



# Coated Freesheet Market Improves, but Supply/Trade Issues May Impact Gains

U.S. demand for coated freesheet declined modestly last year but the drop wasn't nearly as severe as the plummet in coated groundwood. The most welcome news is that prices rose modestly in the last few months. However, while demand is expected to be flat or post a modest decline in 2015, further coated freesheet price gains may be subdued by the strong dollar and excess supply via rising imports.

By Harold M. Cody

Overall the coated paper market didn't do very well in 2014 as demand continued to drop and prices were weak for much of the year before improving during the second half. Coated freesheet demand slipped modestly vs. 2013 levels but fared much better than coated groundwood where demand plummeted. The improvement in pricing is good news, but the outlook is muted for the remainder of 2015. The overall market is expected to follow in line with last year with coated freesheet grades doing better and posting only a modest decline in demand. In contrast, there is concern groundwood demand could continue to suffer.

Without doubt, the biggest news in the coated market recently didn't involve pricing or supply/demand, but rather a major restructuring on the producer-side that significantly changed the coated paper business. In early 2015, ownership of a large majority of North American coated paper capacity changed significantly. The change was the culmination of a long awaited mega-merger as Verso bought NewPage in a \$1.4 billion deal that closed in early-January. The new company has about \$3.4 billion in annual sales based on eight mills in six states.



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Immediately prior to the deal being finalized, NewPage divested several key assets in order to meet Department of Justice concerns about one company monopolizing the coated paper market. The Biron, Wisconsin and Rumford, Maine mills were sold to Catalyst Paper. The move catapulted Catalyst into the No. 1 spot in coated groundwood capacity with a share of about one third followed by Verso with about 25%. Verso remains the largest coated freesheet producer with almost half of North American capacity, followed by SAPPI at about one-third.

The change in ownership was, at least in the short term, likely to have an unsettling effect on prices according to many observers, as mill order books began to reflect the new reality of "who's who" in coated paper manufacturing. It is also likely to provide producers with an enhanced ability to monitor supply and match it to demand — something coated mills have been very good at in the past. A noteworthy example of this was the large amount of coated groundwood capacity shut in the last couple of years.

As noted above, the long term contraction in graphic paper demand in the developed economies of the world continued in 2014. While U.S. coated freesheet demand continued to contract last year, the decline posted was the

lowest of any of the four major printing and writing grades. Total North American printing and writing paper demand fell 4.1% last year to 21.4 million tons, according to the Pulp and

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mill operating rates were 94% vs. 90% for coated freesheet. Operating rates in December were 112% for groundwood and just 81% for coated freesheet. While demand was

Paper Products Council. Coated freesheet demand contracted by 2.3% vs. 2013 levels, falling to 4.1 million tons. Coated freesheet shipments fell by 2.2% and were 3.4 million tons.

The drop in demand for the other major printing and writing paper segments were even larger. Coated mechanical demand fell by over 5% and uncoated freesheet demand shrank 4.3% vs. 2013. Similarly, European graphic paper demand posted major declines as well. The much larger drop in coated groundwood demand is the result of continued stagnation in demand for these grades in products such as magazines and catalogs, as well as continued market share losses to uncoated SC grades in some applications.

Clearly an improvement in mill margins due to higher prices and lower input costs was the best news last year and/or so far this year. Input costs were down for energy and some chemicals, but in some areas this was offset by higher fiber costs due to the extreme winter. Modest price gains for coated freesheet were posted in the third quarter of 2014 during July for web grades, which account for a significant volume, but they remained below year earlier levels. During the fourth quarter 2014, prices increased modestly as well and bringing them to near the same level as in fourth quarter 2013. Coated freesheet prices continued to gain ground a modest amount during the first five months of 2015. Groundwood grades posted even larger increases.

As mentioned, the short term direction in coated paper prices is expected to be unusually hard to predict due to the massive changeover in customer books as a result of the merger and subsequent entry of Catalyst as a major coated paper producer.

Some analysts predict that coated groundwood prices will be stronger this year and an additional price increase is likely to be enacted. In contrast, coated freesheet supply is more abundant and thus gains are likely to be less. Operating rates are one measure that illustrates the tighter supply of coated groundwood. For full year 2014, coated groundwood

weak, the shuttering of a large amount of capacity sustained operating rates for coated groundwood mills.

### Outlook

Looking forward, one key factor that is likely to be important is the impact of the strong dollar on foreign trade. Both the Canadian dollar and the euro have fallen 20-25% since early 2014, and the euro reached its lowest point in several years in early January when it was 1.18 Euro to the U.S. dollar. Coupled with higher prices in North America, European mills are likely to look longingly at exporting more coated groundwood and freesheet. Last year the U.S. imported about 785,000 tons of coated freesheet. Major coated freesheet suppliers to North America include Germany and Finland, while in Asia, South Korea accounts for a large majority of exports.

The bottom line is that a strong dollar makes suppliers in Europe and Canada more competitive in the US market. It has also opened up a huge price gap — reaching nearly \$250/ton on some grades — between prices for similar products in Europe and North America. U.S. prices are now some of the highest in the world. Some producers have been trying to raise prices further in the second quarter of 2015, which will exacerbate the disparity between prices in Europe and the USA. It's likely the opportunity to increase margins on sales of offshore paper in the U.S. will lead to a surge in European imports in 2015.

In turn, if the strong dollar continues, prices could slip later in 2015 and into next year because the large gap between prices in Europe and the U.S. wouldn't seem to be sustainable.

Another key to watch is coated freesheet capacity. If demand shrinks more than projected, then additional capacity reductions will have to be made in order to avoid prices retreating and giving back their recent hard won gains.

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