



Glimmer of Hope That the Bottom is At Hand Good News for Battered Uncoated Groundwood Markets

By Harold Cody

North American uncoated groundwood paper demand closely tracks advertising expenditures on key media such as free standing newspaper inserts. Ad revenues have shrunk significantly and in turn so has demand. The outlook for 2010 is for only minor, if any, improvement in demand. While grades such as SC papers have benefited some from grade shifts the overall market is in bad shape and some of the loss in demand may never recover.



Free standing inserts (FSI), i.e. common Sunday newspaper flyers, are a major consumer of high quality SC uncoated grades and thus a key end use and market indicator.

Groundwood paper markets at first suffered at least a little bit less in the current downturn than other grades due to a combination of factors including a wide mix of end users, a broad array of grades and grade shifts benefiting products such as SC papers. However, the current market for uncoated groundwood grades is just as severely mired in a deep downturn as other printing and writing paper markets. The less severe initial declines — such as for prices on SC grades in Europe — have been offset by a plummet in demand and fall in pricing as well in recent months. The overall global market weakness has led to widespread mill closures and market related downtime that began in 2008 and continues today.

Diminishing Advertising Whacking Demand

At the root of the problem is the fact that demand for all groundwood printing papers, which include newsprint, uncoated and coated groundwood grades, is largely driven by advertising expenditures, which have plummeted at an unprecedented rate. Uncoated groundwood grades are also used in products such as paperback books which are not advertising driven, but other key markets such as telephone directories are to some extent advertising based as well. As reported in the recent *PaperAge* column on newsprint, the severe drop in advertising which occurred last year has carried into 2009 and is a key factor leading to the largest drop in graphic paper demand in over 25 years.

Overall advertising, which fell about 3% last year, is forecast to fall nearly 8% in 2009 according to a report on the Communications Industry by consulting firm Veronis Shuler. Newspaper advertising, which includes free standing newspaper insert revenue, fell 13% last year and is forecast to fall an additional 16% in 2009. This means that newspapers have lost almost one-third of their revenues in just two years. The overall advertising outlook in 2010 is for incremental growth at best according to most forecasts. Based on first half 2009 results, it appears newspaper advertising could be weaker than forecast in the recent report. Newspaper advertising for example was down 30% vs. the prior year in each of the first two quarters of 2009. Forecasters seem to have been under estimating the severity of the current downturn.

As noted, free standing inserts (FSI), i.e. common Sunday newspaper flyers, are a major consumer of high quality SC uncoated grades and thus a key end use and market indicator. Insight into the FSI market can be gleaned from data reported by McClatchy Newspapers, one of the largest newspaper chains. The company reported that overall newspaper advertising revenues were down 33% in the first six months of 2009 vs. 2008. Free standing insert volume was down 14% compared to last year over the same period. While insert revenues may have declined less than overall advertising this remains one of the largest drops ever posted, and is indicative of the severity of the downturn.

Shipments Down

With demand drying up, U.S. mill shipments of uncoated groundwood grades plummeted last year and continue to be weak. U.S. groundwood paper shipments for the January to June period are down 28% vs. the prior year, reflecting both extremely low demand and widespread downtime and mill closures. Similar weakness in July data on groundwood paper shipments by mills in Europe reflects the poor global market for groundwood papers. SC Magazine paper demand in Europe fell 6.2% in July vs. prior year levels, according to CEPIPRINT. SC exports from Europe fared even worse, off about 40% to all regions with exports to the USA showing the sharpest decline. The European market for SC grades, however, while extremely challenging, remains in better

shape than coated markets, which are undergoing a very painful and large scale restructuring to eliminate a massive capacity overhang, exacerbated by growing low cost competition from Asia, particularly for coated wood free grades.

As noted, groundwood paper markets fared a bit better initially than freesheet printing and writing grades where demand and prices simply collapsed. One reason was that some users switched or shifted down from lightweight coated papers to control costs in a rapidly deteriorating market for advertising. Markets for machine finish grades such as lightweight directory papers are also a bit less cyclical due to contract terms and publishing frequencies that are typically longer. However, despite these factors groundwood paper prices have also fallen, particularly in North America.

Bottom Reached?

Amidst early signs that the U.S. economy has reached bottom and is turning upward, there is renewed hope that key pulp and paper markets have hit bottom and are beginning to stabilize. Initial attempts to arrest the price declines are underway and price increases have been announced by mills for newsprint, pulp and coated grades. Prices on these grades had fallen to cash cost levels. If successful, these would be the first price gains in many months and would certainly be good news for mills that have been losing money on every ton shipped out the door.

However, a key concern going forward is that the depth of the economic plunge in the U.S. economy is believed, according to some analysts, to have resulted in structural changes to basic paper demand. What this means is that some permanent loss of demand in mature markets such as North America and Europe has occurred that will never be recovered. One key impact of that is that the recovery won't be similar to historical rebounds which are driven by consumer demand and inventory building, and which can make the pace of recovery fairly rapid. In contrast, any current recovery that occurs will be more modest and the factors driving it will be based more on capacity management than demand. This may make for a longer road to recovery. ■

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