



Groundwood Market Slump Continues Due to Weak Demand, Excess Supply

The winds of change may soon sweep through the groundwood paper business which would be a good thing for a market that is severely oversupplied in some segments and in general continues to fight declining demand. A lot depends on a potential major merger which if enacted is expected to result in significant capacity adjustments.

By Harold M. Cody

The market for groundwood papers remains mired in a slump characterized by sluggish and falling demand for most grades acerbated by overcapacity in the lightweight coated sector. Coated mechanical prices slipped further in late-summer and market reports characterize demand as ranging from “terrible to challenging.” Uncoated mechanical grades are faring a little better and demand has actually stabilized in recent months although within individual grade segments results vary quite a bit.

The groundwood papers market is to some extent on hold pending the Verso/NewPage merger, which remains the big elephant in the room and the topic of water cooler conversations industry wide. It’s widely expected that — and the industry seems to be waiting for — a range of capacity adjustments would be forthcoming if the merger goes forward in order to balance out supply and demand as well as to optimize the combined company’s mix of mills and machines in order to maximize efficiency and lower costs across their mill system. In North America NewPage and Verso are the top two coated groundwood producers with about 1.8 million tons of capacity.

However, while the industry was holding its collective breath waiting for the merger, two events in September put the merger topic on the back burner. First was the



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announcement of the closure of the 168,000 tpy coated paper mill in Alsip, Illinois, and shortly thereafter an even larger capacity reduction was announced by Resolute at its publication papers mill in Quebec. Resolute’s Laurentide mill makes SCB and soft nip groundwood specialty grades on one 200,000 tpy paper machine and which accounts for a big chunk of the North American supply of these grades.

The two above-mentioned closures will remove almost 400,000 tpy of capacity mostly on the lower end of the quality spectrum relative to standard

LWC and SCA grades, but nevertheless its impact will be notable on the overall market. Resolute is the largest producer of uncoated groundwood grades in North America with capacity for about 1.4 million tons and by far the largest producer with roughly one-third of industry capacity.

Shrinking Demand

Recent data clearly delineate the challenges facing the industry. North American printing and writing paper demand through the first half of 2014 continues to shrink and was down 3.0% vs. 2013 at 10.59 million tons with shipments off by 4.4% at 9.8 million tons. Coated mechanical demand at 1.69 million tons was down 7.4% vs. the same period in

2013. Shipments were off by just 4.8% at 1.58 million tons owing to a nearly 6% gain in coated groundwood imports. Uncoated mechanical grades fared the best of any printing and writing paper grade with demand essentially flat compared to last year down 0.3% to 2.08 million tons. Uncoated groundwood shipments by North American mills were off 0.8% at 2.08 million tons.

While the drop in demand has moderated for now, demand for uncoated groundwood grades continued to contract as expected last year as well. Demand fell significantly for some grades led by a 14% drop in lightweight (directory) paper demand and a 2.5% drop in standard grades. In contrast, SCA demand is reported to have growth by about 20%. Total demand for uncoated grades in 2013 was about 4.5 million tons including an estimated 2 million tons of standard grades, just under 700,000 tons of SC-B and soft nip papers, 1.3 million tons of SCA and 400,000 tons of lightweight papers. While the 2013 total is about the same level as in 2012, it's down considerably from 5.6 million tons as recently as 2010.

Newsprint mills also continue to suffer and this continues to have an impact on groundwood markets. N.A. newsprint demand is off by 6.6% through the first half of 2014. Even more worrisome is that fact that offshore exports are down 5.6% through June and were off 8.4% in June vs. the prior year.

Underlying Factors

The background behind these challenging market conditions is that groundwood printing grades continue to fight a wave of negative trends including continued losses in key printing markets such as catalogs, direct mail, directories and other traditional uses. Direct mail was impacted to some degree by a postal rate increase. Postal volume data for the last three quarters through June 2014 shows standard mail volume down 0.6% in pieces and 1.3% in weight. In the third quarter, standard mail pieces actually were up 0.9% but weight was off 2.7%. In addition, gains made over the last couple of years replacing newsprint in some uses appears to have eased or ended.

The most pressing problem right now for the groundwood market centers on the weak market for coated mechanical printing papers including both the higher quality No. 4 grades and well as No. 5 grades. In addition to this year's decline, coated groundwood demand fell 7% in 2013 to 3.7 million tons. By contrast, in 2010, coated groundwood demand in North America was 4.5 million tons. Imports have fallen from a level of nearly one million tons in the late 2000s to 444,000 tons in 2013 which was a modest decrease from 2012 levels.

Pricing Weakness

In particular, the problem for coated mills has been a steady erosion in pricing. Observers report that the price weakness, as indicated by the shipment and demand data, wasn't due simply to a fall in demand, but rather more due to an excess of supply. That's really a glass is half full vs. half empty argument but it shows that additional capacity closures are likely needed.

Prices slipped further on coated groundwood grades late this summer falling about \$10-\$20 ton over the June to August period. Prices have now fallen by over \$100 per ton compared to prior year levels on No. 4 and No. 5 grades. Current pricing on No. 5 grades is about \$800/ton on offset grades. SCA prices have also slipped considerably but haven't fallen quite as far and are at a current level of about \$775 per ton, but this is compared to \$830 per ton in August 2013. Coated groundwood prices are now at the lowest level since 2010 and have been trending down since early last year. SC prices also moved down in the U.S. in July.

The oversupply problem is clear as coated groundwood mills ran at an average of 84% in July and 87% year to date, compared to 95% and 92%, respectively for the same periods last year. Uncoated mechanical mill operating rates in July were 90%, which is about the same as reported in 2013.

One development worth noting is that the very low prices for coated groundwood is reported to have slowed the shift by some publishers and printers away from coated grades to attractively priced SC uncoated grades. Unfortunately it's hard to see how users that moved to SC papers when the price differentials were high would switch back to more expensive paper even if the price differential narrowed. In today's highly competitive market it's difficult to justify paying higher prices for paper. In the machine finished grade segment, some mills continue to benefit by higher brightness uncoated mechanical grades taking some share away from uncoated freesheet.

Conclusion

Given the huge uncertainty on the supply side it's impossible to really predict the direction of the market and in essence it remains in limbo until the supply side shakes out. Pending a remarkable and unanticipated turn up in demand this fall, with prices on LWC grades near historical lows, something will have to give, and additional closures are likely. It just remains to be seen how long it takes. ■

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