

# For rail-car builders, the price is right



**Toby Kolstad**

**T**he rapid increase in steel prices during last year's second half caught everyone by surprise — including rail-car builders, which had not included appropriate escalator clauses in the sales contracts they signed many months earlier.

Some builders tried to renegotiate the car prices, but most buyers maintained that financial agreements already had been signed at rates reflecting the old prices. Ultimately, many cars were sold at margins much thinner than originally anticipated.

But every cloud has a silver lining; rail-car builders soon discovered that high steel prices were not necessarily a bad thing, at least in the short run. Just as 2003's cast-parts shortage stopped car builders from destroying themselves through a ruinous price-cutting cycle, the rapid steel-price inflation enabled them to raise new-car prices back to — and then well above — pre-recession levels.

## ORDERS KEEP ON COMING

In my sunny February commentary on the rail-car leasing industry (February 2005 *Progressive Railroading*, page 15), the only clouds on the horizon were high car prices and an interest-rate increase. So much for high prices being a problem.

Although 2003's discount prices didn't entice rail-car buyers, this year's high prices haven't kept them from buying. The orders keep coming, despite the high prices and long waits for deliveries.

And the news gets even better for car builders: In October 2004, my company, Rail Theory Forecasts™ L.L.C., predicted steel prices would fall by as much as 50 percent from their 2004 levels.

At the time, spot prices for cold rolled steel were topping \$800 per ton, up from around \$300 per ton the previ-

ous year. A demand-supply imbalance in China temporarily upset the world market for steel products, but the problem appeared to be a short-term phenomenon, with Chinese supplies forecasted to exceed demand this year.

However, we also predicted that rail-car prices would fall because most sale contracts quoted a base price plus

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surcharges for scrap and steel price increases. So who's perfect? At least we were half right!

Steel prices are headed down, with quotes for cold rolled steel reaching the \$600 per ton range by June.

For car builders, the low margins they suffered during the run-up of steel prices are now being offset by high margins they could only have imagined a few years ago. Who can

begrudge them a reward for hanging in there when times were tough? I recently asked a contact at a car builder when his company would start reducing prices. His answer — "Duh!" — was all I needed to know.

## THE TAO OF 'DUH'

Builders are quoting base prices (sans surcharges) that are similar to the worst-case prices (surcharges included) they quoted in late 2004. Box cars that were priced at \$70,000 two years ago have a base cost of \$90,000; prices for centerbeam flat cars have increased from \$57,000 to \$77,000; and coal cars, rotary gons and rapid discharge hoppers rose from \$45,000 and \$56,000 to \$65,000 and \$75,000, respectively. It doesn't take a rocket scientist to figure the sales margin improvements with these numbers.

How can car buyers afford these high prices? The answer in three words: low interest rates. One can hardly pick up a business magazine or newspaper without reading about the latest theory for why interest rates are so low.

Some pundits say the low rates foretell a recession, others that there is too much un-invested foreign savings going into U.S. treasury notes. Still others argue that inflation is dead and low interest rates should be here to stay. Whatever the explanation, low interest rates have kept lease rates within the affordable range of most lessees, albeit at the high end.

If interest rates finally do increase and lease rates begin to discourage new car buyers or lessees, rail-car builders will be able to respond with lower prices.

Before that happens, a builder might want a larger piece of the pie and go after orders with lower prices and lower margins. But others just might like the place they're in. As my contact said: "Duh." **PR**

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