Stunning Growth In Wood Tie Market
Torrid Pace Leads To 2006 Record Purchases, Production

By Jim Gauntt

There is only one word that comes to mind when describing the wood tie market in 2006. Phenomenal! A blistering 10 percent growth rate in tie purchases, nearly 23 million ties produced, and, remarkably, 21 million ties purchased (estimated year-end totals). Wow!

At the beginning of 2006, the Railway Tie Association (RTA) predicted it would be a great year. The high-end forecast was for 20.5 million ties if various production or installation constraints did not rear their head. But, 21 million? It was not even one of the scenarios considered.

There was a reason that the predictions did not include a total of 21 million ties purchased for 2006. The RTA forecast model has several inputs for which assumptions have to be made (see article on page 8). No scenario seemed plausible that would have created a total purchase amount of 21 million ties.

And, even this year, the forecast model, with relatively aggressive assumptions, outputs a forecast of 20.4 million ties purchased for 2006, 3 percent below the estimated end-of-the-year figures. This is somewhat odd in that the RTA forecast model has been very accurate over the past few years. After all, the model attempts to identify the level of purchases consistent with predicted economic conditions.

What is going on? Does the model have a flaw? Are the assumptions of coal shipments, freight growth and GDP too conservative?

Well, even though no forecast model is perfect, there could be a few other reasons that purchases exceeded the predicted demand.

One reason could be that in the rush to meet the extraordinary pace of purchases, speculation in procurement may have created a little excess inventory in 2006.

There is a sense that west of the Mississippi inventories could be higher than what is optimal at this specific point in time. How much higher is subject to debate, but it is safe to say that even if it is only a little higher than optimal it could have an impact on what will happen in 2007.

In one scenario, if the inventory is a lot higher than optimal, say 400,000 to 500,000 ties, then one could postulate that this could result in a softening in tie purchases starting in the first half of the year.

On the other hand, if the inventory is only marginally higher, then there might not be any measurable impact at all. This is especially true if any or all of the other following scenarios are, in fact, occurring.

The first possibility to consider is that the short line market could be even hotter than what the model predicts. It seems clear that the short lines/smaller markets purchased...
more than 750,000 more ties in 2006 than they did in 2005. This is probably a direct result of the tax credit in place. But, what if they actually bought more than that? That certainly would account for purchasing exceeding an econometric model’s output, since the driver for growth—the tax credit—would not be an event consistent with past economic performance.

Another possibility is that over the past few years freight growth on the Class 1s has been capacity constrained. So, the model would tend to base future growth on a slope that is too shallow due to the historical constraints. Under-predicting would also occur if railroads are just now beginning to realize success in removing the constraint with the utilization of new capacity that is accretive to growth.

Other factors that are sure to be weighing in are those driven by historically high oil prices. Coal shipments escalating at a more rapid pace than what has been predicted and the continued packing of truck freight onto rail may be creating demand that is more than ever insulated from a brief downturn in the economy.

All this suggests that while the growth rate in tie purchases may cool, the actual number of ties in demand for installation may increase.

How will this affect purchases? On the one hand, speculation could lead to the conclusion that nothing will stop this juggernaut. The economy may have the softest of landings and railroads could continue to benefit, building even more capacity and using more ties in new construction and maintenance.

On the other hand, if you are more pessimistic and believe that there is excessive inventory floating out there somewhere, you might buy into the notion that there will be a softening in production by mid-year.

It would be easy to see how this could happen. Some industry observers believe it inevitable, especially if the weather this winter is mild enough to allow continued strong production. A near 23 million tie production rate “feels” unsustainable.

What will a look at a couple of statistics provide in the way of ammunition for both the high and the low case?

The final production number for 2006 is predicted to be 22.5 million ties with an inventory to sales ratio of 0.81. If the model’s prediction of 21 million tie purchases for 2007 is accurate, and purchases match production so that the inventory to sales ratio remains at the same 0.81 by the end of 2007, then production would have to fall by 6.7 percent from 22.5 million to 21 million ties during the year. Even if the inventory to sales ratio were to rise to 0.83, then production would still have to come down by 4.4 percent to 21.5 million ties.

It is hard to avoid a potential softening if one chooses to believe the model is correct for 2007.

On the other hand, if the demand for wood ties continues to grow at a faster pace than what is predicted, production would need to remain at elevated levels experienced in 2006.

Is there evidence that this could occur? If Dakota Minnesota & Eastern Railroad starts on its construction and rehabilitation project, that could certainly change the demand equation. But, a recent exception filed with the Surface Transportation Board by BNSF could prolong or even prevent that project’s realization.

Rail traffic could grow faster than what is currently predicted. However, the question remains: Will new capacity relieve the constraint that allows for this more rapid growth to occur as soon as 2007?

The short lines could have a huge year, figuring that they should take advantage of what could be the last year of their tax credit. Yet, installs in this market segment are already at historic levels. Will it be another blowout year in the growth of tie demand for short lines?

One factor that could impact what will happen in 2007 is treating plant cylinder time/capacity, which is showing signs of constraint in some areas. There are reports that some plants are at or near capacity. If this constraint manifests or worsens, satisfying demand levels above the model’s prediction could be difficult to accomplish.

In another scenario, there is a possible impact created by the supply of creosote. In 2006, tightness in the supply of this preservative caused great consternation for producers trying to meet production goals. And, although creosote suppliers are saying that the supply will be sufficient this year, just how the supply network satisfies all the producers logistically and “just in time” remains to be seen. Supply could proceed like clockwork, or there could be glitches, especially when there is significant dependency on foreign supply. A further question is if tie purchases were to significantly exceed 21 million, would the “planned for” imports of creosote be sufficient to meet that demand?

So, what’s the bottom line? The most straightforward, and admittedly conservative approach is to follow the econometric forecast for a 21 million tie demand level for 2007 and accept the possibility that tie procurement may have peaked in 2006.

But, a bullish case suggests something else. If we go back to the model and fully “un-constrain” coal shipments and freight growth, then 2007 could see tie purchases exceed 21.7 million. And that should be more than enough to keep the production/purchasing juggernaut plowing ahead at 2006 levels. And, given the fact that the model may not be “seeing” some of these accelerating factors it is quite possible, even plausible, that this significant jump in purchases could occur. §