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China's Export Pain May Be Mexico's Gain

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Buying stuff from China isn't such a bargain anymore. One consequence of that: Companies that move freight from Mexico are getting busier.

China has long been the destination for companies looking to cut costs. A huge population of untapped workers, along with a leadership keen to expand the country's manufacturing infrastructure, made it the world's best place to make things cheaply. But nothing lasts forever.

The pool of Chinese workers is getting shallower. China's one-child policy and cultural preference for boys have led to a shrinking population of young people, particularly the women who work the floors of the apparel and electronics firms. The United Nations projects the number of women age 15 to 24 in China will fall from 106 million in 2010 to 92 million in 2015. Add rising affluence, and labor costs are going up faster than productivity increases at Chinese firms can offset them.

Moreover, commercial land prices have shot up, while government-controlled prices for energy are moving closer to market rates. The yuan has risen 30% in trade-weighted terms over the past five years and will continue to creep up. It is no wonder the price of imports from China, flat for many years, has been rising since late 2010.

Supply-chain problems have also led companies to rethink outsourcing. When demand fell sharply following the 2008 financial crisis, many were stuck with inventory on slow boats from China. Volatile energy prices have made transportation costs more uncertain. Last year's tsunami in Japan and Thai floods underscored the fragility of long supply chains.

The changing cost dynamics have boosted hopeful talk that U.S. manufacturers will turn to "in-sourcing," and it is true some companies are moving operations back home. On its earnings conference call Thursday, Carlisle Cos. CSL -1.01%said it was stepping up its tire-making operations in Tennessee because, according to Chief Executive David Roberts, "we can actually manufacture as cheaply or cheaper here in the U.S. than we can in China."

But for many companies, a better step is to beef up production in Mexico. Security concerns aside, wages are substantially lower than in the U.S. A look at recent trade statistics suggests companies are already on the move. The number of loaded shipping containers entering the ports of Los Angeles and Long Beach, Calif.—the major entry points for Asian imports—edged down 0.2% last year. But trains and trucks carried 8.7% more freight, by weight, from Mexico to the U.S. in the first 11 months of last year than they did a year earlier.

A handful of transportation companies have the most to gain. Kansas City Southern Railway's Mexican subsidiary controls a rail system that stretches deep into Mexico. It also controls a railroad bridge that spans the Rio Grande at key border crossing Laredo, Texas. Union Pacific UNP -1.27%has a 26% stake in Mexican railway Ferromex and serves six major border crossings. Shares of both companies have risen sharply over the past year, but earnings have more than kept up. Kansas City Southern KSU -1.71%trades at 23 times trailing earnings, compared with 34 a year ago; Union Pacific's P/E ratio has fallen to 17 from 19. The third major railway serving Mexico is Berkshire Hathaway's BRKB -0.14%BNSF.

Several trucking firms operate in Mexico; the one with the most exposure is tiny Celadon Group, CGI -1.26%which focuses much of its business on border crossings between the U.S. and Mexico. Its shares, which swooned and then surged in 2011, trade at 19 times earnings, down from 32 times a year ago.

The biggest beneficiary is Mexico. The country and its companies were hurt badly over the past decade by a loss of exports to China. The trade shift could be a salve to the economic and social woes that have made some investors skittish of putting money there.