North American **Tissue Market** on Even Keel

Following a period of relatively strong demand and capacity growth, the U.S. and Canadian tissue sector has plateaued and is expected to moderate to more normal conditions in 2007-08.

By Ken Patrick

After two healthy years in 2004 and 2005, following an economic recovery from 9/11 that actually began in 2003, the North American tissue market appears to be cooling its heels a bit this year before transitioning into a period of more normal growth beginning next year. AF&PA's capacity survey that came out in March projected a slight decline in U.S. tissue capacity for 2006, but some observers believe final tabulations will show a moderate net gain for the year.

At least four new U.S. tissue machines have come online this year or are in the process of starting up this quarter. A fifth, possibly late-year startup at Augusta Tissue in Georgia now appears on course for January or February. This flurry of new machine activity follows an empty-set 2005 when there were no new startups, though the impact of five new machines in 2004 was felt well into last year.

The 2006 crop of startups are smaller, specialty-type machines that collectively represent 130,000 -140,000 tons of new capacity directed at both away-from-home (AFH) and at-home (AH) sectors. In perspective, the recent shutdown of a few older Georgia-Pacific machines removed about the same amount of tonnage from the market. Some speedup and rebuild projects, such as those undertaken by Kruger's Scott Paper Ltd. mill in Memphis, have been adding incremental capacity.

Four new TAD (through-air drying) lines are due to start up in 2007, each with 70,000-plus tpy of capacity. Three are by each of the big three, G-P, K-C (UCTAD), and P&G. The fourth one will be by First Quality Products, which will be starting up its second TAD line next year. G-P's $200 million unit is going in at its Wauna, Ore., mill and is set to come online in late 2007. G-P has a second, similar machine planned for startup in 2008, possibly at its Port Hudson operations in Zachary, La.

Market growth rates of 3% - 4% from 2003 through last year are expected to moderate to around 2% beginning in 2007 and 2008, putting the North American tissue sector on a normal, even keel into the foreseeable future, with continued consolidations and controlled capacity/production tending to hold things in check.

To explore some of these trends and developments in the North American tissue sector, PaperAge recently spoke with Shaw Shahery, president and CEO of Convermat, a supplier of tissue parent rolls, napkins, towels, and specialty papers around the world, and Frank Perkowski, president of Business Development Advisory in Marietta, Ga. Shahery has authored an on-going series of articles on the tissue industry, including the Tissue Watch series published in the AF&PA Paper Week Convention Daily as well as PaperAge. Perkowski has authored reports and articles on most all paper and board sectors, including tissue and toweling.

CAPACITY DEVELOPMENTS

The 2006 single machine startups are at Cellynne Corp.'s Haines City, Fla., mill, Orchids Paper Products' Pryor, Okla., facility, Laurel Hill Paper Co. in Cordova, N.C., and Lincoln Paper and Tissue of Lincoln, Me. These machines are more or less from the same mold—30,000 – 35,000 tpy, generally crescent former units with a width around 2.7 m and operating speeds of some 2,000 m/min.

Metso supplied the machines at Lincoln, Laurel Hill, and Cellynne, while the Orchids machine was supplied by Recard of Italy. Metso is also supplying the tissue machine at Augusta

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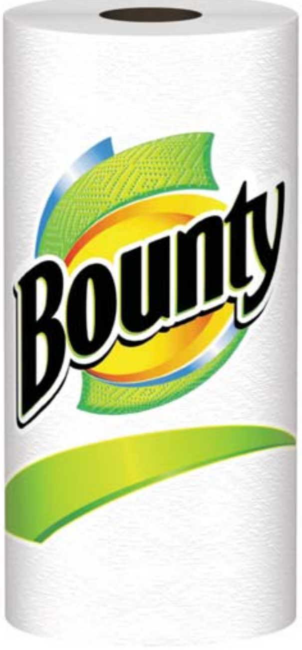
Tissue, and will supply the new TAD machine at G-P's Wauna mill, which will be a 204-in. wide, 6,000 fpm unit producing premium towels for both branded and private label products.

The two new TAD machines will place some 180,000 tpy of high-tech capacity into G-P's premium towel and bath tissue portfolio, replacing the 140,000 tpy of older, inefficient capacity shutdown at several of its mills, including most recently the closure of Old Town, Me. Some 70 older converting lines were also shutdown by G-P as part of its continuing initiative to maximize the benefits of its earlier Fort James acquisition.

Even before the recent spate of shutdowns, G-P had been retiring some of its aging production and converting infrastructure, with the shutdown of nine tissue machines (170,000 tpy) and 47 converting lines since 2001, with much of that capacity being moved to newer, faster assets. Shahery notes that a recent, and healthy, trend in this regard is scrapping rather than selling older, shutdown machines.

ZOMBIE MACHINES

In the past, Shahery says, some of these supposedly retired machines tended to "linger around" in various forms, and often were brought back to life, or resurrected, outside and inside the country. But beginning with recent industry consolidations (especially G-P's Fort James acquisition), suppliers have been working to keep the markets tight and better controlled. "Zombie" machines are now a thing of the past—they just aren't being allowed to come back to life these days, he says. As Perkowski notes, the continuing removal of older, noncompetitive assets and replacing them with larger, modern machines is a significant trend in the North America tissue sector. "G-P removed 140,000 tons by shutting down several machines, but with just the two TAD units will be adding back 180,000 tons. The 70 converting lines they are taking out will be replaced with probably 10- 20 high-efficiency, high-volume lines. Other big players have been doing the same sort of thing. Collectively, this is rapidly upgrading the asset base in North America, which is a very healthy development. We're not seeing that in any other paper or board sector."



Perkowski adds that the "silent revolution" toward significantly more efficient systems and equipment will further accelerate consolidation in the industry that's been going on for some time. "In effect, the rich are just going to get richer and the poorer will get poorer," he says.

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"All of this is paying off handsomely for producers and converters," Shahery says. "Upgrading the asset base is significantly lowering overall production costs, while consolidation is shrinking the market (taking out the inefficient, excess capacity) and bringing some much needed control. Energy, fiber, and other manufacturing costs have been increasing in recent years, but producers and converters have been able to pass on these costs to the end users due to a healthy, supportive pricing structure"

EVOLVING MARKET DYNAMICS

Both Perkowski and Shahery agree that there will continue to be a place in the market for smaller specialty machines, such as those coming online this year. These machines, they note, are not displacing existing systems—they're adding new capacity in both AH and AFH areas where there has been some short supply. They're filling a need not being met by the larger players. The big three are sort of constrained in regard to this market, and "aren't really that interested in supporting the independent converters through parent roll sales." The limited availability of parent rolls has been a growing issue in this country, and has spawned increased import activity, Shahery added.

According to Shahery, increased market demand for parent rolls has stimulated pricing growth in recent years sufficient to attract off-shore producers from around the world, even with all of the freight and transportation costs figured in. But Perkowski points out that consolidation of the AFH customer base might make future price increases more difficult. This customer base is growing bigger and more powerful over time, while investments and stakes are getting higher, he says.

U.S. Tissue Market, million tpy	2004	2005	2006 (e)	2007 (e)
Production	7.11	7.44	7.56)	7.68
Apparent Consumption	7.30	7.63	7.76	7.69
Capacity	8.06	8.23	8.26	8.51
Country or Region	**U.S.**	**W. Europe**	**E. Europe**	**China**
Per Capita Tissue Consumption, kg/yr	23	14	2.3	5
Growth Rate projections, 2006 -2008	2%	2%-3%	8% – 10%	10% -12%

U.S. tissue demand, capacity and production, 2004 -2007, and a global snapshot comparison of consumption and growth outlook (based on various data sources, including AF&PA).

On the retail consumer side, Perkowski says that 70% or more of TAD machines started up in recent years as well as those currently being planned are AH oriented. Shahery adds that, outside of P&G, the focus of almost all new TAD capacity has been for towel grades, specifically the retail kitchen towel segment. Not very much TAD production has been aimed at the bath tissue market, he notes.

Technology-wise TAD has been, by-far, the major development in recent years, and it's further positioning the big three away from the pack, Perkowski explains, pointing out that the K-C drying technology is basically a variation of TAD. A developing strategy of the big three is to dedicate high-efficiency machines to specific grades to maximize through-put and productivity. This will eventually force others to do something similar or accept lower margins, he believes.

Secondary players in the market—Cascades, Kruger, Irving, Potlatch, Baywest, etc.—will have to make some critical moves to remain healthy and alive in the future, Perkowski continues, as the big three grow even stronger. Cascades continues to buy up assets, he notes, to become more integrated and thus more competitive. The Cascades group, in fact, just this month acquired the Newstech 400-mtpd deinking mill assets in Hagerstown, Md., apparently in support of its U.S. acquisitions.

Anytime an industry starts to convert to a new technology, such as TAD, staying up with the leaders becomes critical. "If a company doesn't have the bucks to spend, it just falls further behind. In the future, I expect consolidations to continue in the North American tissue sector for that reason," Perkowski says.

MARKET DRIVERS/OUTLOOK

Drivers of the North American tissue markets continue to include per capita demand and steadily increasing population, but the major factor in the AH sector is household formation, according to Perkowski. "It's similar to the situation with office papers, whose main diver is the printer. The number of office workers is certainly a factor, but what really counts is the number of printers in an office.

Today's houses tend to have more bathrooms and larger kitchens with more appliances, etc. People today are tending to spend more time at home, which means more eating occasions, more trips to the bathroom, etc."

The North American tissue market as a whole has been strong since the first quarter of 2004, "and we've been on the up-curve ever since," Shahery says, attributing this to a combination of drivers. "Basically, on the AFH side it's been the recovery after 9/11— improving corporate earnings and expenditures, steadily improving travel, much improved hotel occupancy rates, increasing restaurant and entertainment business, etc. The sector has more than made up for declines in 2002 and 2003 and has moved through some growth years into a more normal pattern, back to where we're really supposed to be.

"Some of the North American industry's more difficult times seem to have passed, with the bankruptcies of Plainwell Tissue, American Tissue, Augusta Tissue in Maine, and others finally settled and out of the way. We're on sort of a plateau right now," Shahery says, adding that operating rates are staying high at around 92%, due to the market tightness and capacity/production controls implemented by producers and converters.

As far as more converters entering the tissue production arena, as Roses, Southwest, and Cellynne did this year, Shahery says other large regional converters may consider doing so as well. "I wouldn't be surprised to hear such announcements sooner than later. And I wouldn't be surprised to hear of more consolidations among the bigger players," he says. ■

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