GATX Corporation

2012 Third Quarter Conference Call — October 18, 2012

Operator:

Good day, and welcome to the GATX Third Quarter Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Jennifer Van Aken. Please go ahead.

Jennifer Van Aken:

Thank you, Zach, and good morning everyone. Thanks for joining us for the third quarter conference call. With me today are Brian Kenney, President and CEO of GATX Corporation, and Bob Lyons, Executive Vice President and Chief Financial Officer.

I'll give a brief overview of the results provided in our press release earlier this morning, and then we'll take questions.

As a reminder, any forward-looking statement made on this call represents our best judgment as to what may occur in the future. We have based these forward-looking statements on information currently available and disclaim any intention or obligation to update or revise these statements to reflect subsequent events or circumstances.

The Company's actual results will depend on a number of competitive and economic factors, some of which may be outside the control of the Company. For more information, refer to our 2011 Form 10-K for a discussion of these factors. You can find this report, as well as other information about the Company, on our website, www.gatx.com.

Today, we reported 2012 third quarter net income of $53.8 million or $1.13 per diluted share. This includes a benefit of $18.2 million or $0.38 per diluted share from Tax Adjustments and Other Items, which are detailed on Page 12 of the press release. This compares to 2011 third quarter net income of $32.9 million or $0.70 per diluted share, which includes a benefit from Tax Adjustments and Other Items of $1.3 million or $0.03 per diluted share.

Year-to-date 2012, we reported net income of $107.6 million or $2.26 per diluted share, including a benefit of $0.7 million or $0.02 per diluted share from Tax Adjustments and Other Items. Again, these items are on Page 12 of the press release.

Year-to-date 2011, we reported net income of $79.2 million or $1.68 per diluted share, including a benefit from Tax Adjustments and Other Items of $13.9 million or $0.30 per diluted share.

At the end of the third quarter, GATX's North American fleet utilization was 98.2%. The renewal rates for railcars in the Lease Price Index were 26.4% above expiring lease rates, and lease terms were 59 months, on average, for renewals in the quarter. The renewal success rate in North America was just over 80%, which is reflective of the continued strong demand for tank cars. We're taking advantage of the favorable lease rate environment for tank cars by extending lease terms.

GATX's European tank car fleet utilization was 96.6% at the end of the third quarter, and we are achieving lease rate increases. We note there are signs of a slowdown in the chemical markets, as it is taking longer to place chemical cars on lease.

American Steamship Company has moved more tonnage year-to-date 2012 compared to the same period of 2011, as steel production is at higher levels in the current year. ASC's performance for the remainder of the year will be partially dependent on weather conditions on the Great Lakes.

The Portfolio Management segment had another solid quarter, benefiting from strong performance and asset remarketing by Rolls-Royce and Partners Finance, our spare aircraft engine leasing joint venture with Rolls-Royce.

During the third quarter, investment volume was over $130 million, primarily in rail assets. As asset prices increase, it is challenging to find good opportunities for investment in the secondary market. However, we continue to take delivery of new railcars and make selective acquisitions of cars in the secondary market.

In North America, demand remains robust for railcars delivering under our multi-year supply agreement. We continue to place these cars on high-quality, long-term leases, and are now allocating cars into the second quarter of 2014.

As noted in the press release, we expect 2012 full-year results to be at the high end of the previously announced guidance range of $2.65 to $2.75 per diluted share, excluding the impact from Tax Adjustments and Other Items.

So with that overview, we'll go to your questions. Zach?

QUESTION AND ANSWER

Operator:

(Operator Instructions) And we'll take our first call from Art Hatfield with Raymond James. Please go ahead.

Art Hatfield:

Morning, everyone. Just a few questions here. Just looking at ASC's revenue, and looking at it last year, and I think this was unusual, but fourth quarter last year was stronger than third quarter. Was that a result of what went on with the strike? And if so, can you comment on how much revenue kind of shifted from what normally would have been in Q3 versus Q4?

Bob Lyons:

Sure, Art. This is Bob. That is one of the key drivers. If you recall, the strike preparation really began in late second quarter, and then the actual strike took place, really, during the first few weeks -- first couple of days. But then first few weeks, really, to get back up to full operation of Q3. So we've never really broken down specifically by revenue. We did indicate that on a year-over-year basis, it was probably about -- call it $3 million to $4 million of lost segment profit associated with the strike, with all elements of the strike included.

Art Hatfield:

Is it correct -- was my original assumption about seasonally Q4 is a little bit weaker than Q3 correct? Or is that just dependent on weather?

Bob Lyons:

That is correct, and it is also pretty weather-dependent. We've already seen here in the first couple weeks of October more challenging operating conditions at ASC than we saw in the third quarter. High winds and other challenges on the water have -- not just for ASC, but others -- have resulted in a lot of -- a number of lost operating days for the shippers on the Great Lakes.

So we're watching that closely. And keep in mind, last year in the fourth quarter, ASC really had pristine operating conditions pretty much throughout the whole quarter, and that will be hard to replicate.

Art Hatfield:

Right, and that's fair. Just one last one on ASC. Outside of those kind of weather-related issues, is core demand still fairly healthy?

Brian Kenney:

Hi, Art. It's Brian. There is a little bit of a slowdown, especially on the iron ore side, that we are seeing maybe for the fourth quarter. There are several blast furnaces that we serve that are planning to curtail production due to a little of a softening demand.

But it's not a big issue for us as far as earnings this year. If there's a slowdown we can take vessels out of service, we can do some slow steaming or we can shorten the season. But yes, we are seeing a little bit of weakness on iron ore; at least that is what they are talking about for the fourth quarter.

In coal, our shipments this year are pretty close -- maybe down a little bit from last year, but we see stable demand there for the rest of the year, and those are the two major commodities.

Art Hatfield:

Okay. Thanks for your color on that. You had mentioned in Europe seeing some weakness in the chemical markets. And I think Jennifer had mentioned that you're seeing that through a tougher time or extended period of time as you place cars coming off lease with new customers.

Can you kind of put some numbers around that? How that's changed over the last couple quarters, and kind of what magnitude you're seeing that inability to place quickly with new customers?

Brian Kenney:

You know, utilization is down, I think, from a little over 97% at the beginning of the year to 96.6% now. That is actually a much smaller decrease than we expected. We had a planned return off-lease of petroleum cars from a large customer in Eastern Europe that was scheduled for this year. That's going slower than planned. So those cars are quite old. Most of them will be scrapped or redeployed, so it's not really an issue economically. So we're planning on utilization to drop.

Really haven't seen a big impact in idle cars. I mean, they have increased, as Jennifer said, because they are taking longer to place. If you look at our chemical customers in Europe, it has been choppier over the last two years on the petroleum side. Chemical production in Europe is down about 2.5% year to date, and some of our customers are looking to reduce capacity due to the general economic weakness they're seeing. But others are still looking to modernize their fleet, both to gain efficiency and to deal with noise and age concerns. So the net effect of that is we're still placing cars; it is just taking a little longer to do that.

Art Hatfield:

Okay, and then finally, just some thoughts on your comments on guidance. As I kind of work through my numbers for Q4, I am kind of struggling to get a Q4 number that's kind of close -- that would put you something around that high end of your range. Can you give us some thoughts on how to think about that? And maybe some things that you're seeing within expenses that maybe we wouldn't see from the outside, to kind of get us closer to that number that you're talking about for the year.

Bob Lyons:

Sure, absolutely, Art. And yeah, if you kind of work through the numbers on a normalized basis, Q4 would definitely be the lowest quarter for the year, which is not unusual for GATX. There's a few things that I will comment on.

First of all, remarketing this year -- year to date is about $44 million. That equals to all of what we did in 2011.

Art Hatfield:

Right.

Bob Lyons:

So we are not really, barring any unforeseen events, we're not seeing much at all in the way of remarketing activity in the fourth quarter. That is consistent with what we said actually back in the second quarter. We had a really big first half of the year and it would be very light in the second half of the year, and that will definitely continue in the fourth quarter.

On the expense side, I would say SG&A likely will go up versus the run rate that we've seen year to date. That was a similar phenomenon that we had last year, as the number of projects come to completion. We have some year-end true-up events, compensation items, et cetera, that typically you see that move up in the fourth quarter. And I think last year's fourth quarter SG&A was up $4 million or $5 million versus its prior run rate. So that likely will happen again.

And then the other item I'd comment on really is one of -- we just hit on. It's a little bit of uncertainty. It's really just related back to ASC. Their operations here in the fourth quarter are heavily weather-dependent, and maybe there's a bit of caution on our side there. But definitely October has gotten off to a tougher start than we saw in the third quarter. So we're watching that one closely.

Art Hatfield:

On ASC, is it just a revenue issue from the down days, or do you get incremental expenses that occur in that type of environment?

Bob Lyons:

It's really the lost revenue, Art. We can move our vessels to the wall pretty efficiently, as can others on the Great Lakes, and they've been doing that. So it's the lost contribution margin.

Brian Kenney:

And they'll try their hardest to make that up, being tied up in October. But that could push it into January, for instance, if they're able to still operate then.

Art Hatfield:

Right, that's correct.

Bob Lyons:

We have to be off the water by -- January 15, typically, is the drop-dead date.

Art Hatfield:

Okay, perfect. That's all I've got today. Thanks for your time.

Bob Lyons:

Thank you.

Operator:

We go next to Steve Barger [KeyBanc Capital Markets]. Please go ahead, the line is open.

Tejas Patel:

Good morning. This is actually Tejas filling in for Steve. Just have a few quick ones here. With having a large tank car exposure, has your thought on accumulating more exposure to the petroleum cars, and more specifically to the Bakken, has that changed? And if so, have you put in more orders for tank cars?

Brian Kenney:

We had the large supply agreement that we signed last year with Trinity for 12,500 cars that's delivering over the next five years. And part of that is going into crude service in the Bakken. We currently -- Jennifer, correct me if I'm wrong -- have 1800, about, cars in crude service in North America.

To your point, that will go up over the next couple years, because that supply agreement, you could see it go to as high as 3,000, and a lot of that will go to service in the shale and oilsands, as well.

Terms and pricing, petroleum car loadings are up 35%, 36% over last year for the railroads, and that is driving very strong pricing. So if you look at our cars that carry crude, the average renewal rate increase, the average renewal percentage are much higher than the LPI that we have in our press release.

So don't want to get into any specifics on pricing, obviously, other than to say we're trying to incent our lessees to lock in as long as terms as possible at these higher rates. So yes, we have exposure there. We're increasing exposure there. But in general, we're trying to deal with very good credit for very long terms and with the right car type. And that's always the case for any of these markets.

Tejas Patel:

Just to follow up that with regards to the 12,500 that you've put in with Trinity, are the lead times still looking about the same or have they extended, shortened?

Brian Kenney:

Well, the industry lead times for tank cars are about 15 months. For freight cars, it is four to six months. I think the 15 months is pretty similar to what it was at the beginning of the year. The freight car market, I believe, was longer as far as the backlog at the beginning of the year.

As far as our Trinity order, that's different. Obviously, that was placed last year and we are not subject to those same lead times. And that order is going very well. As I said, it is over five years, so 2500 cars a year. Most of those cars will be tank, although there is a wide variety of car types.

We've ordered and placed, obviously, all the cars that delivered in 2011 the first year. We ordered and placed all the cars that we will deliver in 2012. The same for 2013. We're actually taking orders for the second quarter of 2014, so it's working very well so far.

Tejas Patel:

Great, great. Now moving over to some of the commentary you had on the freight cars, you mentioned that the demand there is a little soft. Could you provide a little bit more color around that?

Brian Kenney:

Sure. The primary area of softness in freight cars is in the coal market, and that's well-publicized by the rail traffic. If you look at our -- let's take the coal market. If you look at our exposure there, we have about 8,000 owned cars that carry coal; we manage another 2,000 more, so 10,000 total owned and managed. And that is out of an industry fleet of 275,000 cars. So it's a small exposure for GATX and a small market share, so let's put that into perspective.

If you look at the industry, there's about 175 to 200 train sets idle right now. That is actually down from the end of the first quarter, where there was over 300 idle. But if you look back at the beginning of the year, there was only 20 idle. So it's been a very volatile market.

Car loads for the railroads for coal are down 8% to 9% from 2011. Probably the only bright spot in coal has been the export market, which has been up from 2011.

Now, if you move to our fleet, we still have utilization in the low- to mid-90%s in our coal fleet, that is down from 98%, 99% at the beginning of the year. But still much higher than the lessor fleet in general, which we estimate more at about 75%.

So our strategy in this market is to hold terms very short and keep cars utilized. And we do think there's going to be a recovery -- if you look at what -- you need a reverse in the factors that drove this weakness to begin with. So there's a number of things that could turn around and some of them could turn around pretty quickly. For instance, attrition in the fleet will be a big factor. There has been over 5300 cars a year, averaging, being scrapped since 2009 in the coal market. If we return to a more normal winter, a colder winter, that will decrease inventories and increase coal shipments.

Railroad velocity has increased this year, and if we have more coal shipments, colder weather, that can reverse as well; that's inter-related. And all those factors can turn around pretty quick and that could push utilization much higher for the industry, even next year. But at a minimum, attrition alone will have higher utilization by 2014.

If you throw in natural gas prices, which a lot of people are saying will go up, you could see rapid improvement. So there's a lot of ways for this to turn around fairly quickly. So in the meantime, we're trying to keep terms short, keep cars utilized.

There's also weakness in other freight car types; grain, as an example, because of the drought and the poor harvest. There's been some weakness in small, cube-covered hoppers over the last year. That has been an up-and-down market -- not because of demand. There's still strong demand for that car type, especially for frac sand service. But it's perhaps been a little bit oversupplied.

So that is most of the weakness we're seeing, in addition to the weakness that's been there for years in anything construction-related. So definitely a split market between tank car demand and freight car demand.

Tejas Patel:

Got you. And the last one, year-to-date, the LPI index, as well as the average lease terms, have averaged 23% and 58 months, respectively. Do you expect that to be similar in 4Q?

Bob Lyons:

Yes, I think the numbers, they may move around a little bit, but the expectation would be right in that ballpark for Q4.

Tejas Patel:

Perfect. That's all I had. Thank you for your time, guys.

Operator:

And we'll go next to James Ellman [Ascend Capital]. Please go ahead.

James Ellman:

Yes, could you just comment on the chemical industry slowdown? Was that specifically in Europe, or is that across the United States as well?

Brian Kenney:

The chemical industry in the United States is fine, and in Europe -- that's where that comment was in the press release. And as I said earlier on the call, chemical production in Europe is down about 2.5%. It's been a choppy market over the last few years anyway, and especially compared to the petroleum business we have in Europe.

And we have customers on both sides. Some are looking to reduce their fleet due to that economic weakness, and others are looking to modernize their fleet. So we're delivering new cars. They're getting placed. They're just taking a little longer because of that weakness.

James Ellman:

And any other places in your business where the weakness in the economic output in Europe shows up in your businesses?

Brian Kenney:

Well, we have a separate business that is not owned; we have a joint venture called AAE that's solely in the freight car business and heavily skewed towards intermodal. That business has been weak for a number of years. It's very short-term leases in comparison to the tank car business in Europe, and especially compared to the business in the U.S. So it turned very quickly when the economy turned down and container shipments went down back in 2009.

It's gotten a little bit better since then, but basically, it has been bouncing along the bottom. And that's been weak for a while. And that's probably the one part of our business where we have a joint venture that's directly tied to economic activity, with very little lag.

James Ellman:

Okay. Just one other question. With the presidential election being so tight, could you just comment on how you are planning for or what would be the impact on the ethanol requirements for gasoline going away?

Brian Kenney:

That is a very versatile car type. That is a 30,000-gallon tank car. And we were always extremely careful during the ethanol boom about placing those cars. So if you look back then, about half our cars went into ethanol service, and no more than that -- those 30,000-gallon tank cars that served that business.

That is the same car type that serves the Bakken and that light crude coming out of Bakken. So it has a number of different uses and we try to keep those uses very well-diversified. So try not to be tied to any one trend or any one market, and that's the way we run our business.

So unclear what will happen to ethanol depending on who gets elected, but I think we're in very good position with the diversity of our fleet and our customers to react to whatever happens.

James Ellman:

Great. Thanks so much for the time.

Operator:

And we'll go next to Steve O'Hara [Sidoti & Company]. Please go ahead.

Steve O'Hara:

Hi. Good morning. Can you just talk about the -- it sounded like the chemical tank car demand was strong throughout the quarter. Was there any difference as the quarter progressed from -- within the three months?

Bob Lyons:

Not really, Steve. To the extent we're looking at the tank car fleet here in North America, the demand -- I think the quote Brian gave in the press release was unprecedented demand. So we continue to try to capitalize on that, and we didn't really see any significant change in that at all throughout the quarter.

Steve O'Hara:

Okay. And then in terms of ASC, are you guys seeing any issues with low water or anything like that? And then in terms of what your guidance assumes, are you assuming kind of a normal weather pattern, or are you assuming kind of something that happened last year?

Brian Kenney:

Water levels are down from 2011 and down from long-term averages, for sure. I think Superior's down about four inches from 2011; Michigan and Huron are down over a foot. And so our outlook does assume a continuation of those water levels.

And the way to think about that is over $200,000 in lost margin for every inch on average that the Lakes go down -- that's generally the effect on our business.

Steve O'Hara:

Okay, and then just on the guidance. So you're assuming kind of a normal weather pattern for the fourth quarter, as opposed to kind of favorable weather pattern?

Bob Lyons:

Steve, I'd say in terms of water levels, we're not assuming any change.

Brian Kenney:

We're not assuming any increase, that's for sure.

Bob Lyons:

Yes, it doesn't change that quickly. And as I mentioned before, one of the uncertainties in Q4 -- and we have kind of factored that into our equation here a little bit -- is the weather and its impact on ASC's operations, regardless of water levels. Extremely cold temperatures, high winds, in particular, are really difficult operating conditions, not just for ASC, but everybody else on the Lakes. And we're seeing some evidence of that already.

Steve O'Hara:

All right. Thank you very much.

Operator:

And we'll go next to Matt Brooklier [Longbow Research]. Please go ahead, your line is open.

Matt Brooklier:

Yeah, thanks. Good morning. I think that previously during 2Q, you had discussed some incremental maintenance expense that was going to be driven by tank cars coming back. I was just curious if you did incur any of those maintenance expenses during third quarter and what's our expectation for fourth quarter?

Brian Kenney:

Third quarter was pretty flat with last year's third quarter in terms of maintenance, but still down dramatically year to date. I believe it is about $15 million. Most of that is driven by fewer cars repaired in North America, and that's commercially driven at this point. So when you're in a market like today, where there is 82% renewal percentage, there's just not a lot of cars coming back into the maintenance network for service that places it with other customers. And we've seen that all year.

We expect more of the same in the fourth quarter, actually. And we expect more of the same next year if this renewal rate percentage continues. Eventually, however, we're going to see higher compliance maintenance –

Matt Brooklier:

Okay.

Brian Kenney:

-- especially HM201, that structural tank inspections. It's been relatively low level over the last couple years. It increases in 2013 and increases rather dramatically in 2014. So regardless of the commercial side of it, compliance maintenance will increase over the next two years.

Matt Brooklier:

Okay. I think if I remember correctly that you had anticipated maybe some incremental maintenance expense in the second half of 2012. And it sounds like now, just given the fact where renewal rates are currently on your cars, and specifically on the tank car side, that there is the potential for less maintenance expense going forward and baked into the guidance.

Brian Kenney:

Let me let Bob talk about the guidance, but as far as the maintenance part of it, what we try to do is even out those big bubbles with compliance maintenance. So we're trying to pull cars forward. That is proving to be very difficult, because customers don't want to let their cars go early. So you will see some increase in compliance events next year, but it's difficult to get customers in a strong market to give up their cars. As far as what's in the guidance, I'll give it to Bob.

Bob Lyons:

Sure. Thank you. And we are going here into the fourth quarter assuming that that high renewal success rate that we've experienced year to date and definitely saw in the third quarter will continue in the fourth. So if you look on where we are at year to date for maintenance expense, and you annualize that, we would be down in the ballpark of $15 million plus versus 2011. So we're not expecting anything unusual from the pattern we've seen here year to date.

Matt Brooklier:

Okay. And then turning to the renewal terms or lease duration at 58, 59 months, I think that's flat sequentially in third quarter versus second. Just curious as to what's driving that. Is that your decision, or is that customer pushback? And if it is customer pushback, is it specific equipment, where they're looking to potentially get a little bit shorter in terms of how long they're holding and utilizing equipment?

Bob Lyons:

First, Matt, I'd just say, first of all, 59 months is a very long renewal, and that's what we've been driving towards. It's certainly not a peak. We saw that probably back in 2007, 2008, at over 60 months or so. But 59 months is a very healthy renewal rate -- or renewal term. And I'd also add on new car deliveries, the average term is well north of that 59 months.

Brian Kenney:

The other thing I'd add is -- and I'm sorry I don't have the number for you, but if you absent coal renewals, which we're trying to keep very short, that number would be even higher.

Matt Brooklier:

Okay.

Bob Lyons:

That would be right around, I think, just a little bit north of 70 months -- 72, 73 months.

Matt Brooklier:

Okay, and coal cars coming back in the quarter, did that -- did you see more coal cars returned and put into storage during third quarter, or was that relatively similar to what you saw in second quarter?

Jennifer Van Aken:

Yeah, during the third quarter, we had a little under 500 coal cars that came up for renewal. About 60% of those renewed, and the remainder went into storage.

Bob Lyons:

Yeah, and as we've indicated, as Brian touched on before, those renewals generally would be much shorter-term given where the rates are today. That's our objective -- is to keep those short, and we'll get another shot at them in a better environment.

Matt Brooklier:

Okay. And with respect to the North American railcar fleet -- also, I think about flattish sequentially. Is the anticipation to keep the number around 109,000 cars moving forward? Or given the demand environment, is there potential to add to that number? What are your thoughts moving forward?

Brian Kenney:

We're certainly adding to it from the perspective of the supply agreement to the tune of 2500 a year. Scrapping's really going to be dependent on both scrap prices and what service we can put it into, so it is a little harder to predict.

But as Jennifer said, I think, in her opening, it is getting very difficult, at least from GATX's investment philosophy perspective, to invest in cars in the secondary market. You know, the prices are pretty high.

Matt Brooklier:

Okay. So I guess we kind of keep the -- the anticipation is we keep the run rate of 109, or it all depends on market demand?

Bob Lyons:

No, I would say here in the near term, absent a sizable portfolio acquisition or something like that, it's going to be in that ballpark, just based on the order -- or the delivery schedule of the Trinity order and normal scrapping.

Matt Brooklier:

Okay.

Brian Kenney:

We have placed some new car orders beyond the supply agreement order. It hasn't been a huge amount of cars, but generally, we're only going to do that at these prices if we can place them with excellent customers for extremely long terms at these rates, as Bob said, because that helps you amortize that higher cost.

Matt Brooklier:

Okay, and when did you place those new orders?

Brian Kenney:

These are literally a couple hundred cars here and there --

Bob Lyons:

Yeah

Brian Kenney:

-- and that was earlier in the year, and they deliver over a long time.

Matt Brooklier:

Okay, so that wasn't during third quarter, it was during the first half?

Brian Kenney:

No, and in fact, that's just an example of why we would order new in this kind of environment.

Matt Brooklier:

Okay, that's all I've got. Thank you.

Bob Lyons:

Thank you.

Operator:

And we'll go next to Zahid Siddique [Gabelli & Company]. Please go ahead, your line is open.

Zahid Siddique:

Good morning, everyone. I have a couple of questions. The first one on portfolio availability. Anything that might be becoming available, either domestically or internationally, from an acquisition perspective?

Bob Lyons:

Nothing significant that we're aware of in the marketplace. There still is a lot of secondary market activity, but it is in smaller lots. And as Brian alluded to, a lot of those transactions are going off at pretty healthy valuations. So we are adding some cars in the secondary market. I think year to date, we've probably purchased just under 1,000 cars in the secondary market, somewhere around $50 million worth. But nothing major is out there at this point in time.

Zahid Siddique:

So I guess we can assume the average price you're paying is about $50,000 a car. Is that a fair assumption?

Bob Lyons:

It is always a little tough on the averages, but if you just do the quick math, that would be in the ballpark.

Zahid Siddique:

Right, and I guess I would think the tank probably are a little bit higher than the freight within that.

The other question I have is on the -- I guess at a more strategic level, what's your plan in terms of use of cash or -- either share repurchases or dividend? I guess you did talk about buying portfolios, but if nothing is available, what is the second best use of cash?

Bob Lyons:

Well, we've continued -- we do pay, as you know, a very solid dividend and have paid it every quarter since 1919. It's very important to our shareholders and we'll continue to look at the dividend and the appropriate level. We increased it very slightly this past year, and we'll look at it again in January or February when we meet with our Board. That's typically when we look at any increase in the dividend.

We have a share repurchase authorization outstanding that has some capacity under it. But as you can tell from the second quarter, we haven't been active in that -- under the share repurchase program. But if you look over the last several years, we have repurchased quite a bit of stock.

But we're always looking to add hard assets to the portfolio, and that is our preference. We feel that gives us the greatest option to generate attractive shareholder returns over the long haul. We continue -- we need to be in a position where we can add assets to the portfolio, and that's -- I guess our preference is typically there.

Zahid Siddique:

Okay. And the thousand cars that you mentioned that you bought in the secondary -- that's year to date or Q3?

Bob Lyons:

That's year to date.

Zahid Siddique:

Okay. And my last question is on the activity in the shale in the Bakken region. Could you comment on how is that activity?

Brian Kenney:

It's what is really driving the tank car market, and not just for cars that go into that service. It's also putting cars that go into other service in short supply. So it's having a positive effect on our entire tank car fleet, every customer, every lease. It's tough to get your hands on a general service tank car right now with backlogs out 15 months. So it's definitely driving the tank car market, and not just for cars that carry crude.

Zahid Siddique:

Okay. And what's happening with the covered hoppers for the sand for fracking?

Brian Kenney:

It's bouncing around. I'd say the rates are down a little bit this year. As I've said, that's one of the markets where there was good demand, but overbuilding -- people getting a little bit ahead of themselves. So I'd say rates are down definitely from the prior peak, and probably down this year overall.

Zahid Siddique:

Thank you so much.

Operator:

And we'll go next to Kent Mortensen [Thrivent Capital]. Please go ahead.

Kent Mortensen:

Good morning. I was curious about, given the tremendous demand out there, why the remarketing income is lower for the second half. Historically in kind of frothy or stronger markets, you guys have kind of cashed in those chips. And I'm just wondering is it because the feeling is that you have kind of legs in the cycle and have this continuing demand that you don't feel like it is kind of time or appropriate to do that? Or I'm just trying to understand why that remarketing income isn't actually stronger, given that the markets have been improving in the second half.

Bob Lyons:

I think if you -- Kent, let me take that one. If you look back, in 2009, our remarketing income was $30 million. 2010, it was $31 million. Last year, we did about $45 million. This year, we're already at $45 million. We'll do a little bit more in the fourth quarter. So it definitely has been moving up, exactly as you said.

As the markets have continued to strengthen and we've seen opportunities to optimize the portfolio, we've done that.

But we also are – we're always looking at the economics of the sale versus the hold, and we're driven by the economics. And we're just not out selling to hit a number.

Kent Mortensen:

Okay. I guess I'm still having a hard time with the guidance. These are probably the strongest leased rates that we've seen in terms of increases in 10 years. The lease rate keeps -- the LPI keeps going up sequentially. The terms are still in extremely high level. And so, I mean, it's amazing just anecdotally, talking to people about shortages of tank cars and the inability to get tank cars. And I understand ASC, but year-over-year reduction in earnings just doesn't seem even possible to me. And I guess I am really having a hard time getting my arms around that.

Bob Lyons:

Well, keep in mind, Kent, we came into the year with an initial range of $2.40 to $2.60, and now we are at the high end of $2.65 to $2.75.

Kent Mortensen:

No, I understand that. I think you were extremely conservative with that guidance, and that has proven to be true. So I am just talking specifically about Q4 year over year.

Bob Lyons:

Sure, so I mean, let's just -- if you took simple math, right, and we said we didn't have any remarketing in the fourth quarter.

Kent Mortensen:

Which you said you will, right?

Bob Lyons:

Well, a little bit. If SG&A is up $5 million or $6 million and ASC runs into some operating challenges, those numbers are all going to drop very quickly to the bottom line.

Kent Mortensen:

So what's driving a $5 million to $6 million increase in SG&A year over year again? You talked about compensation. What were some of the other issues?

Bob Lyons:

It's similar to what we had last year as well. We have a number of projects, IT projects, and some other international consulting expenses, that are going to come rolling through here in the fourth quarter. The compensation true-ups at year-end can be material.

And so on a year-to-date basis, we expected SG&A to be up in 2012 versus 2011, and it hasn't been materially. We'll see some of that catch up here in the fourth quarter.

Kent Mortensen:

It’s just, I guess, I understand ASC is material, but I just didn't view it as a big driver of your story. I didn't think weather was that critical.

And then just with regard to tax rate, just backing out the tax rate adjustments, it looked like your tax rate kind of ticked up from what you were originally talking about for the year. What do you think tax rate will look like for Q4?

Bob Lyons:

It should be lower in Q4, probably back somewhere in that 31% range.

Kent Mortensen:

Okay, great. Thank you.

Operator:

We’ll go next to Brian Hogan [William Blair]. Please go ahead.

Brian Hogan:

Thank you. Most of the questions have been asked and answered, but you were talking about investments earlier, and you were talking about investments in other -- I mean, assets would be your priority. What about other asset classes? Are you interested in other asset classes, and then with that, other geographies?

Brian Kenney:

Let me take that. As far as other asset classes beyond what we are already in, the answer is no; it is not a strategic priority at all. As far as other geographies, the answer is yes. India is probably the best example, where towards the end of the second quarter there, we got the first railcar leasing license in India, and we actually completed a transaction for 450 cars, or 10 rakes, as they call them in India. And so we’re very excited about that market over the next 10 years, due to the high growth and the – we’re very interested in taking what we've done well for 115 years here in North America and applying it to higher-growth markets, and I think you’ll see increased investment in those areas.

Also invested more in European tank cars in 2012. That’s another example. I believe by the end of 2012, we’ll have close to 1600 new cars in Europe, which is a lot on a 21,000 car fleet. So yes, we’re interested in other geographies, especially with prices as they are in North America.

Brian Hogan:

Then, we talked about a little bit of the economy as a whole and just in bits and pieces, but overall what is your feeling on the economy?

Brian Kenney:

You know – it’s bumping along, and it’s good for our business thus far. Yes, there are some weaknesses in certain car types, especially freight, that are not necessarily economic-related as much as weather-related and natural gas price-related and railroad velocity-related. So, some of the freight car weakness that we see have peculiar factors that can turn a little quicker than you might expect.

So I'm happy with the overall growth in the economy. I'd rather actually have it bump along like this with slow growth. What I've seen in the past is when it grows a lot faster; you see some irrational behavior in this market with new competitors coming in, over-ordering, a lot of new production capacity coming in and then rates going down. So I'm happy with the way it’s growing right now, if you put that freight car noise aside.

Brian Hogan:

And the competitive environment, obviously, you're getting some pretty nice terms and you talk about the bumping along economy being pretty nice. But your overall thoughts on the competitive environment.

Brian Kenney:

The competitive environment -- it is very competitive out there. And I don't think there’s anything really to comment on in terms of -- I don't see any abnormal behavior out there in the railcar market right now.

Brian Hogan:

And then one last question on leverage. What is your target leverage ratio?

Bob Lyons:

Well, we've never really specifically zeroed in on a target leverage. We're comfortable where we are at, Brian. I think as we talked in the past, a very solid investment grade rating like we have today is critical to GATX, important to what we do in so many different ways. So we're comfortable with where leverage is at today. Wouldn't look for any material change in that number right now.

Brian Hogan:

Thank you.

Operator:

We'll go next to Kristine Kubacki [Avondale Partners]. Please go ahead.

Kristine Kubacki:

Good morning.

Jennifer Van Aken:

Good morning.

Kristine Kubacki:

You mentioned -- your answer about being -- it still being a pretty rational market out there. So I kind of wanted to ask maybe in a little bit different way, a larger picture question. We saw some really big orders on tanks in 2Q, and I guess we have to have something to worry about, so we see short-term stagnating rig counts, and there's always the threat of pipelines. Could you talk about, maybe, if is not in the next year, but maybe two or three years out, do you think that there could be a tank car bubble in the making?

Brian Kenney:

That's an excellent question, because that's especially applicable to tank cars that would serve the Bakken, and it's something we think about all the time. And that's obviously what everybody would like to know with more certainty, is what is the outlook for tank cars serving the Bakken.

And it's a difficult question. There is a lot of variables that affect our outlook and a lot of these variables are inter-related. So what we look at, we look at projections of crude in the Bakken over the next 10 years. We look at existing and planned rail-loading capacity, and as you said, where pipeline capacity changes might go.

I mentioned railroad velocity trends, which has gotten a little quicker this year, and look at that for the Bakken. We look at the existing industry fleet of large, general service tank cars, and that attrition of that fleet over time over the next couple years. And of course, industry production, as you mentioned, of general service tank cars.

And if you look at all that, from what we can tell, it suggests a strong market for crude-carrying tank cars well into 2014, even with all these variables. And that makes sense. That's essentially -- if you look at how far out we're placed, we're placed out well into 2014; the backlog is just starting to touch 2014.

Beyond that, it does get murkier out there. So how do we react, and what's our strategy? It's -- what we do is try to focus on good credits, long terms, because rates are so high, and the right car type. So we look at very versatile car types. And that way, we are able to react to whatever happens out beyond 2014.

But yes, I could see scenarios where it could become oversupplied in the 2014 to 2016 timeframe, depending what happens with all these factors. I don't know if that helps.

Kristine Kubacki:

That does. Very good. Thank you so much.

Operator:

And we'll go next to Matt Brooklier [Longbow Research]. Please go ahead.

Matt Brooklier:

Just a quick follow-up. I heard a little bit of chatter through our channel checks, large covered hopper market getting a little bit tighter in third quarter. Just curious if you had any commentary on that specific equipment type.

Bob Lyons:

Not really, Matt. I think the specific car types are outliers that we've identified, I think we've pretty much hit on here throughout the call.

Matt Brooklier:

Okay, thank you.

Operator:

And we'll go next to Art Hatfield [Raymond James]. Please go ahead.

Art Hatfield:

Just a follow-up. And I know you've probably commented on this before -- you may have today and I may have missed it. But can you recall what quarter – absolute, just overall lease rates kind of bottomed out in the past trough?

Jennifer Van Aken:

If you look at the way we report on the LPI, that reached its low point in the fourth quarter of 2009, and that was a negative 18.7%.

Art Hatfield:

And that correlates pretty good to what absolute rates are doing as well?

Bob Lyons:

Not exactly. I'd say we probably saw -- continued to see a little bit of degradation in rates after that point.

Art Hatfield:

And I'm sorry, Jennifer, did you say Q4 2010 or 2009?

Jennifer Van Aken:

2009.

Art Hatfield:

I'm sorry. I wrote it down wrong. Perfect. Okay, thank you.

Operator:

We have no further questions in queue at this time. I'd like to turn the conference back over to your presenters for any closing remarks.

Jennifer Van Aken:

I would just like to thank everyone for their participation this morning, and I will be available all afternoon if there's any follow-ups. Thank you.

Operator:

This does conclude today's teleconference. You may now disconnect, and have a wonderful day.