 90% in 2011, combined with the bleak news on demand, prices remained fairly steady on major grades, according to various sources. In early 2012, prices for cut-size papers eroded slightly as it's reported that low cost imports sought market share, while offset roll prices were reported to be holding up better. Copy paper prices were reported at about the \$1,050/ton range in early 2012, a few percentage points below prices posted in early 2011. Prices have remained surprisingly stable for the better part of two years and have remained in a narrow band during that time.

There are a couple of reasons for this incongruity. One is a cost push due to rising prices for energy and relatively high pulp prices — both of these have helped to sustain pricing. Recently, however, pulp prices have dropped significantly since peaking last summer and are now down about \$150/ton or 15%.

Probably the key factor behind price stability is that producers have closed over 5.7 million tons of capacity in the last decade. Ten years ago North American uncoated freesheet capacity was on the order of 17 million tons, dropped to 14 million tons in 2007, before rapidly plunging to just over 11 million tons last year.

More of the Same?

Unfortunately, when we turn to assessing the outlook for the uncoated freesheet market in 2012, the early reports aren't

encouraging. North American printing and writing paper shipments in January 2012 fell to 1.5 million tons, down almost 6% from year earlier levels, PPC reported. Demand dropped 6.6% while operating rates were at 90%. Similarly, U.S. printing and writing paper shipments fell 3% in January as all four major grades posted decreases compared to January 2011 levels. New supply fell 8%. Uncoated freesheet shipments fell 1% vs. the prior year, which isn't all bad, while they rose 5% month to month vs. December. As noted earlier, exports jumped by over 20% in December bringing the full year total to a 4% increase.

The outlook for 2012 certainly isn't very rosy on a tonnage basis. While GDP is projected to post a modest 1.7% gain in 2012, it is widely expected that no end is in sight to the fall off in demand for printing and writing papers in both North America and Europe. It's projected that uncoated freesheet demand may continue to shrink by at least 2-3% and it could contract even more than that. The stability in prices will be challenging to maintain if pulp prices remain weak, but there are recent signs that the slip in pulp prices might be ending. If fiber prices rise again and combine with the recent surge in energy prices to push up manufacturing costs, uncoated freesheet mills may be able to continue to sustain pricing in spite of all the issues battering their markets, and as long as they continue to aggressively prune capacity. ■

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