

# Groundwood Paper Capacity a Key Wild Card as Producers Battle Sluggish Demand



Demand for both coated and uncoated groundwood grades continues its secular decline and in some grades the rate of decline has accelerated. Nevertheless, hope springs eternal as the fall catalog season could bring a boost to demand and a much needed price increase. The direction of the market and any change in pricing, however, could be determined in large part by the state of idled capacity, particularly for supercalendered (SC) grades.

By Harold M. Cody

Today's market for groundwood grades appears to have a little bit in common with the game of Russian roulette. In roulette, chance is the overriding factor in what happens next. You can bet the odds on whether the next round results in a bullet or not, but other than that it's impossible to predict the outcome.

In the case of the North American market for groundwood papers — both coated and uncoated grades — the similarity lays in the fact that a major factor determining the direction of the market is the highly unpredictable nature of capacity. Mills and consumers alike can analyze key indicator and supply and demand data all they want and make lots of forecasts and predictions on trends, etc. But it may all just come down to whether or not one or two major mills restart or not and when they restart. In one case the mill in question faces an array of financial hurdles and other factors not related at all to the paper market. And that is precisely why the outlook is so hard to predict. In another, the timing is more determined by operational and mechanical issues as an accident caused the shutdown.



**The permanent closure of Verso's Sartell Mill in Minnesota, due to an explosion and fire on May 28, removes 180,000 tpy of coated groundwood paper capacity and approximately 35,000 tpy of supercalendered paper capacity.**

## Demand Continues Contracting

If you just look at the numbers, which range from terrible to just poor, there isn't anything surprising so far this year. North American demand for printing and writing papers, including uncoated groundwood grades such as SC-A, lower quality machine finish grades and lightweight coated papers, continues to decline. Through the first seven months of 2012, total printing and writing paper demand is down 6.9% to 13.1 million short tons, according to the Pulp and Paper Products Council (PPPC), with shipments off 7.1%.

The largest decline year to date has been for uncoated mechanical demand, down almost 17% to about 2.4 million ton. Shipments of uncoated groundwood are off by 17%, reflecting not only market weakness but also a significant decline in capacity. Coated groundwood demand, by comparison, is doing better, but demand is still off by 3.3% vs. last year at about 2.4 million tons. Shipments are off by just 3.4%. Operating rates over the same period are reported at 92% and 89%, respectively, for uncoated and coated groundwood papers.

The decline in demand isn't a surprise to anyone that has been following the market in recent years. Various sources are predicting a decline in coated paper demand in the 4% to 6% range overall this year. Coated freesheet demand year to date is off by about 6%. The drop is a continuation of the trend that began several years ago, exacerbated by the recession, as key groundwood paper end-uses such as magazines continue to suffer, as advertising continues to decline and readers shift away from print products.

Other key advertising driven end-uses such as retail newspaper inserts and catalogs, all of which are key groundwood paper markets, are also contracting.

Uncoated demand, as noted, has declined far more than other grades, as demand by catalogs, a key market for SC and other grades, has plummeted, down almost 20%. It's also reported that the extreme financial pressure felt by printers has led them to downgrade from higher quality grades to newsprint and lower quality MF grades. Giving credence to this are data on newsprint use, where non-daily newsprint consumption is reported to be up by almost one-third based on PPC data through April 2012. Magazine advertising pages are off about 7% through the first half of the year. Magazines are the largest use for coated groundwood grades, notably LWC grades, accounting for almost half of consumption.

### Pricing and Capacity

Prices haven't moved much in recent months but producers are attempting to reverse that and have announced increases recently. If demand is given a boost by the fall catalog printing season, the increases might have a chance at success, in particular since most mills continue to lose and struggle financially.

Prices have remained surprisingly stable over the last few months due to the fall in supply for almost all groundwood grades. LWC prices dipped some in July, but looked a little better in August.

Coated groundwood capacity in the U.S. has slipped steadily over the last five years, dropping by almost one quarter according to AF&PA and industry estimates, to just over 3.5 million tons.

Recently, LWC and SC capacity was reduced by the unplanned and now permanent shutdown of Verso's Sartell, MN mill due to an explosion and fire last May which removed 180,000 tpy of capacity. Other coated groundwood capacity withdrawals that have helped to sustain operating

rates include the removal of 90,000 tons by Verso at the Bucksport in late 2011 and 150,000 tpy by Resolute at the Catawba facility this past summer. The situation is similar in Europe where almost one million tons of coated groundwood capacity was closed in the last year.

There is some evidence that the hoped-for seasonal uptick in demand may improve the coated mechanical market. Demand in July was actually up 2.5% compared to July 2011, and shipments were only down by 1.3% compared to year earlier levels.

As noted above, the fluid state of capacity is really hard to predict, in particular in the case of the proposed restart of the 360,000 tpy Port Hawkesbury (Nova Scotia) SC mill, which was shut down last fall. The restart could undermine any chance of a price increase as it represents a significant portion of overall capacity — about one-third — in this grade. The restart isn't based on market factors but on financial and political ones, making it anyone's guess as to whether it will occur. Some sources don't think that the restart will have a major impact on the market while others believe it will. Sure seems like to me that a one-third increase in capacity would have an impact.

While the overall outlook on the demand side remains pessimistic, hope remains that a seasonal boost to demand coupled with recent capacity adjustments may support a price increase. The increase, if it occurs, will likely be fragmented both in terms of the amount and timing, given all the ups and downs of each individual market segment and grades.

In late August, major producers announced a \$60/ton price increases on coated groundwood grades and \$40 on supercalendered grades effective in October. It's been reported that a July increase on coated groundwood has been partly implemented, which raised prices by about \$20 per ton. Average prices for LWC roto grades were about \$975/ton with SC-A grades going for about \$845/ton at the end of the summer.

Producers have worked hard to manage supply and thus the announced price increases, particularly for LWC, have a good chance to succeed. But it still may come down to chance — when and if idled capacity is brought back online. ■

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