



Groundwood Papers a Mixed Bag of Good and Bad as Demand Continues to Slip

While overall groundwood paper tonnage has continued to contract during the first half of 2013 the results vary widely by individual grade.

Demand for segments such as SCA grades is solid but market conditions for other grades range from sluggish to poor. The overall outlook depends on whether demand picks up this fall and tightens demand for grades such as LWC. Pricing has remained largely steady in recent quarters and some of the summer price increases appear to have a chance.

By Harold M. Cody

Despite a generally poor market for printing and writing grades as measured by standard key indicators such demand and shipment data during the first half of the year, 2013 hasn't been that bad of a year so far in some ways. Pricing has held fairly steady over most of the last 12 months, except for some modest price slippage during the second quarter, and producers announced price increases on many grades and some appear to have a decent chance of going through. In turn, producers have been able to turn a modest profit in recent quarters, although results are far from stellar.

However, year to date data continue to demonstrate that overall North American demand for printing and writing grades, and for coated and uncoated groundwood papers specifically, remains lackluster. For the 7 months through July 2013, North American demand was off 2.3% vs. the prior year level at 12.9 million tons, with shipments slipping even more, down 3.4% to 11.3 million tons, according to the Pulp and Paper Products Council (PPPC). The data for July, the most recent available, actually look pretty good compared to prior year and prior month levels, as shipments were up 2% over July 2012 and demand was up nearly 3%.

On an individual grade basis the weakest demand over the seven-month January to July period was posted by coated mechanical papers, which registered a 3.9% drop vs. the prior year at 2.1 million tons. Shipments plummeted by 6.4% and imports rose nearly 18% as offshore mills increased market



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Uncoated mechanical grades fared better, with demand off just 0.7% through July at 2.4 million tons and with shipments of 2.2 million tons essentially unchanged compared to the prior year level. However, the surge in SC demand, which was up almost 9%, masked significant decline in other uncoated groundwood specialty papers. Demand for standard and lightweight papers were down by 9% and 15%, respectively during the first half. First half data were even worse when comparing to last year as overall demand was down 5.1% through June 2013 vs. the prior year, shipments were off almost 11% and imports were up by a double digit amount.

Inventories are also on the rise, with the total up 1.2% vs. June, although that is typical for this time of year. Operating rates also reflect generally weak conditions, with the overall rate at 91% year to date. Operating rates in July were actually better than in some recent months but are still poor, particularly given capacity withdrawals in grades such as LWC.

U.S. printing and writing paper shipment data also reflected similar declines across the board, with total shipments down by 6.1% through the first half of 2013, according to AF&PA data, at 8.1 million tons. The largest decline was posted for coated mechanical grades followed by uncoated free sheet. Coated free sheet shipments over the same six-month period are running about flat with last year, while coated mechanical is down 13% and uncoated groundwood off by 14%.

While the decline in demand continues to grind on, the rate of decline has eased at least so far in 2013. By comparison, North American printing and writing paper demand last year fell by 6.3% to 22.7 million tons and shipments declined by 7% to finish the year at 20.2 million tons. The decrease varied by grade although all major grade segments posted declines. Coated free sheet demand fell 3% to 4.7 million tons as shipments dropped 4% to 3.8 million tons. Imports rose a modest 1.2% to 967,000 tons. Demand in the largest segment, uncoated free sheet, plummeted 4.7% compared to 2011 to 8.8 million tons. Uncoated mechanical demand slipped 16%.

Mills Pushing to Raise Prices, But Chances of Success Vary

Despite the mixed bag in terms of conditions as measured by supply and demand and the fact that some markets remain weak, producers began to get serious about improving the bottom line. A whole range of price increases were announced in early summer by mills seeking to increase publication paper prices to offset higher costs. It began in early May when announcements were made for price increases on all three major grades — SC, LWC, and coated free sheet — targeted for July 1. Prices for SC grades were targeted to go up \$50/ton on both high-end SC-A grades as well as SC-B products. An increase of \$40/ton was also announced on LWC grades and about \$30 per ton for CFS grades.

However, market conditions that would support an increase in price vary widely by grade. SC markets are reported to be much tighter than competitive grades such as LWC, as SCA demand was running strong in early 2013 — up double digit amounts over prior year levels in the first quarter. As noted in last years' column, SC grades have been gaining market share at the expense of LWC as publishers downgrade quality in order to trim costs, particularly in products such as news magazines and supermarket flyers. It's reported for example that magazines using SC grades this year include *Entertainment Weekly* and *Fortune*. Similarly, SC-B supplies are reported to be somewhat tight due to some producers chasing after SCA tonnage on SCB machines. Therefore, the likelihood of a successful increase on uncoated groundwood SC grades appears to be reasonably good. The recent restart of SC capacity in North America had been viewed as possibly undermining the market but it has apparently been easily absorbed.

In contrast, on the surface the market for LWC seems to lack the fundamentals to support any significant or lasting increase. Operating rates for coated groundwood mills have been weakening and were only 84% in May despite a significant reduction in capacity via the shutdown of machines at mills in Sartell and Catawba. As noted they improved to 91% in July. Despite the poor fundamentals many groundwood coated mills appear to remain optimistic about the price increase, and are assuming a surge in business for the fall printing season.

Other uncoated groundwood grades are also contributing to the overall contraction in demand, including a steady loss in tonnage for machine finish grades and lightweight papers, although these are smaller segments from a tonnage standpoint. The driving force behind weakness in the lightweight papers sector is obviously the steady loss in demand by traditional telephone directories as they rapidly lose advertising dollars to other media as consumers switch to online sources for yellow pages data. It's reported by various published sources that directory paper demand has fallen at double digit rates annually over the last few years, and overall demand last year fell to a little under 400,000 tons. In contrast, directory paper demand was just over one million tons before the economic collapse in the late 2000s.

In addition, the rapidly deteriorating state of printed newspapers, which is resulting in a quick and large loss in newsprint use, with North America demand down 10% year to date, is also impacting the market for groundwood grades. Newsprint mills are looking to push tonnage into non-newspaper markets, effectively resulting in an oversupply of machine finish grades for low end printing paper markets. This is being tempered somewhat by the solid demand for North American newsprint in Asia as a result of major capacity shuts in Europe. Exports are up 8.6% through July.

While there are some bright spots in groundwood paper markets, and from some standpoints things may not be all that bad, fundamental underlying demand for graphic papers continues to decline as advertising dollars targeted at traditional print media lose ground to online products. For example, consumer magazine advertising pages were off 4.9% through June 2013 compared to the prior year according to Magazine Publishers of America data. Ad pages for news magazines plummeted even further falling by nearly 20% over the same period. Thus the push to trim costs by downgrading paper quality. There has been some good news, as retail inserts volume and catalogs posted better numbers recently.

Looking forward into this fall and on into 2014, there may be some leveling out of the surge in SC demand if SC prices rise and LWC prices don't, and this could have the somewhat odd result of benefitting LWC mills by allowing them to gain back some lost market share. If the fall printing season brings a much anticipated boost to demand, the chances of SC price increases sticking appear good according to most observers. The biggest question seems to be whether the weak market for LWC grades can improve enough to support an increase. At this point it appears dicey if full LWC year demand continues to fall at a 5% to 6% rate. ■

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