Tie Demand Reflects Drilling Activity

By Fred Norrell

The U.S. economy is limping along, but one would not know it from examining crosstie purchases data. Real GDP is expected to move mostly sideways in 2011 and 2012, inching ahead at about 2 percent rate in both years.

On the other hand, current crosstie purchases are booming. Class 1 purchases are on track to finish the year with a 5-plus percent increase. Small market purchases in 2011 experienced explosive growth, apparently in response to the investment tax credit and gas and oil drilling. Together, these two market segments, helped tie purchases reach 10 percent growth in 2011.

Some time back, Class 1 railroad representatives let it be known that the recession and subsequent growth issues were not going to derail current pursuit of their long-term investment plans, and recent purchases bear that out. However, as the lackluster economic environment stretches into 2012, this resolve is predicted to soften a bit, as crosstie purchases fall off by almost 1 percent. As the forecast summary table reveals, economic activity is forecast (by S&P) to speed up in the years beyond 2012. This drives RTA's forecast, and is reflected in a resumption of growth in tie purchases. This could be on the low side: U.S. carloads of freight increased more than 8 percent in 2011, and in keeping with the recent expansion of oil and gas drilling, carloads of crushed stone, sand and gravel increased by more than 35 percent. If drilling infrastructure continues to be built at this pace, crosstie purchases could well exceed this forecast.

Yearly Forecast Summary
New Wood Crossties (in thousands)

Year approx.	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Percentage.
2006	2.7%	15,937	5,110	21,047	11.7%
2007	1.9%	15,285	5,349	20,634	-2.0%
2008	-0.3%	16,761	3,907	20,668	0.2%
2009	-3.5%	16,216	3,432	19,648	-4.9%
2010	3.0%	16,379	3,200	19,579	-0.4%
2011	1.8%	17,297	4,188	21,486	9.7%
2012	2.0%	17,670	3,560	21,230	-1.2%
2013	2.2%	18,426	3,807	22,233	4.7%
2014	3.4%	19,160	3,765	22,926	3.1%

The "small market" consists of all crosstie buyers other than Class 1 railroads. The outlook here is more confusing. Investment tax credits sometimes win approval late in the tax year, or even fail to materialize. The tax credits came into being in 2005, and have been approved, often late in the years since. The credit was approved late in 2010, and small market tie purchases were off by 7 percent for the year; the credit was approved in advance for 2011 and purchases boomed by about 30 percent. However, this rise appears to reflect another phenomenon as well: RMI reports smaller railroad carloads of stone, clay and aggregates increased by almost 14 percent in 2011, again, reflecting oil and gas drilling activity. Total carloads increased by almost 9 percent.

The outlook for 2012 is comparatively grim: with no tax credit in sight, crosstie purchases are predicted to fall about 15 percent, putting them at a level just above those of 2009 and 2010. Beyond that point, RTA makes no assumption that the tax credit will be available—a victim of political gridlock or not. It is difficult to predict actions in D.C. tomorrow, much less two to three years out. Thus, predicted purchases exhibit only modest performance beyond 2012.

For the crosstie market as a whole, then, 2012 will be a year where Class 1 tie purchases retain more vigor than the small market tie purchases. In the absence of a tax credit, purchases are predicted to fall by about 1 percent overall. As the table shows, subsequent growth largely follows the slow improvement in economic activity. ■

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2012 A Landmark Year For *Innovation* & New Construction

By Jim Gauntt

This year may well be an historic year in the making. The anticipated campaigns, leading to an eagerly awaited November election, promise to be only partly responsible for the landmark year that tie suppliers may remember 2012 for.

Other remarkable items to note for the upcoming year are the initial foray into the use of copper naphthenate by a Class 1 railroad, multiple manufacturers making significant investments to offer this product, including a new copper naphthenate manufacturing facility coming on line (see NS article on page 14), one or more possible new tie treating plants starting construction, and RTA's renewed focus on print and conference content dedicated to sawmill members (see Letter To RTA on page 6).

Another remarkable feature of this year will be the continued and increasing rail infrastructure investment to deal with expanding drilling operations in the oil fields of several areas in the United States and Canada. In addition to the brief article on this on page 4, a recent announcement by Union Pacific noted that shipments of frack sand, pipe and other materials into and out of these drilling operations had doubled in the last year.

Given the turmoil that continues to exist for the oil shipping lanes of the Middle East, there is an ever-increasing urgency for this build-out to accelerate.

Then, there is the commitment from Norfolk Southern CEO Wick Moorman to keynote the annual RTA business luncheon in Tampa in the fall. It's been a while since RTA has been privileged to welcome a Class 1 CEO at this event. And, how about tie demand exceeding 21 million ties? What a difference a year makes in both production and purchases of ties, as Table 1 illustrates.

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All in all, there is much to anticipate and much work to be done.

What The Frack?

Fracking, or hydraulic fracturing, is the propagation of fractures in layers of rock by the use of pressurized fluid. These fractures release oil and natural gas deposits that might have been otherwise unobtainable.

Frack sand is used to keep the fractures open so that extraction of the oil or natural gas can proceed in an uninterrupted manner. Frack sand and pipe and other materials must be shipped to the drilling areas in substantial quantities to achieve the ultimate goal of extracting the oil and gas that are then delivered to the distribution points that lead to refineries.

Production, Purchases & Inventory Sales Ratio (ISR)

Year	Annual Tie Production	Percentage Of Growth	Annual Tie Purchases	Percentage Of Growth	ISR Min-Max
2000	13,983	-14.0%	14,235	-9.0%	.78-.96
2001	14,957	7.0%	15,981	12.3%	.79-.97
2002	17,468	16.8%	16,686	4.4%	.68-.81
2003	17,214	-1.5%	17,194	3.0%	.78-.84
2004	19,338	12.3%	17,749	3.2%	.79-.85
2005	19,261	-0.4%	18,745	5.6%	.75-.83
2006	22,449	16.6%	21,333	13.8%	.75-.85
2007	20,471	-8.8%	20,302	-4.8%	.72-.84
2008	20,258	-1.0%	20,896	2.9%	.68-.84
2009	22,156	9.4%	19,604	-6.2%	.80-.96
2010	17,190	-22.4%	19,736	0.7%	.81-1.02
2011	22,689	32%	21,700	9.9%	.74-.82

2011 is data from January through November.
2011 growth rates are from November 2010 to November 2011.

If the tax credit does come through in the first quarter of 2012, the 2012 forecast could be raised by more than 500,000 ties.

Also, until pipelines are completed, trains carrying these materials in can also be used to transport crude out, so there is increased heavy traffic flowing in both directions in these areas. For example, a recent article from Bloomberg suggests both U.S. and Canadian railroads will benefit from the denial by President Obama of the Keystone pipeline.

"With modest expansion, railroads can handle all new oil produced in western Canada through 2030, according to an analysis of the Keystone proposal by the U.S. State Department," Bloomberg.com reported.

That's where the need for new ties, not related to ongoing maintenance, is greatest outside of any tax credit impact on railroad spending.

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All of this is explained in order to note that in the absence of this new activity and the short line tax credit, new tie demand would not be as high as it is. In fact, as the forecast article points out, these factors play a significant role in what RTA and its members can expect out of 2012.

Although the forecast model includes additional factors to account for the expected impact, the issue is that no one source of information is available to quantify the number of ties that might be needed. Any error in the forecast that may become evident a few months from now could be directly related to higher or lower than expected demand from this infrastructure build out.

How About The Short Line Tax Credit?

At presstime, there did not yet seem to be a vehicle for extending the tax credit. As previously reported on a number of occasions, even if that changes, the impact on 2012 will be significantly less in comparison to years when the tax credit could be "planned" for.

Thus, in its absence, the short line and smaller market tie demand for 2012 is reduced significantly. If the tax credit does come through in the first quarter ➤

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Exports Increase

There is anecdotal evidence that exports of wood ties are increasing to U.S. neighbors to the south. In addition to Mexico, Caribbean and other Latin and South American buyers have been increasing their demand for U.S. wood ties. It is unclear whether this is occurring at this point in time organically or if the increased capacity for boron-based, dual-treated ties have made U.S. hardwoods more attractive to rail operations in these geographic areas.

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RTA will attempt to measure the export effect with member reporting procedures in 2012. In the meantime, the assumption in the forecast is that demand for U.S. hardwood and softwood ties is growing to some degree for these regions.

Hardwood Sawmill Focus

It's no secret that the hardwood sawmill base has consolidated in the last few years. And, of course, this has affected RTA's sawmill membership as well. But that has not stopped the RTA Executive Committee from authorizing increased content specifically for sawmills. In addition to the March/April *Crossties* focus issue announced on page 6, RTA is planning a significant session dedicated to sawmill and timberland issues for the annual conference in Tampa, Fla., Oct. 22-25.

Reynolds Forestry Consulting group is working with RTA to provide articles and dedicated presentations throughout the year and at the RTA fall conference. And, of course, *Crossties* is already providing content for RTA's largest membership group regarding the upcoming vote on a proposed Hardwood Checkoff program (see the November/December 2011 issue).

Many industry pundits have noted that crossties have become an increasingly bigger part of the hardwood sawmill community's output in recent years. By increasing the content for these mills, RTA hopes to reenergize its message that not only is membership in the association valuable as a resource but also that RTA is committed to keeping the markets for ties healthy and profitable for producer members. Plus, as the economy slowly improves, RTA leadership wants to make sure hardwood sawmills maintain a focus on providing the ties that railroads will need in the coming years.

Bottom Line

The forecast this year uses the RTA econometric model as its foundation to which additional information-based support has been added. On the positive side, the economy seems to be growing, if only marginally, and the Class 1 programs are expected to remain solid. Plus, there is new track construction occurring into and out of oil fields of the United States and Canada.

On the downside, short lines likely will not perform in the tie demand arena as well as they did in 2011. Then, of course, there are the ever-present dangers of the world economy and troubles in the Middle East.

Still, RTA members can look forward to another very good year in tie demand. Although off a few points, demand for new ties in excess of 21 million for 2012 is nothing to sneeze at. In that sense, and adding in all the other innovative things occurring on the tie supply side of the equation, this year may yet turn out to be historic. ■