tissue report

Made in North America – Tissue

The North American tissue market is a large one at more than 8 million tons. In recent years, when many product sectors have been suffering from the impact of the recession, it has proved to be the silver lining in the North American paper industry.

By Sanna Kallioranta and Soile Kilpi

North American demand for tissue has been on a steady growth trajectory of 2%/yr since 2000, though the latest severe recession had an impact and US production growth was just 0.6% in 2009, according to AF&PA. The stable long-term demand growth is forecast to continue and Pöyry expects tissue demand to grow 0.8-1.7%/yr. over the next five years, depending on the speed of economic recovery.

The forecast steady but rather modest demand growth is likely to direct tissue players to look for opportunities in higher than average growth or niche markets. Not all tissue end-uses have equal growth expectations, but there are pockets of opportunities for those who focus on the right end-use products and niches.

Towels are expected to have a stronger than average outlook as they substitute napkins and make their way into bathrooms in American homes. Kimberly-Clark is the front runner in the at-home single use bathroom towel market through the Kleenex Hand Towels product launch, addressing consumers’ increasing concerns over hand hygiene. The traditional napkin market in North America is not only feeling the pressure from improved quality kitchen towels but from printed napkins coming from offshore to brighten and to elevate the American at-home dinner experience. New product launches in facial tissues, including scent and care ingredients, as well as packaging innovations, are expected to continue to entice consumers.

In the US, private label tissue has enjoyed less popularity than retailer private labels in Europe. However, the dominance of brand-ed products is changing and the frugality rediscovered during the recession gave it a boost. According to research firm SymphonyIRI Group, in 2009 private label toilet paper sales surpassed the sales of branded products for the first time. Sales of private label have increased by 47% since 2005. The data excludes club store and Walmart tissue sales, but they too are growing in private labels. It is expected that the market share of private labels will continue to grow, as all consumers will not switch back to branded (more expensive) products when the economy recovers, as the product quality offered by private labels is improving.

Although the growing environmental consciousness sets the landscape for growth in recycled fiber tissue, consumers are unlikely to sacrifice comfort and quality over the environmental characteristics. The US consumer tissue market continues to require high product quality standards. Recycled fiber-based or ‘sustainability-certified’ products are

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Another niche may be available in manufacturing and selling non-converted jumbo tissue rolls. Pockets of opportunity for (non-converted) jumbo rolls continue to exist due to regional imbalances in tissue production and converting capacities. Despite the increased integration level trend — both forward and backward integration — overall, midsize to small independent converters have remained a solid market for jumbo rolls, and the stable tissue demand growth continues to attract new players on the tissue converting market. The majority of jumbo rolls are sold to the away-from-home end-use segment, which is dominated by recycled-fiber-based products, mainly for cost reasons. Hence, viable opportunities may be found for producers with recycled fiber capabilities, acquired maybe through experience in fiber flows and manufacturing in other paper grades.

SUPPLY SIDE

The North American tissue sector is highly concentrated, offering market power to producers; it is highly integrated, offering the chance to capture value available in the value chain; and it has the potential to yield stable profits year after year.

North America has the highest industry concentration across global regions (Figure 1), although the concentration level has declined below what is typically considered the critical level for market power (0.18-0.20 Herfindahl Index). The decline has been driven by the trend for independent tissue converters’ to integrate backward into tissue manufacturing.

The industry has a three tier industry structure (Figure 2). The club of million-ton-plus producers is ruled by Georgia-Pacific (G-P) and populated by Kimberly-Clark (KC) and Procter & Gamble (P&G). Taken together, the capacity of the middle class of companies — those with 200-600,000 tons of capacity each — is less than that of the largest producer, G-P.

In addition, the market has a long tail of smaller-scale producers with capacities of less than 150,000 tons each and about 1.1 million tons combined. The top 15 producers (Figure 2) represent 92% of North American tissue capacity.

These demand and supply side fundamentals have attracted, and are likely to continue attracting, interest and investment both from strategic paper industry players who want to

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**Figure 1. Tissue industry concentration.**

**Figure 2. Top 15 producers of tissue paper in North America.**
leverage their fiber processing know-how, and from financial investors who believe in opportunities in basic manufacturing.

**MOVERS & SHAKERS — BIG & MID-SIZE**

North American tissue is one of the few paper industry segments that has seen new asset build up over the past years. In tissue, it has not been an addition of an odd paper machine, but addition of 3-4 new machines per year. The new machines have been installed by the smaller industry players and/or ex-independent converters re-adjusting their operations strategy, such as Cellynne Paper, First Quality Tissue, Von Drehle, Royal Paper, Allied West Paper. An exception to the smaller player characteristic has been SCA’s Barton, Alabama, start-up.

In addition, at least 10 new tissue machines have been decided or are being planned to come on line over the next three years. That would add 550-600,000 tons/yr, or 6%, new capacity on the market. P&G and Irving Tissue will bring 100,000 tons/yr new capacity through projects in Utah and New York in 2010, although the US South remains the hot bed of tissue activity.

Figure 3 shows the dominance of the US South as the tissue manufacturing region. Clearwater Paper announced a go ahead for a new tissue machine and seven converting lines in Shelby, NC, in June. In addition, G-P, First Quality and South Georgia Tissue have all announced plans for tissue machines in the Southern US. Tissue projects are drawn to the US South by the availability of virgin fiber, attractive population growth and low manufacturing costs. The projects up North, such as Empire Tissue in Syracuse, NY, are attracted by better availability of recycled fiber in the region.

Despite the solid demand outlook, there is a limit of how much new capacity the market can absorb. Hence, inorganic growth is bound to be a vehicle for growth in North American tissue, as it has been recently in Europe where Sofidel announced its agreement to buy LPC Group in June, creating Europe’s second largest tissue producer behind SCA. Who will stay? Who will exit?

G-P’s strong production platform serves well its strategic focus on premium consumer products. In 2009, G-P launched the first three-ply bath tissue in the US, Quilted Northern Ultra Plush. Despite the recession, the premium product launch has been a success. The product has captured marketing awards and its first-year sales are reported to be $135 million. G-P’s April 2010 announcement that it is to invest $500 million in new equipment and technology continues to pave its way in the premium consumer segment.

K-C has a solid position as the second largest tissue producer in North America and the largest globally. However, the company has publicly announced its intent to limit dependency on paper products prone to fluctuating commodity prices and competition from store brands. K-C
exited the lower margin private label tissue business in 2007 and has shifted focus to “high margin growth areas” such as workplace safety and medical devices, or as in their latest move, to diaper production in Russia. Also, the No 3 producer, P&G, has shifted focus away from the capital intensive Paper and Food businesses, whose share of sales has decreased from 42% in 2000 to 25% in 2009. P&G sold its European tissue business to SCA in 2007.

SCA is currently the fifth largest tissue producer in North America, but on a growth path. Tissue has grown to be SCA’s largest business unit with 34% of sales. So far, SCA is only in the away-from-home segment in North America and the growth path has recently included asset investments (a new tissue PM and converting lines in Barton, AL) and an equity position in recovered fiber supply chain provider American Fiber Services. What is the next move?

Private-equity/financial-investor involvement brings its own color to the future tissue landscape. G-P is owned by Koch, Cellu Tissue by Weston Presidio, Marcal by Apollo, to name a few private-equity investors with holdings in tissue. It will be interesting to see which assets will be kept and which sold over the next few years. It is likely that more financial-investor money will find its way into tissue, perhaps along with investment from paper industry operators from other sectors, who are eyeing opportunities in tissue.

Overall, tissue margins are higher and more stable than in many other paper industry segments making it an attractive low-risk alternative for investment (Figure 4). The rather stable profitability patterns seemed to have reacted mainly to shifts in business strategy or fluctuations in pulp prices, as pulp prices represent 40-60% of jumbo roll manufacturing input costs.

**FIBER FACTORS**

Market pulp plays an important role in North American tissue producers’ operations strategy, and price fluctuations have an impact on profitability. It is estimated that North American tissue mills purchase over 3 million tons of market pulp per year. The current cyclical rise in pulp prices has taken a toll on tissue producers — and access to own, integrated pulp gives now an edge to existing suppliers, even to expand capacity. Will partnerships between North American tissue producers and Latin American pulp producers be strengthened? Or will domestic capacity be the answer?

North American tissue is estimated to be close to evenly split between virgin and recycled fiber products. Nonetheless, the recycled fiber tissue share has been on slight decline due to installations of through-aided tissue machines, which use virgin fiber for premium consumer tissue products.

The away-from-home segment is estimated to be close to 80% of recycled tissue, while 100% recycled products are a small but growing segment in at-home tissue due to sustainability preferences. Several of the main tissue producers have attained ownership in the fiber-recovery and recycling business in order to better control recycled fiber supply, including G-P via Harmon Associates, SCA via American Fiber Services, and Cascades via Metro Waste Paper Recovery.

The big question mark regarding availability and price of recycled fiber continues to be China, whose appetite for recycled fiber shows no signs of slowing down.

Joining the business platforms of tissue manufacturing and recycling operations might not be too bad an idea for financial or strategic industry investors alike.

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