

# Dynamic Railroads

# FORGE AHEAD



By Jim Gauntt

## Transportation Juggernaut Fuels Vigorous Market

Last year at this time, the Railway Tie Association (RTA) predicted that 2005 would be a vintage year for tie suppliers. The marketplace stood on firm footing, railroads had big investment plans, and purchases of 18.9 million new wood ties were forecast. There were no words of caution to offer other than the uncertainty about U.S. economic growth in a rising interest rate environment.

Although the final December numbers have yet to be audited, 2005 looks to have ended up with a final tally of 18.75 million ties purchased from RTA members. And, in general, it looks like production is finally

starting to equilibrate with demand. How much better can it get?

Maybe a lot better. How does a 20 million-plus wood tie market sound for the next few years? That's what the RTA econometric models suggest, and that's the story railroads are also telling.

Plus, the forecast, which is based on tried and true market data, and conservative assumptions (*see article on page 8*), does not even consider the role that tax credits stimulus in the short line market may have.

If 20 million-plus demand becomes a reality, the bigger question that arises is whether constraints in the system of supply will limit the market from reaching its potential. In the case of the short line market, labor and/or equipment shortages could be the culprit that puts a lid on actual growth.

First things first. Is the true demand really

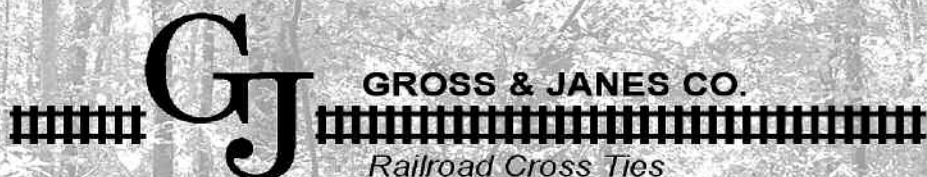
going to exceed 20 million new wood ties? Put on your ciphering caps, and take a look at the following data.

### CLASS 1s

The RTA forecast model suggests that 2006 will see an increase in demand by Class 1 roads from 2005 of 1.5 million wood ties. That means the computer forecast total for Class 1s is 16.5 million ties. The latest available RTA exclusive Class 1 railroad monthly survey reinforces the computer model by saying that wood tie demand for 2006 will be 16.2 million ties.

Thus, it would seem that the current surge in activity will not abate in 2006 and in fact will forge ahead. Of course, everything hinges on a sound U.S. economy. But, remember that the assumptions made in the forecast models for economic growth and

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fuel prices are conservative, so only some major unexpected occurrence could impact U.S. economic activity to such an extent that it would be likely to derail railroads' demand in 2006.

Thus, again, the question is whether production will meet muster.

For most of 2005, the big scramble was on to crank up green tie production to meet the onslaught of demand. There were plenty of worries mid-year that a problem was brewing that would not easily be solved. Then came the hurricanes blowing down acres of timber followed by a very dry fall. This, in part, led to a near historical high in production for the fourth quarter in 2005. Poof, no more green tie concerns (at least not right now).

The concern that has arisen is about wood preservative supplies. Global markets and global sourcing for the by-products of the coal-coking process have become increasingly complex. There are many factors that enter into what by-products will actually be produced—creosote being one of them—and how they will be used. This requires accurate and oft times delicate planning in order to meet the demand for creosote in North America. But now there are also reports from the field that even if the planning was perfect, the global supply may just not be enough in 2006. Can you say pins and needles?

It's too early to tell what will happen because it's a fact that creosote suppliers are working hard to keep this constraint from occurring in the supply system for 2006. If it does materialize, though, thankfully for suppliers and railroads, there are two additional AWP-Approved preservative systems for wood ties. Logistics notwithstanding, Copper Naphthenate and Pentachlorophenol systems could be employed by railroads to ease any short-term issues. These products may not be the buyer's first choice, or rather the issues of utilizing them on a large scale too daunting in the short term, but these well-researched products could help to keep wood, not other replacement products, flowing uninterrupted to track if used appropriately.

Then there is the question of labor. Do the railroads have the people in place to do all the installations? It's a hard question to answer, but if there is going to be a problem, it will likely be in the smaller markets for ties and not at the Class 1 level.

## SHORT LINES, CONTRACTORS & REGIONAL RAILROADS

What we do know is that short lines continue to grow, and major projects are getting funded. One measure, the RMI RailConnect

Index of Short Line Traffic, shows a 6.7 percent gain through Dec. 3, 2005. Adding to traffic growth, and also more RRIF loans in the works, is that states are also funding infrastructure projects and that tax credits for short line infrastructure will be here for at

SALES TO INVENTORY RATIO							
	Mo/Yr	Tie Production	Tie Inventory	Change In Inventory	Tie Purchases	Annual Purchases Rolling Total	Inventory To Sales Ratio
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
	Jun	1,401	11,735	(261)	1,662	16,732	0.70
	Jul	1,533	11,751	16	1,517	16,870	0.70
	Aug	1,647	11,602	(149)	1,795	17,044	0.68
	Sep	1,611	12,006	404	1,208	17,111	0.70
	Oct	1,893	12,927	922	972	16,935	0.76
	Nov	1,370	13,174	246	1,123	17,215	0.77
	Dec	1,127	13,406	232	895	16,686	0.80
2003	Jan	1,288	13,782	376	912	16,585	0.83
	Feb	1,143	13,748	(34)	1,177	16,424	0.84
	Mar	1,255	13,544	(204)	1,459	16,213	0.84
	Apr	1,525	13,354	(190)	1,714	16,280	0.82
	May	1,439	13,148	(206)	1,645	16,080	0.82
	Jun	1,365	13,037	(111)	1,476	15,894	0.82
	Jul	1,577	13,136	98	1,479	15,856	0.83
	Aug	1,587	12,997	(139)	1,725	15,786	0.82
	Sep	1,651	13,020	23	1,628	16,207	0.80
	Oct	1,725	13,403	383	1,342	16,577	0.81
	Nov	1,378	13,658	255	1,124	16,577	0.82
	Dec	1,280	13,426	(232)	1,512	17,194	0.78
2004	Jan	1,615	14,022	596	1,019	17,301	0.81
	Feb	1,470	14,129	107	1,363	17,487	0.81
	Mar	1,927	14,140	12	1,916	17,943	0.79
	Apr	1,583	14,254	113	1,470	17,699	0.81
	May	1,497	14,284	30	1,467	17,521	0.82
	Jun	1,876	14,384	100	1,776	17,820	0.81
	Jul	1,532	14,343	(41)	1,573	17,914	0.80
	Aug	1,656	14,243	(100)	1,755	17,943	0.79
	Sep	1,789	14,342	99	1,691	18,006	0.80
	Oct	1,655	14,728	386	1,269	17,933	0.82
	Nov	1,373	14,865	136	1,236	18,046	0.82
	Dec	1,366	15,015	150	1,216	17,749	0.85
2005	Jan	1,273	14,898	(117)	1,390	18,120	0.82
	Feb	1,270	14,707	(191)	1,461	18,218	0.81
	Mar	1,451	14,410	(297)	1,748	18,051	0.80
	Apr	1,421	13,951	(459)	1,880	18,460	0.76
	May	1,502	13,984	33	1,469	18,462	0.76
	Jun	1,793	13,988	5	1,788	18,475	0.76
	Jul	1,590	13,927	(62)	1,651	18,553	0.75
	Aug	1,860	14,143	216	1,643	18,441	0.77
	Sep	1,882	14,699	556	1,326	18,077	0.81
	Oct	1,774	14,691	(8)	1,782	18,590	0.79
	Nov	1,786	14,904	213	1,572	18,926	0.79
	Dec	1,661	15,531	626	1,035	18,745	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.



least for the next two years. Thus, it does not seem likely that the smaller market purchases will fall below 2005 levels. In fact, it would argue that there would be more growth than the forecast models predict.

The models and mid-year RTA surveys support the notion that 2006 smaller market purchases will remain at least at 2005 levels. For 2006, the non-Class 1 market looks to add 4 million ties to the total demand picture. Add any tax credit stimulus to the mix, and there could be even greater pressure on suppliers of products and services.

At the 2005 short line convention in Anaheim, Calif., exhibiting contractors were feeling their own brand of pressure. One was labor. The other was equipment. It was reported that some tie insertion equipment

manufacturers had order files so deep that new orders were being quoted for delivery 12 to 18 months out. Then, the availability of trained workers, or any workers for that matter, was a big worry for those seeking to meet increased workloads from short lines and other entities. In the diverse world of railroad contractors, it's very hard to determine whether these constraints will impact tie purchases. But it is at least a possibility that contractor capacity to accept more work orders may be stretched.

Then also consider a scenario where tax credit stimulus adds a big chunk of demand, and, say, for example, the Dakota, Minnesota and Eastern Railroad also ratchets up its needs in a hurry. It's hard to see how some constraints wouldn't materialize in the system even if labor/equipment isn't the reason.

### IN CONCLUSION

OK, then. Assume that the models are right—16.5 million new wood ties for Class 1s and 4 million from other markets. That's 20.5 million new wood ties.

It's no longer a matter of whether railroads

are hitting on all cylinders. They've added a couple and have engaged them as well. *Crossties* readers know how conservative RTA has been in the past in forward-looking scenarios. And, in that vein, it would be nice to find the rationale that would lead to some caveats.

But no such rationale seems plausible other than the possible exception of constraints occurring in the system.

So, for the sake of argument, assume that some kind of constraint does rear its head. Knock off 500,000 ties. Still, it's a 20 million new wood tie market.

What is remarkable is how resilient wood tie suppliers have remained over the years and were, particularly so, in 2005. When the mid-2005 worries arose and one industry sage reminded that production often turns on a dime—it did. It's almost like the line from the movie *Jurassic Park* when one of the scientists says, "life will find a way."

In the railroad business, it seems that wood tie suppliers always find a way to meet the needs of their customers. So, watch out 20.5 million, if you're really out there, tie guys and gals are gunning for you. §

## 2006 RTA FORECAST

Millions (000,000 omitted)	
US & Canadian Class 1	15.7-16.5
Short Lines & Other Markets	3.8-4.0
Total Projected Range	19.5-20.5
Forecast	20,000,000

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