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 According to as-yet-unpublished data, Class 1’s installed nearly 12 million ties in 2001.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.

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

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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.

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CROSSTIES • JULY/AUGUST 2002
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

<table>
<thead>
<tr>
<th>Mo/Yr</th>
<th>Tie Production</th>
<th>Tie Inventory</th>
<th>Change In Inventory</th>
<th>Tie Purchases</th>
<th>Annual Purchases</th>
<th>Rolling Total</th>
<th>Inventory-To-Tie Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>1,128</td>
<td>1,281</td>
<td>-103</td>
<td>1,311</td>
<td>16,751</td>
<td>0.66</td>
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<tr>
<td>1998</td>
<td>1,301</td>
<td>1,281</td>
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<td>1,311</td>
<td>17,723</td>
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<td>28</td>
<td>1,549</td>
<td>18,223</td>
<td>0.80</td>
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<tr>
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<td>1,728</td>
<td>1,759</td>
<td>11</td>
<td>1,759</td>
<td>18,398</td>
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<tr>
<td>2001</td>
<td>1,928</td>
<td>1,759</td>
<td>5</td>
<td>1,759</td>
<td>18,608</td>
<td>0.85</td>
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</tr>
<tr>
<td>2002</td>
<td>1,928</td>
<td>1,759</td>
<td>5</td>
<td>1,759</td>
<td>18,608</td>
<td>0.85</td>
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</tr>
</tbody>
</table>

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.

CROSSTIES • JULY/AUGUST 2002