



Despite Fighting Major Headwinds Coated Freesheet Market Holding Steady

Overall, the coated freesheet market remains relatively stable despite poor demand. However, the outlook remains challenging as subdued economic growth and shifts in use result in a continued shrinking of demand. The market should hold course again this year but it's uncertain if a recent round of price increases can be supported.

By Harold M. Cody

The market for coated freesheet papers remained relatively balanced most of last year. Demand continued to decline but good supply-side management maintained operating rates at reasonable if not high levels and producers also kept mill inventories low. In turn, pricing remained steady for most of the year with little change. These conditions for the most part continued into the first quarter of 2013 although a minor amount of price discounting was reported in January.

Looking at the outlook for the remainder of 2013 is a lot like looking into the rear view mirror. It appears the major market forces that were in place in 2012 will continue without significant change in 2013. Economic growth might be a little worse this year, but the difference isn't significant enough to really shift the direction of major market drivers such as advertising or paper consumption trends.



One major reason behind a relatively stable coated market over the last two years despite a drop of 7% in demand has been the closure of a significant amount of capacity.

Declining Demand

As reported in last year's column, the main problem for coated freesheet, and for that matter essentially all graphic paper grades, is a secular decline in demand in the mature markets of North America and Europe. A key factor is lackluster advertising spending which is a major driver for coated paper demand. This is due to both secular changes and economic trends including macro-economic factors such as sluggish economic growth and stubbornly high unemployment.

In addition, an ongoing fragmentation of media markets and explosive growth in the use of digital media are negatively impacting paper demand for many grades and this impact is growing. As units sales of smart phones and now tablets grows rapidly more and more information is consumed online. This in turn has led to reduced paper consumption in a wide range of products including magazines,

direct mail, promotional materials, catalogs, etc.

The most recent data, for the first quarter of 2013, clearly shows the downward trend in demand is continuing and even accelerating in some segments. North American printing and writing paper demand in the January to March period decreased 5.2% compared to the same period last year, falling to 5.4 million short tons as shipments dropped 4.9% to 5.2 million tons according to the PPPC. Coated freesheet grades fared a bit better than that, but demand still fell 3.9% to 4.5 million tons. Shipments fell 1.8% to 939,000 tons in the first quarter and imports dropped by almost 14% to about 218,000 tons.

In 2012, North American printing and writing paper demand fell by 6.3% to 22.7 million tons and shipments declined by 7% to finish the year at 20.2 million tons. The decrease varied by grade although all major grade segments posted declines. Coated Freesheet demand fell 3% to 4.7 million tons as shipments dropped 4% to 3.8 million tons. Imports rose a modest 1.2% to 967,000 tons. Demand in the largest segment, uncoated freesheet, plummeted 4.7% compared to 2011 to 8.8 million tons. Uncoated mechanical demand slipped 16%.

Using the first quarter data and extrapolating it for the full year projects that coated freesheet demand would decline to 4.5 million tons this year. Similarly, total printing and writing paper demand would be 21.7 million tons.

A 4% drop in demand this year — assuming no change in import market share — equates to 180,000 tons of capacity that will have to be shut in order to maintain operating rates at present levels. To push operating rates to the 94% to 95% level, which historically represents the level where producers have improved pricing power, would require additional capacity reductions.

Of course one major reason behind a relatively stable coated market over the last two years despite a drop of 7% in demand has been the closure of a significant amount of capacity. In the 2011-2012 period over 3.0 million tons of global coated capacity was shutdown with the majority of this in Europe. Most of the capacity shuts in North America were for groundwood grades, but it included shutdown of a coated freesheet machine at the Smart Paper's mill in Hamilton, Ohio.

Grade shifts may also impact demand for coated paper this year, according to various published reports. Uncoated SC grades recently gained market share vs. coated groundwood LWC due to low prices for these grades. If this continues, coated groundwood demand could post a more significant decline this year.

Can Prices Be Improved?

As noted, coated freesheet prices have remained essentially level since the second quarter of 2012. By contrast, coated mechanical papers saw a modest \$50/ton gain in prices during the second half of 2012. However, in early May producers announced price increases on several printing grades as they moved to set the stage for higher prices for the second half of the year. The announcements were a little surprising given the poor demand data noted above. In fact, an attempted increase of \$50/ton on coated freesheet earlier in the year failed.

The increases include \$20 to \$30/ton for coated freesheet announced by Sappi, West Linn and NewPage for July 1. Increases were also announced on LWC (\$40/ton, July 1), and SC (\$50/ton, July 1) by most producers.

While the announcements may have been a little surprising, a couple of factors would tend to indicate it might go forward. These include the fact that coated freesheet prices didn't increase last year when coated groundwood grades did. In addition, imports play a larger role in coated freesheet than in coated groundwood and offshore mills face serious cost pressures due to in particular to higher pulp prices but also higher costs for freight and energy. With imports accounting for about one-fifth of the coated freesheet market, part of the rationale behind the domestic increase may be the fact that offshore producers have been trying to increase prices to match the higher prices in other markets.

The bottom line is that coated freesheet markets are expected to continue to remain relatively stable even as U.S. demand shrinks an additional 3-4% this year. Producers would like to gain a little more margin, or at the very least recover some lost margin by implementing the price gains. If they continue to manage supply it might just work but it's not a done deal. ■

Harold Cody is a contributing writer for PaperAge. He can be reached by email at: HCody@paperage.com.