Sideways On A Fast Track
Puzzling Factors Drive Regional, National Markets For Ties

By Jim Gauntt

There's an old saying that everything comes out in the wash. In a way, that is what has happened to the Railway Tie Association's (RTA) forecast for new wood tie purchases in 2007. That forecast, which was published in late January 2007, had actually been developed the preceding December. At that time the prediction was that tie producers would see sales of 21 million new wood ties over the ensuing calendar year. As of the end of November 2007, the 12-month rolling total for new wood tie purchases was 20,966,000. It's hard to get much closer than that in forecasting.

But, for most of the year that was not the case. In fact, as of June 2007, the 12-month rolling total of purchases dipped below 20 million to 19.9 million for the first time since early 2006. Furthermore, as late as September, the market looked like it would end the year as much as 2 percent down compared to 2006.

So, what is happening this late in the year? Is the market beginning to accelerate? And, if so, will it continue? Or, are there signs that problems now surfacing in the economy will soften tie demand in the coming months?

One of the theories that occurred to some market watchers was that the short line and regional railroads were booking heavier than usual end-of-the-year orders to maximize the benefit of the last scheduled year of the tax credit. And, some tie plants have indeed seen a surge in short line and contractor sales in the fourth quarter.

However, other plants are not reporting larger than normal activity in these specific markets. Could this be because some short lines believe that the tax credit will ultimately be extended? If so, these roads may not have felt that they needed to boost tie purchases in late 2007.

Yet, it is hard to ignore the fact that some manufacturers are reporting better than expected fourth quarter tie orders from short lines and regional roads. So, at least some of the increase in tie purchases may be attributable to these entities and the contractors servicing them.

Then there is the Dakota, Minnesota & Eastern (DM&E). Are we seeing the signs of the first big push to upgrade and expand track from this road? One industry observer suggested that over the last quarter of 2007, DM&E might have placed orders for as much as 150,000 to 200,000 ties. This certainly could explain a big fourth quarter, but others are not so sure.

Recent Surface Transportation Board (STB) action postponing the decision on the Canadian Pacific's purchase of DM&E until fall of 2008 would suggest that extra tie demand is premature at this time. Plus, other tie manufacturers have not reported any unusual DM&E activity for now. So, again, even if DM&E's current orders are a little heavier than normal, it's likely they are not the main factor in the demand equation.

What about the Class 1 railroads? Well now, maybe there is something here to look at. Many providers to the Class 1's are seeing a strong end of the year with shipments of 2008 maintenance program ties flowing out of the plants at an unabated pace. Field reports indicate that things could be really heating up. As one tie manufacturer said, "our railroad hasn't missed a beat and is

TABLE 4 –Tie Production, Purchases & Inventory *(000's omitted)*

Year	Month	Tie Production	Annual Production Rolling Total	Tie Inventory	Change In Inventory	Tie Purchases	Annual Purchases Rolling Total	Inventory To Sales Ratio
	Jan	1,615	17,541	14,022	596	1,019	17,301	0.81
	Feb	1,470	17,868	14,129	107	1,363	17,487	0.81
	Mar	1,927	18,540	14,140	12	1,916	17,943	0.79
	Apr	1,583	18,598	14,254	113	1,470	17,699	0.81
2004	May	1,497	18,656	14,284	30	1,467	17,521	0.82
	Jun	1,876	19,166	14,384	100	1,776	17,820	0.81
	Jul	1,532	19,121	14,343	(41)	1,573	17,914	0.80
	Aug	1,656	19,190	14,243	(100)	1,755	17,943	0.79
	Sep	1,789	19,328	14,342	99	1,691	18,006	0.80
	Oct	1,655	19,258	14,728	386	1,269	17,933	0.82
	Nov	1,373	19,253	14,865	136	1,236	18,046	0.82
	Dec	1,366	19,338	15,015	150	1,216	17,749	0.85
	Jan	1,273	18,996	14,898	(117)	1,390	18,120	0.82
	Feb	1,270	18,797	14,707	(191)	1,461	18,218	0.81
	Mar	1,451	18,320	14,410	(297)	1,748	18,051	0.80
	Apr	1,421	18,158	13,951	(459)	1,880	18,460	0.76
2005	May	1,502	18,162	13,984	33	1,469	18,462	0.76
	Jun	1,793	18,079	13,988	5	1,788	18,475	0.76
	Jul	1,590	18,137	13,927	(62)	1,651	18,553	0.75
	Aug	1,860	18,341	14,143	216	1,643	18,441	0.77
	Sep	1,882	18,434	14,699	556	1,326	18,077	0.81
	Oct	1,774	18,553	14,691	(8)	1,782	18,590	0.79
	Nov	1,786	18,966	14,904	213	1,572	18,926	0.79
	Dec	1,661	19,261	15,531	626	1,035	18,745	0.83
	Jan	1,734	19,721	15,747	217	1,517	18,872	0.83
	Feb	1,674	20,125	15,890	142	1,532	18,943	0.84
	Mar	2,128	20,803	16,178	288	1,840	19,035	0.85
	Apr	1,744	21,126	15,981	(197)	1,941	19,097	0.84
2006	May	2,405	22,030	15,711	(269)	2,674	20,302	0.77
	Jun	1,981	22,218	15,573	(139)	2,120	20,633	0.75
	Jul	1,609	22,237	15,606	33	1,577	20,559	0.76
	Aug	2,169	22,547	16,002	396	1,773	20,688	0.77
	Sep	1,967	22,632	16,317	316	1,651	21,014	0.78
	Oct	1,724	22,583	16,586	268	1,456	20,688	0.80
	Nov	1,713	22,510	16,654	68	1,645	20,761	0.80
	Dec	1,599	22,449	16,646	(7)	1,606	21,333	0.78
	Jan	1,609	22,324	16,367	(280)	1,889	21,705	0.75
	Feb	1,426	22,076	15,936	(430)	1,857	22,029	0.72
	Mar	1,768	21,716	16,537	601	1,167	21,356	0.77
	Apr	1,633	21,604	16,280	(257)	1,890	21,305	0.76
2007	May	1,863	21,063	16,074	(207)	2,070	20,700	0.78
	Jun	1,942	21,023	16,745	671	1,271	19,851	0.84
	Jul	1,611	21,025	16,270	(475)	2,086	20,361	0.80
	Aug	2,126	20,981	16,561	291	1,835	20,423	0.81
	Sep	1,593	20,608	16,397	(163)	1,757	20,528	0.80
	Oct	1,914	20,797	16,730	333	1,581	20,653	0.81
	Nov	1,611	20,695	16,382	(348)	1,959	20,966	0.78
	Dec	1,375	20,471	16,816	434	942	20,302	0.83

NOTE: The information in this chart is calculated from reported production and inventory numbers by RTA members. This represents more than 95% of the U.S. and Canadian market for wood crossties.

shipping stronger than usual for this time of year." On the other hand, other manufacturers report that their Class 1 roads have pulled the horns in just a bit, having already met or exceeded their buying requirements.

One bright spot seems to be the Kansas City Southern (KCS). KCS is quite bullish on 2008 and is increasing its capital program significantly. KCS tie procurement in late 2007 reflects this and may be one of the reasons tie purchases are accelerating as 2007 comes to a close.

Yet, if one reads the latest CEO report published by *Railway Age* in the December 2007 issue (www.railwayage.com), one can definitely sense a mixed bag. Canadian roads are upbeat, followed by some U.S. roads, but in general it's hard to feel the confidence factor in an article entitled "Railroads Under Siege."

Puzzled? So are the majority of industry decision makers, and all it's going to take is a weak December 2007 purchase tally and the final tie numbers could fall for the year as much as 2 percent from December 2006. Since the weather has been horrendous throughout the nation's (and tie region's) midsection in early December, that could certainly happen.

Then there are the worries for the sawmilling community. More than one market observer has said recently that the times the tie industry are experiencing now are unprecedented—that never before had there not been at least one bright spot for low-grade material sales, other than ties, that would buoy hardwood sawmills. But, with flooring down, lumber down, pallets down and really no relief in sight, hardwood mills seem to be fighting a losing battle even in the midst of a stellar tie market.

Pressures on the raw materials, both on the green tie and in the markets for the creosote used to treat them, could weigh heavily on the black tie market in the coming months. Some analysts watching the raw material side of the equation worry that a sure-to-come contraction in the hardwood sawmilling community could become a major headache for all markets served by these mills within the next six months.

So, what are planners and forecasters to do? On the one hand, things don't look like they are slowing down one little bit. On the other hand, there sure are a lot of questions out there.

The biggest of these is railroad traffic and revenue. It's no secret that if the trains are running then the ties will flow. But, U.S. Class 1 rail traffic and revenue are also slowing, if only marginally. Shipments are down 1 percent year to date as of week 51 of 2007 based on ton-miles reported in Association of American Railroads (AAR) weekly traffic reports. If that trend continues into 2008 it's sure to have an impact on all products purchased by railroads.

Also, the economy could get worse. The housing market could decline more, mort-

Press Time Update — 2008 Forecast Lowered

The data used for the two market forecast articles was updated to include December sales at the time of publishing this issue of *Crossties*. It was too late to revise the complete text of those articles, so this brief essay is designed to help readers put the new data into perspective as it relates to the broad picture. As noted in one of the articles, RTA had, in fact, expected a weak December sales figure, but the final totals were even weaker than had been predicted. The year-end sales totals for 2007 are now 20.3 million ties rather than 20.56 million as predicted by the econometric forecast. Does this mean a deceleration has already hit the market? Will this impact affect the econometric forecast model output for 2008 and beyond? Well, the two short answers are "maybe" and "yes," respectively.

The "maybe" part comes from the fact that December sales numbers are historically all over the map. Questions about the dynamics of the market during December abound. The biggest one always confronting market watchers at that time of year is: Are some, or any, of the Class 1's shipping ties early for their 2008 program or are they holding off for end-of-the-year budgetary reasons? Looking at any one single month for clues to market direction is always perilous, but December data as a standalone snapshot of the marketplace is particularly so for this reason among others. Thus, it is important to take more into consideration, and when you do, you find that 2007 total purchases now come in 1.8 percent lower than 2006. So, it is hard to avoid the conclusion that the economy is already taking a toll on the demand for ties.

And, the economic news has been less than helpful in discerning direction. The Fed has reacted with interest rate cuts signaling their recognition of a slowdown. But, there are now reports that mortgage applications are picking up. On the other hand, the loss of so many construction jobs must put a damper on overall consumer spending, right? But then exports are picking up, yet capital spending by business isn't. Too little time, too little space to analyze all of this.

But, remember, RTA was conservative in its assessment of the marketplace when the original articles were written. So, how about dissecting one more layer of the model to see what it may allow. The model appears to be overestimating Class 1 freight growth for 2007, so a downward adjustment was made to the forecast of freight data. Prior to this adjustment, the RTA model predicted that 2007 would see a 5 percent growth in U.S. Class 1 freight and 20.56 million ties would be purchased (total market.) With the adjustment to account for lower freight growth, projected tie demand falls and comes more in line with actual reported 2007 sales.

Will it affect 2008? Historically, whenever there is a slowdown in the economy tie demand tends to be affected over a longer time period. Thus a one-year economic downturn would typically see tie demand fall over a period that exceeds one year. Thus, it would seem inevitable that if the economy was slowing in late 2007 that not only 2007 but also 2008 and even some of 2009 may be impacted. And, that would be the call at this juncture. But since the original forecast was conservative to begin with readers should be pleased to note that the downward revision is modest. The following table is now the more likely scenario for the foreseeable future. §

UPDATE: Forecast Summary (thousands of new wood ties)

Year	Class 1 Purchases	Small Market Purchases	Total Purchases	PCT
2004	14,307	3,695	18,001	9.3%
2005	15,029	3,776	18,805	4.5%
2006	15,937	4,709	20,647	9.8%
2007	15,900	4,383	20,282	-1.8%
2008	16,015	4,018	20,033	-1.2%
2009	16,169	3,950	20,119	0.4%
2010	16,631	4,044	20,675	2.8%

gage defaults could increase, related financial instruments could lose more value, and credit could tighten for this reason.

Another factor could be inflation. The last monthly data for November 2007 suggest that the Fed may need to bolster its fight against inflation. Although the Fed avoids reacting to one month of price data, and usually waits to see where the quarterly data fall out, if it determines that it needs to tighten credit to attack inflation, then investment and consumer spending could take a dive.

Compounding these concerns? More job losses in the housing and related industries look probable, which could further reduce consumer spending.

What increases the tension is that it is hard to count on even the most seasoned analysts for guidance. Unfortunately, economic forecasters usually fail to accurately predict the onset of recessions. So, maybe it isn't surprising that a majority of these pundits say that while a slowdown is likely for 2008, they don't expect it to be a recession.

Dig a little deeper, though, and one finds that the pessimists in the crowd are growing in number. The key thing to remember is that if a recession does actually occur in 2008, it would deliver a blow to tie purchases not only in 2008 but also in 2009.

On the plus side, the RTA forecast model, using conservative assumptions, has predicted that 2008 will essentially be a repeat of 2007. There is also the possibility that the short line tax credit will be renewed and that CP/DM&E could start their track improvement push. Twenty-one million ties or more could easily happen in 2008 if either of those scenarios occurs.

Yet, there is the uncertainty in the banking and housing industries, and energy costs and recent inflation data are tapping on the economy's brakes. Add to this the prospects of a contentious election year that promises to cast a negative shadow on everything it touches and it may be that better-safe-than-sorry should be the by-word for business planners this year.

The good news is that even with all these concerns one can still reasonably forecast a year for tie purchases very similar to 2007. Considering that this means railroads will likely buy 20.5 million-20.6 million new wood ties, fantastic by any measure for this industry, it may not have producers dancing in the streets, but it certainly shouldn't have them ducking for cover either. §