



# Freesheet Market Looks Up As Major Capacity Shuts Tighten Supply

A significant reduction equal to about 10% of capacity over just the last six months set the stage for a rebound in uncoated freesheet pricing that began in late 2013 and carried over into early 2014. With operating rates expected to remain strong, the increases are likely to be enacted despite the continued and steady drop in demand.

By Harold M. Cody

Uncoated freesheet markets began the New Year, from the mill standpoint, in probably the best position they've been in for several years. By swallowing the hard pill of a significant and permanent closure of U.S. uncoated freesheet capacity, producers have sent the strong and clear message that they "get it." A closure of over one million tons of capacity in a short period of time has "rebooted" the uncoated fine paper business by shifting the supply and demand balance significantly to favor producers. Shortly after the largest closure was announced, the first of two price hikes was initiated and a second increase announcement followed shortly thereafter.

While the improvement in pricing is likely the best news producers have seen for some time, not all of the news is good. North American demand for printing and writing papers continues to contract, posting a 1.6% decrease to 22.3 million tons in 2013, according to the Pulp and Paper Products Council. Uncoated freesheet demand fell a more modest 1.4% to 9.5 million tons, while shipments were off 2.9% at 8.7 million tons, and imports posted a substantial gain rising by almost 20% to 763,000 tons. The largest drop in demand was posted by coated mechanical grades, which fell by 6.6% vs. the prior year.

U.S. uncoated freesheet grade by grade shipment data



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confirm that the decline in usage is fairly widespread across many key grade segments. Shipments of bond and writing papers, the largest segment which includes common cut-size office papers, fell 1.6% to 3.8 million tons in 2013. The good news is that this was the smallest decrease posted by the major grade segments. In contrast, shipments of offset, envelope and form bond grades fell by 3.1%, 2.6% and 6.9% respectively. U.S. uncoated freesheet imports rose 6.7% to 1.0 million tons while exports were flat, rising 0.5% to 991,000 tons.

The uncoated papers business continues to face severe challenges

caused by shifts in demand due to technology as well as weak economic and job growth which all continue to result in lower usage for a number of key grades. The ongoing move to increased use of mobile devices, electronic bill paying and online resources is hitting key grades such as envelope papers particularly hard.

In contrast, there are a few beacons of light. For example, in the "other" papers segment, there is some optimism that this category could actually post gains as the wide range of specialty grades comprising this group has shown some growth. The segment includes many products and end uses ranging from release liner paper for labels to specialty packaging papers used for take-out food — a growing market.

## Big Shut by International Paper Shocks the Market

As noted, a big reduction in capacity has shifted the supply and demand pendulum to favor producers. The largest capacity reduction, which was huge, was by International Paper at the big Courtland, Alabama mill, where three uncoated freesheet machines with a capacity of about three quarters of a million tons were retired. Following the shutdown of the first production line late last year, the last two machines which accounted for about 550,000 tpy were reported to have been shut down in early February.

Additional capacity reductions announced or enacted last year include an additional 225,000 tpy by Boise Paper and Georgia-Pacific on three paper machines. Two paper machines with a capacity of about 125,000 tpy will be shut down at the Boise mill in International Falls, Minnesota and GP shut down one PM with an annual capacity of about 100,000 tpy in late 2013 at the Crossett, Arkansas mill. With uncoated freesheet demand falling on average at about 3% annually since demand first began to fall over 10 years ago, the shuts are an ongoing requirement to keep the market in balance. Last year, the decline in uncoated freesheet papers demand, at under 1.5%, was only about half of the long term average.

## Varying Prices

With the impetus provided by the capacity reductions, producers began to push for higher prices almost immediately beginning in the fourth quarter of 2013. A successful increase would be the first major improvement in prices in over 2 years and would begin to offset a roughly \$100 drop in prices on the major graders over the last year or so.

The initial move to raise prices was targeted at October 15 by one major producer and would raise prices by \$60/ton on all grades except cut size. Soon most producers had announced increases for the latter part of October.

By February 2014, prices had moved up across a wide spectrum of grades. The degree of success varied widely it's reported, but in the big cut-size segment prices appear to have risen by about \$20/ton according to reports. Prices on grades other than cut-size, which is particularly price sensitive since a lot of tonnage is sold via office supply stores, rose by somewhat larger amounts of \$40-\$50 per ton on offset and envelope grades. However, prices continue to lag below year ago levels.

Trying to maintain momentum in early 2014, additional price increase announcements were made by most of the major players. According to reports, a \$70/ton increase is targeted for shipments beginning in March. The increases vary from the higher amount down to \$40/ton on other grades.

A combination of the October and March increases would result in one of the larger increases in a long time and the \$70/ton increase itself is almost without precedent in recent times. Again, the driving force behind this was the aggressive steps taken to cut capacity the equivalent of about 10% of U.S. capacity.

## Postal Price Hike No Help

As noted, not all of the news is good. One notable development to watch is the late-2013 announcement by the U.S. Postal Service of a surprise 6.0% hike in postal rates. The increase will certainly have a negative impact on demand although it may be modest. The impact is likely to be felt even more so by coated grades.

U.S. Postal Service mail volume data illustrate one underlying cause for the drop in demand and are a key indicator. For example, for the fiscal year ending last September, first class mail volume in pieces of mail was down 4.2% vs. the prior year at 66.7 billion pieces, with mail volume as measured by weight off 3.6%. Standard mail volume data was better with mail volume in pieces up by 1.5% at 80.9 billion pieces but weight was down 1.1%. First class mail is a major user of envelope and several printing grades as well as cut-size papers, while standard mail volume is a larger user of printing papers such as coated and uncoated groundwood.

## Not a Bad Start to 2014

With a head of steam behind them producers appear to be in the best position they've been in 2-3 years. Operating rates are expected to remain high due to the reduction in supply providing the platform for producers to push through the recent announcement and possibly additional increases as well. On the upside, overall paper use may benefit from stronger economic activity expected this year, with most forecasts projecting a GDP increase of about 2.5% in the U.S. and slightly stronger growth for the world overall. However, according to some observers the decline in uncoated freesheet demand is likely move back to the long term rate of about 3%.

One thing to monitor is creep capacity at coated mills caused by weak coated paper demand. By simply shutting down the coater, mills may target increased tonnage at the uncoated market given the recent rise in prices which make it an attractive option. Overall, however, producers started off the year with a bang and while it's still a tough world it should be a better year than last year. Unless you are a paper buyer. ■

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