Crunch Time

More installs than expected in 2001 and big 2002 programs squeeze supply

By Jim Gauntt

Despite all the tough things that happened in 2001—terrorist activities, military responses, stock market woes and a mild recession—it was not such a bad year for railroads and tie suppliers. Railroad income was up, and, according to Railway Tie Association production data, sale of new crossties grew to an unexpected 1.7 million ties in 2001. Fortunately or unfortunately, depending on the perspective, production did not keep pace. New tie production rose only by 1 million ties.

That's good news from a historical perspective and from an economic efficiency standpoint as well. The inventory to sales ratio began to reach more normal levels. Table 1 (next page) illustrates the point. Historically, the average inventory to sales ratio has hovered around 0.67. But, in February 2001, it was at a staggering 0.97. By the end of the year, though, it was at 0.79, a marked improvement.

If an average price of a green tie is assumed to be $17, and a carrying cost equal to the average of prime rate for 2001 is applied, this inventory reduction induced economic efficiency for railroads and producers by a collective $400,000.

The trend in inventory reduction has continued steadily into 2002. Table 1 illustrates that demand is up and has increased faster than expected. With supply not yet keeping pace, inventory to sales ratios show a continued downward trend. The ratio in April was at 0.74. By the end of May, it was at 0.71. While this is still not down to the historical average, it is not too far from it, and tie inventories are now below 12 million for the first time since October 1998.

Is a dilemma brewing? The answer may be found in a closer look at why demand is increasing. The most complete information about the market comes from U.S. Class 1 railroads. U.S. Class 1 installs for 2001 were more than predicted by the RTA surveys and forecast. According to as-yet-unpublished data, Class 1's installed nearly 12 million ties in 2001. Our best estimates had been 11.7 million based on surveys. Our most conservative estimate was for 10.5 million. This discrepancy requires a bit of extra digging for answers.

Economic Background

Real Gross Domestic Product (GDP) is a measure of value created in a given period. In 2000, real GDP increased 4.1 percent. In 2001, however, it slowed to 1.2 percent. GDP reflects all products; the mix includes houses built, clothes, food, cars, coal, computers, etc. The recession in 2001 was concentrated in the high-tech sector, affecting mainly computers and communications. Yet, these are not products closely tied to rail delivery, so their fall did not significantly affect railroads. In fact, railroad income increased by about 5 percent, translating into a healthier-than-expected pace for tie installations.

Look For Updated 2003 Forecast In Next Issue Of *Crossties*

RTA surveys for 2003 and an updated forecast will appear in the September/October issue of *Crossties*. Based on preliminary survey data and the fact that tie supply is not currently keeping pace with demand, it is shaping up to be another tight year for supply.

If the preliminary survey data is correct, then U.S. Class 1 railroads are expecting to install as much as 12.9 million ties in 2002. It is debatable whether current supply shortages may keep this from happening. But, if railroads do install that many, then there are early indications that they would want to install even more in 2003. A figure of 13.0-13.2 million installs for 2003 could emerge as the survey forecast number when all the data is in.

What could happen, though, is that supply or other factors won't allow the installation of the 12.9 million ties in 2002. If that occurs, then the question will be whether railroads will attempt to catch up. If, for example, installs for 2002 are only 12.5 million ties, will railroads try to add the shortfall to their needs for 2003? Look for more updates on this question in the next issue of *Crossties*. §

Competition

Another aspect to be considered is the recent resurgence of railroads as a competitive force to be reckoned with. A recent article in the *Atlanta Journal-Constitution* explains (see full article on page 16). Railroads are putting their money on the line with guarantees of on-time service. This is what shippers want, so railroads are proving that they are up to the task. Intermodal service is increasing at an aggressive pace. And, although the final data is not yet calculated, other railroad

activity has increased as well based on the income figures.

Efficiency

Yet another factor would appear to be a change from within. Even though railroads have pared down their track mileage by 16 percent over the last decade, ton-miles of freight transported has grown by a whopping 40 percent. Customers have realized the benefits of railroads increased efficiency. In real terms (adjusted for inflation), the price of transporting freight has been reduced by nearly 30 percent since 1990. This increase in economic efficiency means railroads are even more competitive today with other modes of transportation.

Thus, demand is currently rising for track maintenance materials—quickly and, most likely, for the long term. Crunch time for suppliers is here.

The problem is that as railroads are doing what everyone in the maintenance supply business wants—increase demand—the weather has been horribly wet in some of the largest tie-producing regions. Because of this, logs are hard to come by and expensive in these areas. Other market forces are also in play. Some sawmills just don't have homes for all the secondary products that are produced when ties are cut, and, with log costs up, most sawmills are still having a hard time paying the bills. The result is that production is continuing to lag behind demand.

Many within the industry fear that this problem is likely to get worse before it gets better. Some producers are already behind in procurement for ties that will be needed in 2003. And recent information from the field indicates that demand isn't going away.

These are exciting times, though. Railroads, by innovating and improving their competitive posture, are changing the landscape of the transportation industry. This landscape holds promise for all railroads and their business allies. Now if we can just get the ties. §

TABLE 1

	Mo/Yr	Tie Production	Tie Inventory	Change In Inventory	Tie Purchases	Annual Purchases Rolling Total	Inventory To Sales Ratio
1997	Jan	885	11,281	895	(10)	16,566	0.68
	Feb	1,164	11,134	(147)	1,311	16,751	0.66
	Mar	1,140	10,598	(536)	1,676	16,730	0.63
	Apr	1,424	9,733	(865)	2,289	17,496	0.56
	May	1,330	10,107	374	956	16,659	0.61
	Jun	1,309	9,340	(767)	2,076	16,714	0.56
	Jul	1,577	9,274	(66)	1,643	16,966	0.55
	Aug	1,901	9,154	(120)	2,021	17,275	0.53
	Sep	1,738	9,762	608	1,130	17,050	0.57
	Oct	1,787	9,245	(517)	2,304	17,334	0.53
	Nov	1,358	9,562	317	1,041	17,299	0.55
	Dec	1,575	10,135	573	1,002	17,439	0.58
1998	Jan	1,363	10,283	148	1,215	18,664	0.55
	Feb	1,438	10,340	57	1,381	18,734	0.55
	Mar	1,556	10,018	(322)	1,878	18,936	0.53
	Apr	1,653	10,220	202	1,451	18,098	0.56
	May	1,487	10,182	(38)	1,525	18,667	0.55
	Jun	1,746	10,244	62	1,684	18,275	0.56
	Jul	1,752	10,273	29	1,723	18,355	0.56
	Aug	1,799	10,568	295	1,504	17,838	0.59
	Sep	1,954	11,264	696	1,258	17,966	0.63
	Oct	1,938	11,798	534	1,404	17,066	0.69
	Nov	1,664	12,715	917	747	16,772	0.76
	Dec	1,749	13,284	569	1,180	16,950	0.78
1999	Jan	1,507	13,549	265	1,242	16,977	0.80
	Feb	1,597	13,519	(30)	1,627	17,223	0.78
	Mar	1,854	13,633	114	1,740	17,085	0.80
	Apr	1,320	13,511	(122)	1,442	17,076	0.79
	May	1,267	13,750	239	1,028	16,579	0.83
	Jun	1,539	13,981	231	1,308	16,203	0.86
	Jul	1,189	13,972	(9)	1,198	15,678	0.89
	Aug	1,363	14,009	37	1,326	15,500	0.90
	Sep	1,251	14,178	169	1,082	15,324	0.93
	Oct	1,187	14,089	(89)	1,276	15,196	0.93
	Nov	1,175	14,086	(3)	1,178	15,627	0.90
	Dec	1,007	13,900	(186)	1,193	15,640	0.89
2000	Jan	1,151	14,263	363	788	15,186	0.94
	Feb	1,103	14,153	(110)	1,213	14,772	0.96
	Mar	1,059	13,750	(403)	1,462	14,494	0.95
	Apr	1,038	13,129	(621)	1,659	14,711	0.89
	May	1,191	13,002	(127)	1,318	15,001	0.87
	Jun	1,218	12,636	(366)	1,584	15,277	0.83
	Jul	1,036	12,143	(493)	1,529	15,608	0.78
	Aug	1,385	12,177	34	1,352	15,634	0.78
	Sep	1,280	12,740	564	716	15,268	0.83
	Oct	1,394	13,174	434	960	14,952	0.88
	Nov	1,239	13,473	299	940	14,714	0.92
	Dec	889	13,648	175	714	14,235	0.96
2001	Jan	1,128	13,811	163	965	14,412	0.96
	Feb	1,117	13,839	28	1,089	14,288	0.97
	Mar	1,274	13,719	(120)	1,394	14,220	0.96
	Apr	1,109	13,398	(321)	1,430	13,991	0.96
	May	1,363	13,009	(389)	1,752	14,425	0.90
	Jun	1,213	12,427	(582)	1,795	14,636	0.85
	Jul	1,267	12,315	(112)	1,379	14,486	0.85
	Aug	1,414	12,108	(207)	1,621	14,756	0.82
	Sep	1,147	12,114	6	1,141	15,180	0.80
	Oct	1,415	12,382	268	1,147	15,367	0.81
	Nov	1,226	12,764	382	844	15,271	0.84
	Dec	1,284	12,624	(140)	1,424	15,981	0.79
2002	Jan	1,446	13,057	433	1,013	16,029	0.81
	Feb	1,399	13,118	61	1,338	16,278	0.81
	Mar	1,312	12,760	(358)	1,670	16,554	0.77
	Apr	1,370	12,482	(278)	1,648	16,772	0.74
	May	1,359	11,996	(486)	1,845	16,865	0.71

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. Look for an updated production and inventory report in Tie Trends in the September/October issue, where some of this data will be added to existing information.