A CRUDE & *Exciting* Situation

By Fred Norrell

Crude by rail (CBR) has gushed into the crosstie market, and is now explicitly represented in the Railway Tie Association (RTA) forecast process. The result is explosive growth in predicted tie demand. But why would CBR have such a large impact?

Data indicate recent increases in U.S. crude oil production correlate very highly with carloads of CBR. The U.S. Energy Information Administration predicts U.S. crude production will expand at a rapid pace for the next few years; the RTA forecast model shows CBR doing likewise.

This latter result is based on a fairly small amount of data, since CBR is a recent phenomenon, and this poses the risk that the production/CBR relationship may not hold with the same level of accuracy during the next few years. After all, some pipeline additions could alter the outcome and it is not yet certain if the relationship will remain stable when the initial build out of the infrastructure is complete and the railroads go into maintenance mode only in that trackage.

But it is hard to doubt the crosstie market is in for major changes. RTA data indicates tie purchases up by almost 1.5 million in 2013. These results, along with the effects of CBR, flow through the RTA forecast model and translate into a large and fast-growing demand for ties *(See Table 1)*.

Some concern exists that tie suppliers may not anticipate the full extent of the demand growth possible in the new CBR-driven railroad system. Therefore, the need exists to present a scenario in which some constraints operate to reduce the volume of transactions in the crosstie market.

At issue is the tie supply chain, starting with logs and carrying through to treating cylinder capacity. Additionally, RTA reports show a rather low (less than 70 percent) inventory-to-sales ratio, meaning tie suppliers have little margin of safety when trying to fill orders. A companion article addresses these issues in more detail.

A "Constrained Scenario" is offered that includes subjective reservations about the crosstie supply chain, possible pipeline additions, and uncertainties regarding the forecasting process *(See Table 2)*.

One characteristic of this scenario is that it more closely matches recent experience following large upticks in railroad tie installations. Another characteristic is that even with significant reductions from the forecast tie demand in Table 1, the level of purchases remains impressive.

Herein lies the question: are crosstie suppliers in a position to move beyond the past and current challenges in the supply side of the marketplace? ■

TABLE 1

New Wood Crossties (in thousands)

Year approx.	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Pct.
2011	1.8%	16,525	5,363	21,888	11.8%
2012	2.8%	16,968	6,054	23,023	5.2%
2013	1.9%	17,136	7,312	24,448	6.2%
2014	2.5%	17,705	7,738	25,443	4.1%
2015	3.2%	18,262	8,007	26,269	3.2%
2016	3.3%	18,806	8,112	26,917	2.5%

TABLE 2 (Constrained Scenario)

New Wood Crossties (in thousands)

Year approx.	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Pct.
2011	1.8%	16,525	5,363	21,888	11.8%
2012	2.8%	16,968	6,054	23,023	5.2%
2013	1.9%	17,136	7,312	24,448	6.2%
2014	2.5%	17,205	6,422	23,627	-3.4%
2015	3.2%	17,862	6,674	24,536	3.8%
2016	3.3%	18,006	6,546	24,551	0.1%

Out Of The Frying Pan?
If So, Then To Where?

By Jim Gauntt

To say that there remains some level of uncertainty about tie supply as it relates to demand, even under normal market conditions, was an understatement yesterday. Today, it's a whopper.

Who knew that in 2013 overall tie purchases would rocket skyward with a 1.5 million surge as compared to 2012? RTA's last forecast indicated there was some inclination toward an overall increase in demand of that magnitude. In fact, that forecast was just 300,000 ties short of the final tally for 2013. But, if one were to look back to the forecasts at the beginning of 2013, growth was only expected to be 2.7 percent for the year. It turned out to be 6.2 percent. That's a gaggle more ties than expected 18 months ago.

To the consternation of most industry members, that demand came during a time that can only be described as problematic for tie supply. There is a laundry list of issues that converged at the same time:

1. 2013 was the wettest year on record since 1895. This was especially true for tie producing regions that all saw greater than average rainfall making logging difficult, if not impossible, for weeks at a time.

2. Hardwood lumber, pallets, board road, crane mat and other low grade markets ramped up at equal or greater pace than ties at the same time.

3. Hardwood sawmill capacity was at or near historical lows.

4. Logging capacity was at or near historical lows.

5. Limited financing from commercial lenders was available.

6. Rapid price escalation was experienced for products sawn from available logs.

7. There was restraint in adjustment of prices for ties until late in the year.

8. Impacts to output from industry consolidation and other factors such as more Boultonizing.

The result in 2013? Tie supply was 15.5 percent lower than 2012 and the inventory-to-sales ratio was at 0.74, significantly below the five-year average of 0.82. Thus, as reported in the companion article, there is now the expectation for the constrained scenario to more closely match the final 2014 tie purchases total than the model-driven forecast.

Why? Unfortunately for suppliers and their customers, not a lot has changed since the end of last year. Most of the factors listed previously are still having their effects. It is true in some regions that the weather is now beginning to cooperate, but that does not describe the entire equation. Since Jan. 1, 2014, member-reported production is down 14.1 percent from year ago levels, and inventory has plummeted another 9.5 percent. The inventory-to-sales ratio is now 0.66. By some estimates, the effects of what is now being experienced in the marketplace will be felt well into the future.

While reported price adjustments have led to some firming of supply, many industry observers have yet to report increases. Production for the most recent month of April was less than 1.6 million ties. That's the lowest total for April in four years.

Where is this leading? Reports are trickling in of new mills coming online, but so are the reports of some potential customers buying alternative materials because they have to.

Usually, market imbalances take a long time to get created and even longer to correct. If that's the case, suppliers may be working overtime for the foreseeable future. But, another thing happens often enough in the hardwood industry to quote it here.

A former RTA board member once remarked that every time he predicted exactly what would happen in tie supply, something would occur that would make a fool out him. If that "always happened" to one of the most seasoned sawmillers who ever cut ties, making a prediction of tight supply for the foreseeable future may offer hope. Producers and customers can hope time is near for such a fool-making occurrence to happen in a way that rapidly reverses the current course of tie supply. ■