



## Coated Freesheet Recovery Showing Signs of Age, But Cost Pressures and Capacity Reductions Help Sustain Mill Gains

Coated freesheet markets regained a lot of lost ground in 2010 as demand, buoyed by stock rebuilding, rebounded strongly. In turn, operating rates rose strongly and drove major price gains. Demand cooled in early 2011 demonstrating that while markets are much improved they continue to face challenges derived from shifts in underlying demand and a sluggish economy.

By Harold M. Cody

**I**n step with a surging recovery last year in almost all major pulp, paper and paperboard markets, coated freesheet papers staged a solid rebound from the precipitous downturn that the industry endured for almost two years that ended in 2009. For most of last year coated freesheet volumes rose significantly as did prices, and these gains resulted in much improved mill economics.

However, economic growth continues to be erratic which makes it difficult to gauge the strength of the recovery in paper demand this year and its sustainability. Modest overall growth in key areas such as retail spending continues, but it's offset by extremely slow recoveries in housing and employment. Cost input pressures — energy, fiber — also continue to pressure mill margins.

Nevertheless, while improvements may be sporadic better economic conditions clearly resulted in a rebound in advertising and other promotional activity. And advertising is the underlying driving force to demand for high quality printing papers. Magazine advertising posted the first year-over-year gains since early 2007, albeit it is important to note that they have a long way to go to get back to where it all started before the crash. Similarly, catalog mailings have risen for three straight quarters. These gains should continue, although the pace of growth may slow.

These improvements resulted in a significant recovery in shipments and demand for coated papers, including coated freesheet grades, aided by the need to rebuild inventories of stocks depleted when demand simply fell off a cliff. A widespread recovery in the overall printing and writing papers market actually began in the latter part of 2009. Demand, which declined steadily and at times precipitously

beginning in mid-2007, bottomed out in the first half of 2009. Following this, coated fine paper shipments rose fairly steadily from mid-2009 to third quarter 2010.

U.S. coated paper shipments for full year 2010 posted a solid 12.8% gain over weak 2009 levels. Coated freesheet shipments posted the strongest gains of any major printing and writing grade, with shipments rising by 15% to 4.2 million tons, vs. 3.6 million tons in 2009. Coated groundwood shipments by U.S. mills rose about 10% to 3.7 million tons.

Overall, North American printing and writing paper shipments posted a 3% gain in 2010, according to the Pulp and Paper Products Council. Coated groundwood and freesheet shipments rose while shipments of both uncoated freesheet and uncoated groundwood slipped. Total North American apparent consumption of coated papers grew by about 11% in 2010.

Perhaps of even greater importance to coated paper producers is that mill operating rates posted significant improvements as well, rising from the 80% range in 2009 to 96% in 2010 for both coated freesheet and coated groundwood. In turn, this set the stage for a turnaround in prices which rose from a low in January 2010 when prices for coated freesheet bottomed out at a little under \$900/ton according to various sources. Successive increases raised prices to about the \$975/ton range for No. 3 web grades by the end of the year.

### Can Recovery Continue?

Unfortunately, coated fine paper markets have recently showed signs of weakness that raise concerns about the direction of the recovery. Coated freesheet shipments in

March jumped nearly 20% above February levels and were 2.3% above March 2010. However, through March coated freesheet shipments were only about 1% above prior year levels, according to AF&PA. Year-to-year comparisons were also weak in the latter part of 2010. Other grades are showing similar weakness.

Shipments and consumption have stabilized at levels that are about 85% and 90%, respectively, of 2007 levels for coated freesheet. It's a fairly widely held view that the prior levels of consumption will not be reached again, and that the gap between demand as measured prior to the collapse in demand, and the current level, may be permanently lost.

So, if demand has reached an inflection point, where is the market headed? In the past if demand growth slowed, supply would exceed demand and prices would inevitably fall — at times rapidly. However, it appears there's a good chance that not only won't this occur, but prices may trend up a bit more.

First of all producers have been monitoring demand skillfully and have shown little hesitance in matching supply to demand. Notable capacity reductions made in recent years have been a major factor in sustaining operating rates. For example, an estimated 3 million tons of coated capacity were shut down in North America in the 2006-2010 period. In Europe, the situation was even more pronounced, with about 3.6 million tons shuttered. In 2009 alone it's estimated that over 900,000 tons of coated freesheet capacity was removed as European demand contracted and exports shrank.

Trade trends also seem to be supporting the case that the market may remain in balance.

One reason, unfortunately, is that a natural disaster has again had an impact on the industry. Similar to when the Chilean earthquake hit market pulp, the earthquake and tsunami disaster in Japan have shut down a large portion of Japan's coated paper industry. This will at least impact the market in the short term since last year the U.S. imported about 75,000 tons of coated free from mills in Japan, making them one of the major off-shore suppliers. The impact is likely to be somewhat more limited than it was in the pulp market because most Japanese paper is sheeted and is more of a localized issue in the western U.S.

### Price Pressures Continue

Market pulp prices remain a key factor in the direction of coated freesheet prices, since many mills buy pulp. Pulp prices have remained high in early 2011, which has been a surprise to many observers. Global softwood demand



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continued to grow, with record shipments posted in March 2011, buoyed by strong demand from China. In turn, NBSK prices began the year around \$950 - \$960/ton, and at the time of writing this column, NBSK in North America is hovering around \$1020/ton (Europe is looking at \$1040/ton, June 1). The large jump in energy prices has also added pressure on mill costs.

Printers suffered through three price increases in 2010, and endured an additional attempted increase during the second quarter of 2011. They are certainly hoping for some relief. But while demand won't post anywhere near the double digit gains seen in 2010, it's expected to remain solid enough that coated freesheet operating rates will likely remain above 90%. And if producers closely monitor supply in case demand falters, that coupled with costs pressures mean producers might be in the drivers seat into next year. ■

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