GATX | GATX Corporation

2018 Second Quarter Conference Call July 19, 2018

Operator:

Good day and welcome to the GATX second-quarter conference call. Today's conference is being recorded. At this time, it is my pleasure to turn the conference over to Ms. Jennifer McManus. Ma'am, please go ahead.

Jennifer McManus:

Good morning, everyone, and thank you for joining GATX's 2018 second-quarter earnings call. I'm joined today by Brian Kenney, President and CEO; Bob Lyons, Executive Vice President and CFO; and Tom Ellman, Executive Vice President and President of Rail North America.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements. Actual results or trends could differ materially from those statements or forecasts. For more information, please refer to the risk factors discussed in GATX's Form 10-K for 2017. GATX assumes no obligation to update or revise any forward-looking statement to reflect subsequent events or circumstances.

Earlier today, GATX reported 2018 second-quarter net income of $38.8 million or $1.01 per diluted share. This compares to 2017 second-quarter net income of $53.4 million or $1.35 per diluted share. Year to date 2018, we reported net income of $115.1 million or $2.99 per diluted share. This compares to $110.9 million or $2.79 per diluted share for the same period in 2017.

2018 second-quarter and year-to-date results include a net negative impact of $5.8 million or $0.15 per diluted share attributed to costs associated with the closure of a railcar maintenance facility in Germany. 2017 second-quarter and year-to-date results include a net gain of approximately $1.1 million or $0.03 per diluted share associated with the planned exit of the majority of Portfolio Management's marine investments. These items are detailed on Page 12 of our earnings release.

Now, I'll briefly address each segment.

Our second-quarter results are reflective of a gradually improving business environment. While railcar oversupply persists, certain rail industry metrics were favorable relative to 2017.

Excellent execution by our commercial team resulted in Rail North America's fleet utilization increasing to 98.9% and renewal success rate increasing to 78.6% at the end of the second quarter. During the quarter, the renewal rate change of GATX's Lease Price Index was negative 16.1% with an average renewal term of 41 months. While it is still a challenging lease rate environment, we did see quarter-to-quarter sequential improvement in absolute lease rates across our fleet.

We continue to successfully place cars from our committed supply order with a diverse customer base and have already placed 6,700 railcars from our 2014 agreement. We've already placed scheduled deliveries with customers through Q1 of 2019. Meaning our earliest available scheduled delivery is in the second quarter of 2019.

We continue to capitalize on the active secondary market for railcars in North America. Rail North America's remarketing income was approximately $4.5 million during the quarter, bringing total remarketing income for the year to $54.4 million, which is essentially our full-year expectation. While we are always active in the market, any second-half activity will be modest in size and very opportunistic.

Within Rail International, the European railcar leasing market is experiencing improvement within the markets we serve. GATX Rail Europe is seeing steady demand across the fleet, with utilization increasing to 97.8%. As noted in the earnings release, in the second quarter, we closed our railcar maintenance facility in Germany and incurred pre-tax expenses of approximately $8.6 million. We continue to operate as a full-service provider in Europe and continue to operate our maintenance facility in Poland.

Rail International's investment volume was approximately $34.6 million during the second quarter, with close to a third of this attributable to investments in India. We are on track to double our fleet count in India by the end of the year.

Portfolio Management's results were supported primarily by the excellent performance of the Rolls-Royce and Partners Finance affiliates. Our RRPF results were driven by both higher operating performance and remarketing activity within the quarter. Quarterly and year-to-date segment profit in the Portfolio Management segment is down from 2017, primarily due to the $8.3 million residual sharing fee earned in the second quarter of 2017.

American Steamship Company is performing well, with 10 vessels currently deployed. While there were difficult ice conditions at the beginning of the season, higher water levels and increased demand for iron ore have more than offset the initial delays ASC experienced early in the season.

As noted in the earnings release, we are raising our full-year 2018 earnings guidance to a range of $4.90 to $5.10 per diluted share. This increase is based on the improving environment and benefits to our business year to date. This guidance excludes any impact from the railcar maintenance facility closure in Germany.

Those are our prepared remarks, so I'll hand it over to the operator so we can open it up for questions.

QUESTION AND ANSWER

Operator:

(Operator Instructions) Our first question comes from Allison Poliniak with Wells Fargo.

Allison Poliniak:

Good morning.

Robert Lyons:

Good morning.

Allison Poliniak:

Could you flesh out -- obviously, the railroads are having -- struggling with velocity. Metrics on your side are improving. But what is really base fundamental demand versus what you think are due to some of the railroad operational issues and maybe this is sort of a near-term blip? Any thoughts there?

Tom Ellman:

Yeah, this is Tom. It's really hard to tease out exactly what is driving the factors overall. But you're absolutely right that a big piece of what's going on is the railroad congestion problems coupled with the fact that trucking is very oversupply -- not oversupplied; that trucking is very tight right now and the ability to switch to truck is difficult.

So, you definitely see that in a variety of car types. One of the ones that we've talked about historically where it shows up in our fleet the most is boxcars. And you've seen that this quarter was pretty strong for our boxcar fleet. So that piece of it is definitely a major contributor to the quarter.

Allison Poliniak:

Got it. And then just touching on Europe, with the VTG news and so forth over the past few weeks, any change in dynamic in terms of valuations or how you are thinking about that region near term?

Brian Kenney:

Well, the VTG that's -- it's Brian, first of all. And the VTG news, that's new. We thought it was an odd press release, and sure enough, it looks like it's almost a hostile situation.

So I don't know how that works with the rules in Germany, but obviously we're not really concerned about it unless new ownership changes the way they compete in the market. Like, grows aggressively, uneconomically, something like that. So we just have to wait and see on that.

But Europe, that's not what I'm focused on. I'm focused on the market improving in 2018 for the first time in a long time. So utilization is a full point higher than we expected coming into the year and that's really utilization is higher across all fleet types.

If you look at petroleum, obviously that started in the third quarter of last year with petroleum prices going up. If anything, that's accelerated in 2018. Refinery production is up; railways are struggling a little bit to meet transport demand for a variety of reasons, such as locomotive driver shortages. And that's just resulted in good car demand and absolute lease rates actually starting to climb for the first time in a number of years.

And the other big surprise in Europe is a chemical market, which also started late last year and I would say has accelerated in 2018. There's a lot of positive chemical news in Europe. Once again, consumption and exports are up.

The production index and capacity utilization is actually approaching pre-Great Recession highs. And we've seen that strength materialize in our fleet statistics. So utilization is up there as well, over 98%, which is the highest I've seen it.

Lease rates are up, both on an absolute and renewal rate basis. And there is just good demand for cars, even old cars, especially in Eastern Europe. So the situation in Europe is just more attractive than it's been really over the last decade. So that's more what we are focused on rather than what's going on at VTG.

Allison Poliniak:

Perfect. Thank you.

Operator:

Thank you. Our next question comes from Kristine Kubacki with Mizuho Securities.

Kristine Kubacki:

Hi, good morning. My question was a little on duration in North America. Obviously, it looked like it inflected positive. It looks like this was a pivot point. So what's given you the confidence -- obviously, you talked about lease rates. But just any color about where you think duration is going to go for the balance of the year? And then if you could comment on kind of if your LPI expectations for the full year have changed as well?

Tom Ellman:

I'll start out with term and then let others chime in if they wish. But on the lease term, for the majority of car types, even though we have indeed seen rate improvement, most car types are below long-term averages. So in general, we're continuing to try to go a little short on lease term.

One of the things we caution everybody about each quarter is that looking at a single-quarter LPI statistic or term statistic can be misleading because a small number of transactions can influence what's going on there. And on the term getting a little longer, I wouldn't read anything into that other than a couple of transactions would have driven it a little bit longer. In general, we're still trying to go short.

Bob Lyons:

And Kristine, this is Bob. I will weigh in on the LPI, the second part of your question. We came into the year expecting the LPI to be negative 25% or more. Clearly through the first half of the year, we've done -- experienced better results in that metric.

So for the full year, we will likely do better than that for sure. Very difficult to predict, given how things are moving across car types right now, the timing of renewals, what's coming up for renewal, what's getting early renewed. Things are moving a little bit faster than anticipated in terms of the commercial activity.

So it's a little difficult to predict where the LPI comes out in the second half of the year. But we'll certainly do better than the negative 25% we put out at the beginning of the year.

Kristine Kubacki:

Okay, that's helpful. I was just wondering also if you could provide some color about the closure of the German maintenance facility.

Brian Kenney:

Yeah, I can do that. So GATX Rail Germany closed that facility in Hanover in the second quarter. The facility was producing high-quality work, but it just has been cost-disadvantaged relative to our third-party maintenance network for a number of years.

So, numerous attempts were made to try to fix that business in an effort to make it more competitive. But ultimately, they decided to close it. They'll redistribute that work elsewhere. So what that means in the second quarter, we close the facility. It affects about 65 employees, so it wasn't a huge facility.

And management at Jungenthal is currently in negotiations with the Workers Council on the social plan. So severance, job placement, etc., for the affected employees. And that charge we took reflects our best estimate of those costs. As far as the work that was done in that facility, it will just be redistributed into that third-party network.

Kristine Kubacki:

Very good. Thank you very much for the time.

Operator:

Thank you. Our next question comes from Justin Long with Stephens.

Justin Long:

Thanks and good morning. So first question I had was on the 2018 guidance. You increased your expectations there. But I was wondering if you could give some more color on the key assumptions that are driving that increase. I know at the beginning of the year, you gave a little bit more detail on some of those assumptions. So just curious if you could point to the key items.

And then this may be a component of that, but I also wanted to ask about North American maintenance. We saw a pretty material stepdown this quarter. So just curious if that's changed your expectations for the full year.

Bob Lyons:

Sure, Justin. This is Bob. And certainly there's a part of that, but let me give a broader commentary on that. First of all, the increase in guidance really is a general reflection of a more favorable environment than we anticipated coming into the year. And I would say that's across all business areas. So no significant one item I could point to that's really driving the change in the guidance.

However, with that backdrop, there are a couple of items, one of which you already mentioned, which is the maintenance expense. That has run more favorable year to date than we anticipated. Part of that is due to the timing of railroad repairs, commercial activity, tank qualifications, and the pace of those. We expect that some of that will catch up during the second half of the year and we'll see maintenance expense go up and won't run as favorable as it has through the first half of the year.

Also, we've had scrap income year to date, which was not anticipated coming into the year. And really, Rail International and American Steamship, while generally in line with our expectations year to date, are coming into the second half of the year with a little bit more favorable environment than planned. And we've assumed that that continues. So those are really the main drivers.

Justin Long:

And maybe to follow up on a couple of those. I think at the beginning of the year, you talked about North American maintenance being up 3% to 4%. Do you have a revised estimate for that? And on the scrapping piece you mentioned, is there any way you could quantify how much of a benefit that is as well?

Bob Lyons:

Sure. So far year to date on the scrapping front, total U.S. and -- North America and Europe, it's about $7 million of income that we had not anticipated being there.

Now, scrap rates remain high or higher than they had been and we'll continue our scrapping activity in the second half. But as I noted at the end of the first quarter and as we actually saw in the second quarter, some of those scrap gains will be offset by cars that we are scrapping at a loss. There are some disadvantaged car types that we're taking advantage of in terms of getting those out of the marketplace. So some of those scrap gains will be offset by some of the scrap losses.

In terms of the overall net maintenance expense, we had anticipated that it would be up 3% or 4%. To end up in that range, we would probably need to see about a $5.5 million to $6 million pickup in quarter-to-quarter maintenance expense during the second half of the year. That's certainly within the realm of possibility.

And so we'll probably be off of that 3% to 4% number, maybe flat with last year. So again, positive performance through the first half of the year, but we'll see some catch-up in the second half.

Justin Long:

Thanks. That's really helpful. And then last question from me. I wanted to follow up on what Allison, I guess, was asking about earlier when. We look at the industry data on railcars in storage, it's obviously come down pretty meaningfully from the peak. But over the last two months, we've actually seen that trend stabilize and start to slightly reverse.

Based on what you see in the market, is this just some short-term noise in the numbers? Because it sounds like demand is getting much better. Or do you think we could see an emergence of a new trend, just given what's happening with rail service stabilizing and maybe getting a little bit better in the back half?

Tom Ellman:

So one of the stats that we haven't talked about yet is the railcar loadings, which are also up this quarter versus a year ago about 4% for all of North America. So, in addition to the railroad velocity that we talked about earlier, there are some positive demand signs.

That 17% number of cars that haven't moved in 60 days is still pretty low on the overall continuum. A lot of that, though, is driven again by the railroad performance. And to your point, it's been pretty -- it has not been good by historical standards. And if you compare it to the last several years, even with the little change this quarter, it's still at the low end.

So at least for the rest of 2018, I would expect the combination of performance and the loading situation to be pretty consistent with what we've seen in the first half of the year.

Justin Long:

Okay, great. I'll leave it at that. Thanks so much for the time.

Operator:

Thank you. Our next question comes from Matt Elkott with Cowen.

Matt Elkott:

Good morning. Thank you. I had a question about the sequential improvement in lease rates that you guys noted. I believe this is maybe the third or fourth consecutive quarter where you see a spot lease rate improvement.

Can you give us some more color on the magnitude? In the last few quarters, it was pretty modest, I think, low-single digits.

Tom Ellman:

Yeah, so one of the first things we always talk about when looking at this is that it varies by car type. But to try to summarize: tank cars have seen more sequential improvement than freight cars. Tank cars, quarter to quarter, overall a number around 10% is what we've been seeing.

For freight cars, it's up very slightly. Most freight car types are relatively flat, but we've seen significant improvement in centerbeams, which is causing the whole freight area to move up just a little bit.

Matt Elkott:

Got it. And just speaking of centerbeams, I think CN has ordered 700 or is ordering 700 centerbeams. I think this will be the first time this car gets manufactured since 2004. Do you guys have any plans of adding to those, given where housing starts are?

Tom Ellman:

Yeah, so we don't comment on individual investment in car types. But certainly the performance of that part of the fleet has improved. But again, some of that is due to the railroad performance. So it's something to keep an eye on going forward.

Matt Elkott:

Got it. And on the DOT-117s, we're hearing that that fleet seems to be fully deployed at this point. Can you guys remind us how many crude-specific tank cars you have in the fleet? And are there any strategic moves on that front?

Jennifer McManus:

Matt, this is Jen. We have about 1,400 cars in crude service right now.

Tom Ellman:

Yeah, and as far as our – we've talked repeatedly about we think long term, crude-by-rail is going to be very limited. Crude moves most efficiently in a pipeline, so it is not an area that we've done a lot of investment in and wouldn't expect to do a lot of investment going forward.

Matt Elkott:

Got it. Perfect. Thank you very much.

Brian Kenney:

The other point I'd make is that investment in crude is all in the DOT-117.

Matt Elkott:

Great. Thank you very much for the color, guys.

Operator:

Thank you. Our next question comes from Mike Baudendistel with Stifel.

Mike Baudendistel:

Great, thank you. Just wanted to follow up on that last question. You talked about tank rates being 10% higher. I mean, were those the type of tanks that would be competitive in the type of crude-by-rail that's been -- Canadian Pacific is talking about basically doubling their crude-by-rail? I know you don't do a lot of crude by rail, but just wondering if that's what's impacting that dynamic there.

Tom Ellman:

Without going too deep into the LPI statistic or the rates that we're talking about, what we're talking about in general, to give everybody a flavor, is renewal rates, existing car rates. So crude-by-rail, you just don't have a lot of renewal activity. It's a pretty new fleet. So the rates we're talking about are -- I would disassociate that for many crude-by-rail commentary.

Mike Baudendistel:

Got it. And then just wanted to ask you, the renewal of -- I guess the extension of the agreement with Trinity. I mean, is there anything there that's different than the existing agreement? And do you have the clauses like you did the previous time, where it fluctuates based on the manufacturers' production cost?

Tom Ellman:

Yeah, so basically, what we did is, we extended that agreement in order to have a consistent source of supply for our customers. And all that we did there is extend it for four more years.

Mike Baudendistel:

Got it. Just an extension. And then I just want to ask. You said the remarketing income is -- was at your -- for the first half was at your previous full-year expectation. Do you have an updated number for that?

Bob Lyons:

Yeah, it's not going to change much from where we are year to date, Mike. I think the remarketing activity as we see it based on the packages we're looking at largely done for the year. Anything else we do from here would be relatively small in size and really targeted at certain car types or opportunities. So nothing on a material scale.

Mike Baudendistel:

Got it. Thanks very much.

Operator:

Thank you. Our next question comes from Justin Bergner with Gabelli & Co.

Justin Bergner:

Good morning, everyone.

Bob Lyons:

Good morning.

Justin Bergner:

I want to approach the sort of guidance increase another way. Given that you are taking up the midpoint from $4.65 to $5, I mean, is there any way to sort of roughly break out what percentage of the increased guidance is coming from different buckets?

It seems like there are a lot of things helping the business between utilization pricing, lower maintenance in North America, better European rail, maybe better portfolio management. I mean, is it possible to just sort of segment the percentage increase across some of those buckets?

Bob Lyons:

It's pretty difficult to do because there's a lot of -- I would say it's a number of modest incremental improvements from where we expected coming into the year. But obviously, the bulk of that would be in North American Rail.

I mentioned ASC and Rail International are both coming into the second half of the year in a more favorable environment. And they will do a little bit better than we expected, but it's not significant. So really, it comes down to North American Rail.

You hit on one with the maintenance number being one; scrap, another one. The other thing I would point out, too, though, is that our revenue expectation coming into the year -- we are very much right on line. We expected revenue to be down 3% to 4% at North American Rail. That's basically where we're at midyear and it's where we continue to expect to be at full year.

So the rate environment, even though it's a little bit better, because cars renew evenly throughout the year, you don't get a real significant impact or movement from what the expectation was coming into the year. So it's not top-line driven. Again, it's on the maintenance side we've seen better performance, scrap side better. Those are two of the biggest ones at North American Rail.

Justin Bergner:

Okay, that's helpful. But I mean, it would seem that the utilization being as strong as it is is going to be coming in a little bit better. So maybe you're at least at the high end of your revenue anticipation coming into the year. Is that fair?

Tom Ellman:

Yeah, so the one thing I point out on utilization is for most car types, utilization is almost exactly what we expected. The biggest variable there is coal cars. And as we've talked about before, coal cars are at such a low lease rate that whether they're on lease or off lease, it has very little impact on performance.

Justin Bergner:

Got it. All right, moving on to a separate question. The Portfolio Management business had a pretty good quarter. Is that sort of tracking ahead of where you thought it would be? Any sort of comments on what's helping drive the strong performance?

Bob Lyons:

Well, there's two things going on in Portfolio Management, and to some extent they're a little bit offsetting. Rolls-Royce continues to perform extremely well; had a very good first half of the year. Not materially beyond what we expected. So good performance overall, good investment volume. Maybe a little bit ahead of plan and we'll see how that plays out for the second half of the year.

As you know, we also have another investment there that is comprised of five ocean-going vessels that are noncore to us, but they're there in the portfolio. The performance of those has actually run behind. And so we have seen more challenges with those vessels in terms of the rate environment, the charter rate environment.

They primarily are in the LPG service globally. And the vessels' charter rates there have been depressed and continue to be very challenged. So that's actually running behind what we had expected coming into the year. So those two are really kind of offsetting.

The big difference between the first half of the year performance versus 2017 again, and Jen mentioned this in her opening, is that last year in the second quarter, we had a pretty sizable residual sharing fee in our managed portfolio, about $8.7 million, which is not repeatable. So that had an impact on the quarter-to-quarter and year-to-date performance versus 2017.

Justin Bergner:

Okay. That's helpful. And then just a clarification on an earlier question. The maintenance expense -- I mean, is it safe to assume that the new guidance includes sort of more of a flattish year-on-year maintenance expense in rail versus the 3% to 4%? Or --?

Bob Lyons:

Yeah.

Justin Bergner:

Okay.

Bob Lyons:

Yeah, I would say flat to just marginally up.

Justin Bergner:

Okay. That's helpful. And then finally, the India investment, could you just remind us how big the fleet is in India? Or how big it will be in the context of the investment volume metric that you quoted earlier?

Brian Kenney:

Sure, Justin. Right now the fleet at the end of the second quarter is about 1,350 cars and that represents probably around $50 million of gross investment. But there is a clear path to doubling the size of that fleet over the next year just with existing orders that are committed to customers. So you could see that double within the next year.

And it's going great. The fleet's 100% utilized. They're finally diversifying their fleet away from just container cars. So it's going very well over there.

Justin Bergner:

Okay, fantastic. Thanks. Great quarter.

Bob Lyons:

Thank you.

Operator:

Thank you. Our next question comes from DeForest Hinman with Walthausen & Company.

DeForest Hinman:

Hi, thanks for taking the questions. A couple different ones. You talked about scrapping a little bit, but big picture, are the elevated scrap prices right now combined with the tariffs potentially on steel, could this be a meaningful clearing event for some older car types over the next, I don't know, 6 to 12 months? Is that feasible or is this just a blip?

Tom Ellman:

Yeah, so higher scrap prices certainly help. What happens when a car comes into shop, what we look at, what our competitors look at, is what is your expectation to earn that car over the rest of its life versus what could you get if you scrapped it. So obviously, scrap price is up. That encourages, makes it more likely that you scrap the car.

As far as predicting what the scrap pricing is going to do going forward, that's extraordinarily difficult. And we wouldn't alter our behavior based on future scrap price expectations anyways. It's a real-time decision when the car comes in.

DeForest Hinman:

Would you be willing to speak about what other people are doing? Is there, generally speaking, are owners more willing to scrap? Are you seeing more units go to scrap yards generally?

Tom Ellman:
It's not something that we track what other people are doing as far as scrapping goes.

Bob Lyons:

I think the industry -- there are some industry data or forecasts that indicate scrap rates will be up or scrap activity will be up this year. But we will have to see how that plays out full year.

DeForest Hinman:

Okay. And then on the Rolls-Royce affiliate income, you've added some disclosures in the Q that have been helpful. You've been disclosing the dispositions in the Qs. Did we have engine dispositions in the second quarter or is that 15.9 that we reported kind of a baseline with no sale event?

Bob Lyons:

There was about $4 million of remarketing in that number.

DeForest Hinman:

Okay, great. So I mean, if we're doing forward modeling and we don't assume engine dispositions with the current engine count in the, I don't know, 430 range, is that kind of a baseline expectation of $11 million of income from that business?

Bob Lyons:

Year to date, our pre-tax is about 30 -- is roughly $33 million. And we came into the year -- last year was 57 for all of 2017. We said we would probably be between 55 and 65 for the full year in 2018. I don't see any change to that right now.

DeForest Hinman:

Okay. And then back to the maintenance again, some other people asked about it. But in terms of the -- I think there's some disclosures in the K or the Q that talked about tank recerts. Are those more back-half weighted or have you already been experiencing some of those recertification costs in the first half of the year reflected in those maintenance numbers we've reported?

Tom Ellman:

So the way that works is, customers have to make the car available to us over the course of the year. But it's not like there is a requirement: this many this quarter, this many the next quarter. It's just an annual requirement.

They have come in more slowly than we expected when we entered the year. So given the requirement to get them done this year, we expect the back half to be -- them to come in at a higher rate than we originally thought.

DeForest Hinman:

Okay, that's helpful. And you touched briefly on the ocean-going vessels, LPG area. I think that has been pretty weak for some period of time. Can you give us the longer-term thoughts on what we do with those vessels? Do we hold onto those and wait for that market to improve? Or are those something that we're actively trying to sell?

Bob Lyons:

Well, as I said, they are not core to GATX. So my view on that is our best opportunity for those vessels longer term is to keep them deployed. They currently are operating within a pool and we're looking at all options with regards to those vessels.

DeForest Hinman:

Okay, and then last question. You guys have been fairly active with the stock buyback over the last few years. I think this is the first quarter; in the press release, you didn't disclose you bought back stock. Can you give us some better understanding of why that occurred? And if you were looking at any sizable transactions that put you in a blackout for the whole quarter?

Bob Lyons:

Sure. Yeah, we did not repurchase any stock during the second quarter. And during the quarter, we were in discussion with railcar manufacturers about the completion of a significant railcar supply contract. And given the probability and materiality of that potential contract, we were not in the market.

Subsequently, as you know, we filed an 8-K and we've already talked about previously on the call that we did place that order or the extension for 4,800 cars to be delivered between 2020 and 2023. So that's completed and we would expect to be active under the repurchase during the second half of the year.

DeForest Hinman:

Okay, thank you.

Operator:

Thank you. Our next question comes from Steve O'Hara with, Sidoti & Company.

Steve O'Hara:

Can you hear me?

Bob Lyons:

Yes.

Steve O'Hara:

Just, I think in the past with the talk about being maybe too many cars in the fleet, too many cars on order, I guess that maybe is shifting a little bit. And I think in the past, you've talked about -- and I'm paraphrasing -- things like oil kind of bailing the industry out a little bit. I mean, is there anything you can point to here that's doing that? Or is it maybe we're not bailed out yet, but we're kind of moving in the right direction?

Tom Ellman:

Yeah, so I think your last sentence is a good one, that we're moving in the right direction. But again, if you look at these -- the lease rates compared to long-term averages, for the vast majority of car types, we're still well below. And our LPI, though improving, is still negative.

So we absolutely have seen improvement. We talked about the 10% quarter over -- I mean, versus a quarter ago for tank cars. But they're still at low levels on a historical basis.

As far as what might be helping out, we've talked about it a couple times. What's helping out is the fact that the railroad performance is still relatively low. So a solution to that problem is to throw more cars at it. And the alternative of going to truck is not readily available, so that is certainly helping the industry. You combine that with the uptick in loadings, that's why we've seen improvement. But again, still a ways to go.

Steve O'Hara:

Okay. And then just if the dip in rates and things like that, you're still well below average rates. I guess I'm just -- do you think it maybe is time to be more aggressive on asset purchases or on looking at fleets or something like that?

Or is it the cycle overall, the economic cycle, is still kind of long in the tooth? And maybe it's not the right time to be as aggressive as things were more under pressure or not recovering as quickly?

Brian Kenney:

It's Brian. I can take that. As far as looking at acquisitions, when asset prices are increasing and steel prices are increasing, you probably look less at the possibility of an acquisition because things are getting more expensive.

It doesn't mean we don't look at placing a railcar; you saw one in the second quarter. And we continue -- we always look at placing a new order. But as far as doing something bigger and more growth-oriented on the order side, we're going to have to get the right terms. But it's something we always look at. It's a focus this year as the market recovers.

But on the acquisition side, I'd say it's the opposite of what you said. As asset prices increase, things become less attractive. And that's the whole thing on tariffs in general. It's been good for short-term results already. You see it in scrap, you see it in higher demand at ASC, you've seen some higher railcar loadings for metals that are driving strength in certain car types.

But it's bad for investment. Steel prices are going up; new car prices are going up because of that. Manufacturers are refusing to quote new car builds at fixed prices for any length of time. So it's the usual as this happens: bad for investment, good for near-term operating results.

Steve O'Hara:

Okay. And then just within ASC, I mean, in terms of the -- obviously, you said demand is better with tariffs, I guess, helping. I mean, do you have a sense for capacity utilization within the industry itself and amongst your competitors? And is there -- if demand continues to improve, I mean, is there enough capacity out there? And can you maybe charter some back in if you wanted to? Thank you.

Brian Kenney:

Yeah, I mean, it's a good question. I will tell you: our fleet, which now is 10 vessels deployed, those 10 vessels are fully scheduled through the year. We talked about the weather challenges at the beginning of the year and increased demand. So those are fully utilized for the year. And I think in general in the industry, the fleets are fully utilized for the year.

So as far as upside of ASC through new demand, it will come through spot tonnage. That's what has happened over the last two years, although it largely had been for iron ore pellet export volume through the Seaway.

To the extent that higher steel prices create spot demand for ASC, they'll have to figure out if they want to bring out another vessel. And so it can't be a small request for spot tonnage. It has to be a bigger one because obviously it's expensive to bring out a new vessel.

So yes, there's upside at ASC. And you're already seeing it. I think coming into the year, we said they would carry lower tonnage, just at a higher price and more efficiently. That forecast has gone up as our customers have asked for a little more volume within the existing contract.

But the real upside is when they ask for spot tonnage, which you can -- you have the freedom to price outside the contract. So, we'll have to see how the year develops, but it's certainly a possibility.

Steve O'Hara:

Okay, thank you very much.

Operator:

Thank you. Our next question comes from Willard Milby with Seaport Global.

Willard Milby:

Hey, good morning, everybody. Most of my questions have been answered, so just two quick follow-ups. On the share repurchases, I think at the beginning of the year, you all were still targeting about $100 million of repurchases in 2018.

Does that mean we could see some catch-up? Or are you all more likely to stick with your, I guess, $25 million a quarter that's been the norm for the past, call it, year and a half?

Bob Lyons:

Yeah, we're looking out through the end of the year. As we're looking at it right now and layering that into our outlook, we're still in that $100 million range.

Willard Milby:

All right. And also on the SG&A expense, I think you all expected that to step down maybe a percent or two looking at the full year. Is that still the case after two quarters of year-over-year growth? And kind of what drives that expense?

Bob Lyons:

Well, if you look at where we're at year to date, we are at, call it, $91 million year to date on SG&A. And if you annualize that, we would be exactly flat with where we were in 2017. So we're not at our goal; we'll still try to tighten that number down a little bit in the second half of the year.

And the big drivers on that are obviously whether, as is standard with anybody, salaries, compensation, all of our T&E, everything else that lays in there. No significant items off the mark from where we thought the year would be. So we'll continue to keep it as a focal point, though.

Willard Milby:

All right. And just looking historically, I guess the second half of the year has come in heavier, looking at the last couple years. Do you think that there is a chance that this, call it, $91 million run rate is sustainable and won't be higher?

Bob Lyons:

We're not forecasting that right now.

Willard Milby:

Okay. All right, well, thanks for the time.

Operator:

Thank you. Our next question comes from Justin Long with Stephens.

Justin Long:

Thanks for taking the follow-up. Just wanted to circle back to some of the questioning earlier. A number you've provided previously is the gap between lease rates today on average versus what you feel like is needed for an attractive investment. I think the latest number you gave on that was a 25% gap.

Curious if you have any update to that number. And how that number would compare if you were to look at tank and freight?

Brian Kenney:

You know, I hate throwing out that number because unfortunately, a lot of people take it as you wouldn't invest if lease rates were at those levels. And that's not what we're saying. In fact, we are investing with lease rates at that level. So as long as we understand that.

They have to average higher than just today's rate in order for it to be an attractive investment. And I've also been admonished not to generalize too much about this, Justin, because it is, as Tom pointed out, very dependent on car type. There's tremendous dispersion across the fleet.

So, to give you a little bit more color on the tank car side, current lease rates for just a few car types are at attractive levels. So an example would be sulfuric acid cars are at an investable level from the perspective of an average lease rate over the term. And in other car types, in fact, most car types are much lower. In fact, like high-pressure cars are down 30% to 40% from where they need to be to make that investment attractive over the long term.

On the freight car side, also wide dispersion. There's really nothing on the freight car side that's at an average level that would be that attractive. Small cubes are close, I think, right now. And there's others that make it uninvestable and the best example there is coal. So it's better than last quarter, but it's still wide dispersion across the fleet.

Justin Long:

Thanks. I know that it's tough to generalize, but that color is helpful. I appreciate the time today.

Operator:

Thank you. Our next question comes from Justin Bergner with Gabelli & Co.

Justin Bergner:

Hi, guys. One quick follow-up. The decision to not repurchase shares in the second quarter, was that driven by a self-imposed blackout because of the Trinity discussions? Or could you have repurchased shares notwithstanding the Trinity contract that was announced?

Bob Lyons:

No, as I mentioned previously, we were -- given that we were in discussions with manufacturers about an order and one that came to fruition, the materiality of that and the probability of it, that was the reason we were not in the market.

Justin Bergner:

Okay, great. Thanks.

Operator:

Thank you. There are currently no further questions in the queue at this time.

Jennifer McManus:

I'd like to thank everyone for their participation on the call this morning. Please contact me with any follow-up questions. Thank you.

Operator:

Thank you, ladies and gentlemen. This concludes today's teleconference and you may now disconnect.