

THE WORLD OF TISSUE

Unprecedented boom in tissue capacity underway in China

China is adding over 2 million tons, or 40%, to its tissue making capacity during 2009-11. By 2020 the country may be the world's largest tissue producer, moving up from number 2 behind the USA today.

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China: Big country. Big population. Extremely rapid economic growth. And enormous market potential for tissue. These facts have clearly not escaped notice as there is presently an exceptionally large tissue building boom taking place. Significant new capacity - some might say too much - is coming or has already been installed, adding around 2 million tons. This is from a base of about 4.5 million tons in 2008.

All signs are that this big increase in quantity will also lead to a very major increase in the quality level of tissue in China. The drivers from the demand side are fueled by a rapidly growing middle class, estimated to be around 200 million people today, that wants the comforts of a middle-class lifestyle, which includes tissue products. Thus as this growing middle class becomes larger and yields more spending power, combined with the development of the retail sector, consumption and quality demands will go up accordingly. Economic development on a good track. Ms Jiang Manxia, Secretary General of the China National Household Paper Industry Association (CNHPA) says 2009 was the most challenging year in China's recent economic development. However, the Chinese government's economic stimulus took effect and the Chinese economy recovered ahead of the western markets. The total 2009 GDP reached 33.54 trillion Yuan (USD 5 trillion), up 8.7% from 2008. According to data from A.C.Nielsen, retail sales of Fast Moving Consumer Goods also increased by 8.7% in 2009. So the great recession had very little impact on China. For 2010 it is estimated that GDP rose about 9-10% though it is still too early for definitive numbers.

"Considering that the consumption base is growing and GDP can be driven by investment and exports to some extent, the annual growth rate of tissue paper consumption will be quite close to or slightly lower than the growth rate of the GDP (coefficient of 0.8 to 1.0). It is forecasted that the annual per capita consumption of tissue paper will reach 4.2 kg in 2015 and 5 kg in 2020."

1 KG EQUALS 45 TISSUE PMS. With 2010 per capita tissue consumption estimated at about 3.3 kg, China is below the world average level of 4.1 kg. The gap is enormous compared to developed countries such as the USA where it is around 25 kg and the European average of around 15 kg. Small changes can have enormous impact, with just a 1 kg per capita increase in China meaning a jump in consumption of 1.35 million tons. This is equivalent to 45 tissue PMs making 30,000 tpy.

SMALL PRODUCERS GOING OUT OF BUSINESS. In China there are over 500 enterprises making tissue. However, the majority of these companies are very small and making very low quality paper on simple, small machines with under five tons/day or 1,500 tpy capacity.

The qualities are generally divided into four levels referred to as Best, Good, Normal and Bad. Today it is estimated that about 30% is best or highest quality made from 100% virgin fibers. As the quality levels continue to rise, and as total market demand does the same, higher quality equipment will be needed both for papermaking and converting.

The small producers are caught in a tight squeeze. Demand from consumers for high quality tissue is rising; at the same time as supply of this high

quality from the advanced larger companies is also increasing dramatically. The hundreds of tiny old machines making small volumes of very poor tissue can simply not compete with the modern, bigger PMs making high quality brands. This has thus led to the closure of large numbers of small tissue makers in the past year or two.

FOUR BIG PLAYERS GETTING EVEN BIGGER. Statistics from the CNHPA show an extremely long list of new tissue capacity expansion projects. Jiang estimates that new tissue making capacity amounted to 333,000 tons in 2009; 626,000 tons in 2010; and a giant increase of 1.1 million tons in 2011. Thus by the end of this year capacity will be around 6.5 million tons.

"The new round of high-level tissue paper production capacity increases," explains Jiang, "will promote the technological progress of the industry. However, in the mean-time, the industry will encounter the difficult market cycle as a result of the rapid increase in capacity and market demand which needs time to catch up."

The big four players in the Chinese market today are APP Gold Hongye, Hengan, Vinda and C&S. These companies accounted 27% of total tissue sales revenue in 2008 and that proportion is increasing each year as the industry concentrates. It is estimated that they will have perhaps 40% by 2015. They all have important tissue brands, some national and some regional.

And they are all expanding very rapidly, both in terms of capacity as well as new plant locations to get better nation-wide coverage. For the period 2009-11 the big four producers are growing at incredible 30-40% annual rates, far outpacing the market growth of about 8%. This means they will take market share at the expense of the smaller producers.

APP GOLD HONGYE is basically doubling capacity, from 400,000 tpy in 2009 to 850,000 tpy in 2011. And further to 1.1 million tpy in 2013. It also has established new production sites further inland at Sichuan and Hubei.

HENGAN is doing pretty much the same thing, going from 420,000 tpy in 2009 to around 900,000 tpy by end 2011. It is also increasing the number of production bases, from the current three to five, located at Changde Hunan, Weifang Shandong, Jinjiang Fujian, Wuhu Anhui and Banan Chongqing.

VINDA is expanding as well but at a slightly slower pace, from about 300,000 tpy in 2009 to 500,000 by end 2011. It already has a wide production network but is also adding a new base at Anshan Liaoning in northeast China.

C&S (previously known as Zhongshun and also called CNSN) is number 4 with 186,000 tpy in 2009 and will rise to 350,000 tpy by 2012. In 2010, it added one production base for a total of six now. The new plant is in Tangshan Hebei, covering the formerly weak northern Chinese market.

In addition, many other companies are adding tissue capacity, but not at as fast a pace as the big four.

At the same time, new players are also coming in, such as Shandong Chenming Paper which is already a big supplier of printing and writing and packaging papers.

Western suppliers have received many of the paper machine orders for the capacity expansions. This includes companies such as A.Celli, Andritz, Metso, PMP, Toscotec, and Voith, among others. Many have now introduced simpler machines that are becoming popular in China. In addition, Japanese supplier Kawano with smaller, energy efficient machines has also been very successful at getting many orders.

PULP PRICE PLAYS KEY ROLE. Market pulp prices, according to Cao ZhenLei, president of the CNHPA, have played a very large role in the developments, both in stimulating the capacity boom as well as hastening the closure of small producers.

"After the financial crisis of 2008, the pulp price was very low. Tissue makers then bought market pulp very cheap, at around US\$400/ton, and built a lot of pulp inventory. As tissue is a consumer product, prices did not fall in 2008 and 2009 as they did for other paper grades like printing and writing, and packaging. Therefore in 2009 the profit margins for tissue were huge. Tissue companies had lots of money to reinvest in new tissue production machines and the big boom in capacity got started. Also new companies, attracted by the high profit margins on tissue, came in to the business."

Now the much higher pulp price is squeezing profits again, especially for the small producers who continue to disappear in the new landscape. As an illustration of the swing, in 2009 pulp imports rose 45% in tonnage terms but in value it was only up 2%. In 2010 it was totally different, with imported pulp tonnage falling by 60% but value of those imports rising 40%!

OVERCAPACITY WILL HAVE AN IMPACT. The short-term overcapacity will take a few years to digest although things can take surprising turns. "Overcapacity is a worry," continues Cao, "but last year in 2010 we actually saw a shortage of tissue finished product since so many small mills went out of business. This year and 2012 will be a different story. There are newcomers coming but they have no distribution channels yet. So I think they will have to sell jumbo rolls at low prices. It is a very competitive market. But the big brand guys should be OK since they have distribution and loyal customers."

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BRIGHT PROSPECTS. Agreeing with the good long-term outlook for tissue in China is Esko Uutela, tissue consultant with RISI. He sees tissue in other emerging market areas looking positive as well. "Globally, the tissue business is increasingly expanding most in the emerging markets. China in particular, but Latin America and Asia Far East as well will be very important. Asian tissue demand did not suffer much from the great 2008 recession. In China the effect was very minimal, and many other Asian countries were also very resistant, recording consumption growth during 2009 as well."

"Overall I see very good long-term growth prospects in all of the Asian tissue markets, with China leading the way. Major restructuring is ongoing in the Asian tissue industry as shown by the big investments particularly in China, but also in other countries such as Indonesia. Closures of small tissue mills using non-wood pulps will continue for environmental reasons in China, which will help to keep the balance, but a threat of overcapacity clearly exists." •