

The recovery has arrived

U.S. pulp and paper executives predict better times ahead.

JOHN C. EDWARDS

One year ago this industry was dealing with a number of problems. Oversupply and soft demand depressed prices, many global economies were trying to shrug off a recession, and government regulations threatened to stifle the few meager profits that could be attained. Today's market, although still plagued by these and other issues, offers more than a ray of hope that the 4-year-long industry recession may be behind us.

Comments from last year's *CEO Forecast* are reminders of difficult times (1):

"Global economic softness has hurt our industry, particularly because it has created overcapacity in many grades."

"Our greatest threats [to recovery] are the increasingly strict environmental regulations, often enacted by uninformed or misinformed individuals."

"Worldwide exchange rates and their fluctuations have impacted us the most."

While some of these concerns are less prominent today, environmental legislation still commands our full attention.

The Environmental Protection Agency (EPA) formed a "cluster" group to jointly develop a set of rules to reduce the level of air and water pollutants from pulp, paper, and paperboard mills. The rules change which pollutants are regulated as well as how various processes are monitored. The EPA estimates the new rules will cost the industry US\$ 4 billion in compliance costs, but the American Forest & Paper Association (AF&PA) predicts costs could reach US\$ 11.5 billion (2, 3). Most of our respondents believe that an ongoing effort between the EPA and AF&PA could reduce the industry impact to US\$ 5–6 billion. The impact of the cluster rules is perhaps the largest concern of paper company executives today.

The North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT) are universally hailed by our participants. NAFTA, in force as of Jan. 1, 1994, removes all trade barriers to goods and services among the United States, Canada, and Mexico over 15 years. The Uruguay round of GATT talks is based on the principle that discrimination is bad for trade and that every country participating in GATT would open its markets equally to each other (4). However, the early impact of these agreements will

be slight, because they are gradually phased in over several years.

While domestic demand for paper and paperboard climbed 3.1% to 89.1 million tons in 1993, production rose by a more subdued 1.7%, to 84.4 million tons. In spite of the gain in domestic demand, production trailed the long-term growth value of 2.7% (5). The improving supply and demand equation, as well as the favorable value of the dollar relative to many foreign currencies, provides encouragement to the industry.

The following executives spent some of their valuable time addressing prominent issues in today's marketplace: George J. Harad, president and CEO, Boise Cascade Corp.; James B. Heider, senior VP, North American Containerboard, Paper and Pulp Division, Stone Container Corp.; William B. Howes, chairman and CEO, Inland Container Corp.; Eli Karter, VP and operating officer, Mead Corp.; George Mead, chairman, Consolidated Papers Inc.; and Lynn O. Michaelis, director, marketing and economic research, Weyerhaeuser Paper Co. We appreciate their participation.

TJ:

The pulp and paper industry generally appears to be recovering from several difficult years. Which factors do you believe are most aiding this recovery?



George J. Harad

President & CEO

Boise Cascade Corp.

Boise, ID

HARAD: The fundamental issue is that the imbalance between supply and demand either has or is beginning to correct itself in virtually all grades and in most parts of the world. The recovery that we're seeing in the United States is going on in Europe and is just beginning in Japan. Those issues are linked

through the pulp market, which is the largest world market, and also through other grades that have large export components (e.g., linerboard and newsprint). We've seen a fundamental shift in supply and demand, and the reasons for that vary from grade to grade. Most of that shift has been on the supply side and complemented by some demand. In the pulp and uncoated free sheet markets, most of the shift has been on the demand side, particularly as Europe has recovered and the U.S. markets continue to grow.



Eli Karter
VP and Operating Officer
Mead Corp.
Dayton, OH

KARTER: Several factors are aiding the recovery. We had excessive expansion in the industry through the last up cycle. This created a situation of global oversupply in some grades. Much of the world then went into a recession, exacerbating the oversupply situation. We are recovering from these problems partly because the U.S. economy has picked up. Europe and the Far East (with the exception of Japan) are also becoming stronger.



George Mead
Chairman
Consolidated Papers Inc.
Wisconsin Rapids, WI

MEAD: The paper industry is very dependent on the economy as a whole. Our industry is recovering because of strength in both the U.S. and European economies. The European economy has been influencing us more than it did in the past. Paper company recoveries usually lag the domestic economy and, in this case, this lag was longer than usual.



Lynn O. Michaelis
Director, Marketing and
Economic Research
Weyerhaeuser Paper Co.
Tacoma, WA

MICHAELIS: The most important factor aiding the recovery is that the general economy is recovering, and with it are the various factors that drive the pulp and paper business. In the containerboard business, we have industrial production running about 6% ahead of one year ago. This has helped drive box demand to 5% ahead of that one year ago. Because help-wanted and retail advertising is increasing, the demand for coated papers and newsprint is improving.

TJ:

Do you see this as a short- or long-term recovery for the industry?

HARAD: I don't think the business has repealed its economic structure. It will continue to be cyclical, but I think this upturn has a lot going for it. First, because we've been down so long, capital spending has been restrained, and there's little new capacity being built or planned in most areas. In addition to that, there are some changes in available fiber supply and increasing environmental requirements for existing and new facilities that have the effect of slowing reinvestment.



James B. Heider
Senior VP, North American
Containerboard, Paper and
Pulp Division
Stone Container Corp., Chicago, IL

HEIDER: We're already seeing significant wood price increases in the Northwest, and there are proposed regulations in the Southeast that would impact those wood costs. Absent the issues of excessively restrictive regulations and fiber supply uncertainty, I expect a long-term, stable recovery for the industry.



William B. Howes

Chairman and CEO

*Inland Container Corp.
Indianapolis, IN*

HOWES: We expect a recovery length that is standard for the industry; we are optimistic for 1995 at least through 1997. Some are predicting a longer recovery, in part because the growth has been more steady than in other boom cycles.

MICHAELIS: The international recovery is in its early stages. For the pulp business, for example, where Europe is one of our major markets, the longer-term prospects, including the value of the dollar, look very good. From the United States' point of view, the international markets look promising for the next 2–3 years.

TJ: *How has this trend impacted your company, including capital investments and research spending?*

HEIDER: Our industry has been operating for the last four years under tight controls on capital spending. For Stone Container, as this recovery continues, we expect to spend more capital in our mills in the form of modernization and incremental capacity. We are a basic commodity supplier without a large research budget. Most of our research is done by our support of institutions like the Institute of Paper Science and Technology.

HOWES: From 1987 to 1992, even though these were difficult times, we recapitalized our company, spending nearly US\$ 1.2 billion in capital improvements. However, we don't expect to buy a new paper machine before the end of the decade. We do most of our research work in package development. One area we are focusing on is expanding our structural design capability throughout the country. We also built a new graphic center featuring a preprint press. Finally, we encourage research by supporting paper-related programs at Auburn University and the Institute of Paper Science and Technology, for example.

KARTER: Our capital expenditures have been primarily aimed at improving quality and productivity, although some funds have been spent on growth issues. We have seen consistent per-quarter earnings increases over the last 11 quarters. Our research spending has been fairly constant; it has at most grown at the rate of inflation.

MICHAELIS: Weyerhaeuser has maintained a fairly steady capital slate, and we maintained our research spending through the downturn. Because spending in these areas was not reduced in the downturn, we don't expect substantial increases at this time.

TJ:

Is this recovery apparent on a global scale? What factors are necessary to initiate/continue worldwide stability in the industry?

HARAD: The recovery that is under way started in the global commodity market. It started first in market pulp at the end of 1993, and it moved to linerboard fairly quickly (again a major export and world-traded grade). Midway through the spring of 1994, we began to see the effects of the recovery in newsprint; it then moved on to the other publishing grades (coated and uncoated) and finally to the office grades.

HEIDER: This is, without question, a global recovery. I think that demand will continue on a global scale. Only a worldwide recession, which would slow economic growth in major and third-world nations, would threaten this recovery. However, I don't expect that to happen.

KARTER: Perhaps "stability" is not the correct term; stability implies a lack of competitiveness. Competitive companies can take advantage of change and the dynamics of the marketplace. If the global economy continues to improve, our industry will do well, providing we are meeting the needs of our customers. We must use caution in building additional capacity so we do not repeat the scenario of the previous downturn.

MICHAELIS: We are especially seeing a global recovery on the pulp side of the business. There has been a strong recovery in Europe; paper sales and production were up 15% in the first half of 1994. Asia, with the exception of Japan, continues to be booming, and the attendant demands there remain strong. Japan is struggling to achieve a recovery, but once it occurs, Japan will be positioned for strong growth for several years.

TJ:

What grades of your product have responded best in the past year to improved industry stability? What grades lag the trend?

HEIDER: We haven't seen any grades lag this trend. Containerboard is extremely strong; we're getting significant price restoration (i.e., prices approaching those seen in 1989). In bleached pulp, we're seeing rapid price restoration. Although we haven't reached 1988–1989 levels, we expect to be there by the second quarter of 1995. Newsprint has been slower to recover, but price restoration is also occurring in that area.

HOWES: The different grades of our main product, containerboard, are quite interactive and generally move to-

gether in an upswing or a downturn. With the current improvement in the industry, we, like others, can look more closely at returns on a machine-day basis, and increases that restore previously discounted prices are inevitable.

MEAD: Most of our grades have responded well. Our coated specialty products in packaging felt the recovery first. The basic enamel paper line, which includes magazine and catalogue papers to heavyweight free sheets, recovered more recently. Our recovery, generally across the board, has been felt over the last several quarters.

MICHAELIS: Our containerboard business has done very well lately, primarily due to the strength of the domestic economy and the industrial production side. The paper-grade pulp business has also done well because of favorable exchange rates, the demand increase in Europe, and reduced capacity growth. Fluff pulp slightly lags the current trend today; it typically lags both the up and down sides of our business cycles. Printing and writing papers, although still recovering, are also slightly lagging the current trend.

TJ:

How have changes in pulp supply, demand, and pricing affected your company (including the quality and availability of recycled material)?

HEIDER: All of our facilities are fully integrated, and we don't purchase market pulp. We do sell pulp, and we have seen some price restoration in this commodity. In the late second quarter and early third quarter of 1994, we saw large increases in the cost of old corrugated containers (OCC), which is our major recycled fiber supply. We have not seen a decline in the quality of recycled material. If there has been a degradation in OCC, we probably have not noticed it because our mills' cleaning technology is able to handle it and our finished product quality has not been impacted.

HOWES: In the past, in the kraft side of our industry, we had access to an inexpensive fiber supply. This is changing because we've lost much of the land on the West Coast due to government regulations. As a result, we must look to the Southeast to supply this fiber. Prices for wood from this region have increased about 20% over the last three years. We anticipate that prices will continue to increase, although perhaps at a slower rate. Recycled OCC fiber costs have also moved up sharply. Although prices have dropped somewhat, I don't look for them to retreat to the US\$ 35/ton level we saw in December 1993. There was a slight degradation in recycle quality during the winter of 1993–1994, but the quality has since rebounded.

KARTER: Pulp prices were very low about a year ago, but because pulp is now in tight supply, prices have rebounded. In the long term, I believe fiber-based materials will remain in demand, because these materials come from a renewable re-

source and are recyclable. On the other hand, however, there are also extreme environmental pressures that have taken fiber supply out of production, particularly in the western United States. The sharp price increases we have seen, for example in recycled OCC, are aberrations in the fiber markets, although I do expect fiber prices to gradually increase.

MEAD: Although we are about 80% integrated, we buy nearly 200,000 tons of pulp per year. Because of this, the 60–70% increase in pulp prices hurt us. We are seeing some pulp shortages, but our supply is sufficient for the moment. There has been a degradation of recycled fiber, especially that from older plants. The poorer quality is more a result of certain recycle processes than a reflection of the source material (e.g., office recovered paper).

TJ:

How has NAFTA affected the industry and your company? What impact might GATT or other international agreements have?

HARAD: NAFTA has had a modest, favorable impact on the industry. The impact is greater in terms of the boost it gives to the general economy as opposed to the pulp and paper industry. Most of the changes in the agreements are phased in over a period of time, and we've seen some improvements in our business with Mexico because the trend is toward liberalization. Similarly, most of the changes of GATT, as they relate to pulp and paper, are back-end loaded and don't take effect until years later in the agreement.

HOWES: We now have two plants in Mexico, although we would have gone to Mexico had NAFTA not passed. NAFTA is surely an aid to trade between our countries. Talks are ongoing between Mexico and Chile that could result in Chile becoming a dominant trade partner. Argentina may follow thereafter. At some point, we will see a strong economic base throughout the Americas. We support open trade, however that may be defined.

MEAD: We have recently had some business in Mexico and Central America. The real impact of NAFTA and GATT will be minimal in the short term because these agreements are being phased in over a number of years. Free trade is best for our industry, providing it is equally free for all the participants.

MICHAELIS: We expect a smaller impact from NAFTA compared to other industries (e.g., Caterpillar), although we're very supportive of this agreement. We currently participate in the Canadian market and expect to trade more with Mexico at some point, and we believe NAFTA will be good for our industry as well as others. Similarly, given our position in international sales, we expect GATT to open trade routes for us in the long term.

TJ:

Which of the various EPA requirements will most affect the industry through the end of this decade and in what ways?

HARAD: The cluster rules are the most prominent EPA regulations before us today. If the rules were implemented as currently proposed, the cost/benefit relationship would be inappropriate. There is little scientific evidence that, for the billions of dollars needed to be spent by the industry, these regulations would provide significant environmental improvements.

HEIDER: If the cluster rules are passed in their present form, they will have a devastating effect on this industry. We have estimated that these regulations would cost Stone Container US\$ 300–450 million to comply. Some of these funds are being spent proactively; in 1993, we spent some US\$ 30 million in environmental improvements. Most of our capital expenditures over the last four years have been for environmental projects. As the cluster rules exist today, some of the mandated actions would require using unproven technology. The AF&PA has presented an alternative proposal to the EPA that uses current technology to achieve the same environmental benefits at about half the cost of current proposals.

KARTER: The biggest issue we are facing is the cluster rules. The proposed regulations not only attempt to define end results, but also dictate the technology we must use to achieve these results. This stifles the creativity of the industry and individual companies in meeting any proposed regulation. Forcing technology on the industry will impact our ability to compete on a global scale. Mead has been proactive, for example, in reducing AOX levels, but the major decisions about closing or updating various mills must wait until the cluster rules are finalized. If the regulations stand as currently proposed and with existing deadlines, it will be nearly impossible for this industry to react in 3–4 years and comply with them. At the same time, productivity and quality improvement expenditures will virtually come to a halt. ■

Literature cited

1. Edwards, J. C., *Tappi J.* 77(1): 47(1994).
2. Nichols, W., *Pulp & Paper* 68(9): 75(1994).
3. Hinsey, N. W., *Tappi J.* 77(9): 65(1994).
4. Anon., *The Economist* 329(7840): 25(1993).
5. Young, D. E., *Tappi J.* 77(6): 71(1994).

Edwards is a freelance technical writer based in Uniontown, OH.