GATX | GATX Corporation

Operator:

Good day, everyone, and welcome to the GATX second quarter earnings conference. As a reminder, today's presentation is being recorded. At this time, I'd like to turn the call over to Jennifer Van Aken. Please go ahead, ma'am.

Jennifer Van Aken:

Thank you, Doris, and good morning, everyone. Thanks for joining us for the second quarter conference call. With me on the call 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 base 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 2012 Form 10-K/A 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 2013 second quarter net income of $35.1 million, or $0.74 per diluted share. This includes the benefit of $3.0 million, or $0.06 per diluted share from Tax Adjustments and Other items, which are detailed on Page 11 of the press release. This compares to 2012's second quarter net income of $23.5 million, or $0.49 per diluted share, which includes the negative impact from Tax Adjustments and Other Items of $15.3 million, or $0.31 per diluted share. Year-to-date 2013, we reported net income of $62.2 million, or $1.31 per diluted share, including the benefit of $1.7 million or $0.04 per diluted share from Tax Adjustments and Other Items. Again, these items are detailed on Page 11 of the press release. Year-to-date 2012, we reported net income of $53.8 million, or $1.13 per diluted share, including the negative impact from Tax Adjustments and Other Items of $17.5 million, or $0.36 per diluted share.

We continue to see strong demand for tank cars in North America. The renewal rate change of GATX's Lease Price Index was 36.0%, the highest quarterly result achieved since we began reporting the statistic. While achieving remarkable lease rate increases, utilization remained high at 98.2%, and the renewal success rate strong, at nearly 80%.

Rail International continues to have solid performance, with a utilization of 95.6% at the end of the second quarter. While the economic environment in Europe is rather weak, we have been successfully renewing leases and placing new railcars with customers.

American Steamship Company is currently operating 13 vessels and is performing in-line with expectations. Based on customer input, we continue to expect to move modestly less volume in 2013 than in the prior year.

Portfolio Management continues to perform well. The Rolls-Royce and Partners Finance affiliates maintained high utilization, and, as noted in the press release, we dissolved a joint venture consisting of ocean-going, multi-gas carriers. As a result, GATX retained five of the vessels.

Investment volume was over $320 million during the second quarter, and over $470 million, year to date. In addition to the solid investment volume, we also repurchased nearly 1 million of our own shares, for approximately $50 million, year-to-date.

Based on the continued strength in North American Rail and anticipated asset remarketing events, which are more heavily weighted toward the second half of this year, we are raising our full-year 2013 guidance to a range of $3.20 to $3.30 per diluted share. This increase excludes any impact from Tax Adjustments or Other Items. So with that overview, let's go to your questions. Doris?

QUESTION AND ANSWER

Operator:

(Operator Instructions) We'll go first to Justin Long with Stephens.

Justin Long:

Hi, and good morning. The LPI number was strong in the quarter. I was wondering if what you've seen, in terms of the progression of tank car lease rates over the course of the first half of 2013? I think it's pretty clear we've seen a massive increase over the past couple of years, but would you say, at this point, tank car lease rates are still moving higher? Are they holding firm? Or, are you seeing any pressure, given the narrowing of spreads over the course of this year?

Brian Kenney:

Yes, it's Brian. It's a good question, and you're absolutely right. We've seen dramatic increases in tank car rates over the last 18 months, due to the unprecedented demand for the cars. In the second quarter, we still saw a few absolute rate increases on some of the car types, but in general, I'd say that they're more holding firm at this point.

Justin Long:

Got you. And--

Brian Kenney:

We haven't really seen any decreases.

Justin Long:

Okay. And--

Brian Kenney:

At least in the business we do.

Justin Long:

Got you. And you originally guided for LPI in 2013 to look similar to last year, but with the LPI numbers over 30% through the first two quarters, is it fair to say that you're looking at a year that could be a little bit better than 2012, or is there any reason to think we'll see some moderation in the second half?

Bob Lyons:

No, we will do better than 2012. Originally, we came in expecting 2013 to be -- I think we've said in the range of what 2012 was, about 26%, 27%. But based on the first half of the year performance and what we're looking at here in the second half of the year, we'll be north of 30%, in that 30% to 35% range for the LPI for the full year. So, much stronger than anticipated.

Justin Long:

Okay, great. You guys have been pretty open about your concerns of a potential oversupply of tank cars as it relates to crude service, longer term, but I was wondering if you could comment on your view of the supply/demand dynamics for non-crude tank cars, and to what degree do you think these other types of tank cars will be impacted, if we'll see some volatility in demand for crude-by-rail?

Brian Kenney:

Yes, they will be impacted. You're already seeing a very competitive environment for non-crude tank cars, right now. We got ahead of that, and we didn't put a whole lot of cars into crude service. As you know, we probably have around 1,600 right now, which is a very small percentage of our fleet. But I imagine, as we've been saying, if it gets overbuilt, and I think it probably will, for crude service, you will see more competition, as people change production and start building the other tank car types.

Justin Long:

Okay, last question, and I'll pass it along. But, are you seeing any strength in lease rates for markets outside of tank cars right now? And if so, could you give some more detail on those car types where you are seeing any pick up?

Brian Kenney:

Well, outside of tank cars -- it's a bifurcated rail market for sure, and tank car's very strong, and freight cars generally less strong. If you look at coal and grain, they're still what we'd call very low and depressed, although improving somewhat. We had some success in the quarter placing coal cars, so that's -- in general, I think the industry utilization actually went up a little bit. But if you look at the rates we're realizing there, it's nothing to get excited about. But it's always good to have them utilized. We think that'll get better over the next year, especially if there's continued improvement in economy and more normal weather patterns, et cetera.

Grain's another car type that hasn't been doing great over the last year. It looks like it will be a better harvest this year. That will improve the situation, but we really don't expect a lot of strength there, perhaps until next year, as that works its way through the market. But there are some cars on the freight car side, or non-tank anyway, that are showing some strength, and auto would be a great example.

Justin Long:

Okay, great. I appreciate the time. I'll pass it along.

Operator:

Our next call comes from Mike Baudendistel with Stifel.

Mike Baudendistel:

Thanks and good morning. Thanks for taking my question. I just want to make sure I'm interpreting your guidance correctly. The raise in guidance seems like it's due to increase in gains in the second half of the year. Is it fair to say that operationally, your outlook is more or less unchanged?

Bob Lyons:

No, I'd actually -- the remarketing income for the full-year is probably going to come in-line with what we anticipated, coming into the year. It's just more weighted to the back half. So we're not anticipating a significant increase in remarketing from what we expected, coming into the year. The change in guidance is really driven by a couple of the points that we touched on already, which is the far stronger lease rate environment than we anticipated, coming into the year.

So when you really look at the LPI performance and our renewal success rate, those are two big drivers for us in our North American rail business. We've done better than we expected, and based on what we see in the marketplace today, we feel that that's going to continue through the balance of the year -- that's the big driver.

Mike Baudendistel:

Okay. And on the uptick in utilization, what car types were you able to place that were not being utilized before?

Bob Lyons:

Well, I'd say in general, we did a little bit better on coal than we anticipated, coming into the quarter. That number can move around a little bit, by 30, 40 basis points, as it did. In general, we're nearly fully utilized across pretty much every car type in the fleet.

Mike Baudendistel:

Okay, great. And when you think about the Lease Price Index that you'll report in future quarters, when will you start to have a bit of a more difficult comp there, with lease rates that are expiring?

Bob Lyons:

Well, if lease rates stay where they're at today, we have a very long runway in front of us of positive LPI, or multi-year runway with positive LPI. But the expiring rate does start to move up. In 2014, it's really expected to be a relatively modest uptick in the expiring rate. So, we feel we have a pretty good window here, and runway, in front of us.

Mike Baudendistel:

Great, that's very helpful. And then, one final one for me. The media seems to be somewhat fixated on the DOT-111 tank cars. Maybe there's some regulation coming up there. Do you have any comments on what you expect, as far as regulations on those cars, and how many of those car types do you have?

Brian Kenney:

Well, sure. Can't comment on what regulations might happen, because we're -- we did not have any cars on that train. We're not part of the investigation. It's very early in the investigation, and you just don't know what might happen, if anything, coming out of that accident. There's also been focus -- you mentioned DOT-111 -- there's been focus on that, as if it's a single car type in the media -- it's really not. It's a regulatory designation that essentially tells you the car's not a high-pressure car, and it could be used in HAZMAT service, if outfitted appropriately.

And to give an example, there's 300,000 plus tank cars in the industry, and over 200,000 are DOT-111 cars of varying types. So the real focus, I think, of the regulators to date, and maybe we'll see going forward, has been on the DOT-111 cars that are in flammable liquids service. And if you look at that industry population, that's more along the lines of 64,000. So it's a smaller population, and as far as our exposure at GATX, of the very large DOT-111 cars that are in flammable service, there's a population there of about 7300, and that's on our 110,000 car fleet.

Mike Baudendistel:

That's great detail. Thanks very much.

Operator:

And our next question comes from Steve O'Hara with Sidoti and Company.

Steve O'Hara:

Hi. Good morning. You noted that you're keeping, I think, lease terms short for certain car types that had been weaker, or seen weaker demand. Is this a -- something of a change in strategy? And then -- or is this something you've always been doing, or have been doing recently? And is this due to the glimmer of hope for boosting demand that you noted earlier?

Bob Lyons:

Yes, Steve. I'll take that one. It's Bob Lyons. No, it's not a change of strategy at all. It's typical of what we -- the way we like to approach the marketplace. I think the most relevant car type to really reference with that regard is coal. So we have a very young, modern coal fleet that we're -- we believe in long term, but that market is oversupplied right now. So we don't really have an interest in going long term.

We want to keep the cars utilized, so we'll be aggressive on rate, as we have been, but we'll keep the terms short, because we absolutely believe there will be a better environment to remarket and to re-lease those cars in the future. So in some cases, we're doing -- we'll do a year- to 12-month lease. We'll keep it short, and we're confident in the equipment and the opportunity to do better further down the road.

Steve O'Hara:

Okay. And then, just in terms of the maintenance expense. I know on the income statement it's up about 10%, but if you look at the segment breakdown, North America, I think, was actually down a little bit. Is maintenance and other line items that maybe were boosted, as well?

Bob Lyons:

No. On a year-to-date basis, if you look at Rail North America, their maintenance expense was $112 million for the six months. But let's just focus on where we are mid-year -- that's up from $97 million a year ago. So we have, as we expected, seen an uptick in that maintenance expense. Despite the fact that our renewal success rate is running higher than anticipated, we're dealing with compliance cars, as we talked about, coming into the year, and railroad repairs are up. So, it is up materially, and we anticipated that.

Steve O'Hara:

Okay. And then, I don't know if you did mention it, but what was your renewal success rate in the quarter?

Jennifer Van Aken:

Steve, our renewal success was close to 80%.

Steve O'Hara:

Okay. All right, thank you very much.

Bob Lyons:

That's a very strong level -- continues to be very strong.

Operator:

And from Raymond James, our next question comes from Art Hatfield.

Art Hatfield:

Morning, just a couple of questions -- a bunch of my questions have been answered. But first on SG&A. Bob, can you -- SG&A was a little bit higher than what we thought it would be, and it kind of jumped from Q1. Was there anything that you would consider, I don't want to say one time, but unique to Q2, with regards to SG&A?

Bob Lyons:

Not really, Art. We definitely -- we have some projects underway, both on the IT front and on some international tax planning that we're doing that work their way into those numbers. But in general, I would say where we're at year to date, at about $88 million in SG&A, that would be a good second-half run rate, as well. So we anticipate, I think we'll be in the $175 million to $180 million full year, and the uptick from 2012, one of the biggest drivers there is pension expense, probably a consistent theme you're hearing from other public companies.

Art Hatfield:

Yeah.

Bob Lyons:

And also, we had run with a fairly low headcount, as you will recall, in 2009, '10 and '11. And we're coming back to some more normalized levels on that front, both in 2012 and this year. So we're getting the full-year impact of those additions from 2012 to this year. That, coupled with some of the project work, and also some of our additional focus really on international growth -- rail growth markets, China, Russia, India. We're absorbing some SG&A there as well, and making some investments there for the long term.

Art Hatfield:

Okay. Thank you, that's very helpful. With your change in some of your marine -- with your marine JVs -- looking at Portfolio Management in Q2, how that kind of played out, is that how that should -- is Q2 a good representative of how that -- those businesses will be accounted for, going forward?

Bob Lyons:

Yes, absolutely. We have made a number of changes there. So over the course of the last couple of years, two of our big marine joint ventures -- we have restructured into 100% ownership, with the current -- with our former partners being the manager of those assets. We feel that gives us a better economic -- potential economic outcome and flexibility with those assets. So the way they're accounted for in the second quarter will be the case, going forward.

Art Hatfield:

And with Q2, was Q2 a full quarter accounting for that, or was it a partial?

Bob Lyons:

It was a partial. We closed that transaction, the split of the joint venture around Tax Day, around April 15th. So --

Art Hatfield:

So, a couple weeks difference?

Bob Lyons:

Yes, about six weeks. So we'll -- third quarter will be a much better representation, going forward.

Art Hatfield:

Very helpful. And then, Brian, if I could go back to the situation in Quebec and just ask about that. And that was good color you gave on the flammable cars and service, and where you sit. If -- and obviously, I am speculating here, but theoretically, if there's something that comes out of this where there needs to be a retrofit or something with regard to those 64,000 cars. Obviously, you have 7300 you own, but is there a potential there for that to be a net positive for you, if you end up bringing some of those other cars for shippers and whatnot into your shops, and doing some work there?

Brian Kenney:

You know, I hadn't really thought about it that way, Art. It's a net positive for us, from the perspective of -- if you can look at our Vision Statement, it's all about being the best railcar company in the world, not just for our shareholders and employees and customers, but also for communities where we operate. And making sure that this equipment is safe, that it's operated safely by the railroads, and handled safely by our customers, that's where it all starts. And if that equation -- if we don't get that right, then nothing else we do matters.

So, it's kind of secondary to us -- or I would call it third-order concern -- is the cost of any of this. We just want to make sure these cars are as safe as possible. So, I don't know what's coming out of there, but whatever it does, we'll not only conform to it, we'll probably exceed those standards. And we'll participate in that discussion as it comes out, and they figure out what happened in this accident. But I hadn't really thought about it in terms of --

Art Hatfield:

That's the last thing on your mind when something like this happens, but --

Brian Kenney:

It really is.

Art Hatfield:

Yeah, but unfortunately, those questions crop up occasionally -- thought I'd ask. Thanks for your time today.

Bob Lyons:

Thank you, Art.

Operator:

And we’ll go next to Doug Dyer with Heartland Advisors.

Doug Dyer:

Hello, gentlemen. Just wanted to confirm that the shortening in the lease rates is apparently being all caused by some coal and grain cars coming back into the market. Is that the case, or is there some other cars that are seeing shorter terms?

Bob Lyons:

Well, that's primarily the case, Doug. Shortest definitely in coal, and that does work its way into that term, and as we've mentioned, we are being aggressive in the marketplace to keep those cars in service, being aggressive with rate and staying short.

Doug Dyer:

All right. Thank you very much.

Operator:

(Operator Instructions) An We’ll go next to Steve Barger with KeyBanc Capital Markets.

Steve Barger:

Hi. Good morning, guys.

Jennifer Van Aken:

Morning

Bob Lyons:

Steve

Steve Barger:

Brian, in response to an earlier question, you had said that you hadn't seen a decrease in lease rates, and then you added in, "in the business that we do." Does that suggest there's been decreases in other parts of the market, or I guess more directly, what are you hearing in the market, in terms of pricing for some of the shorter-term tank leases.

Brian Kenney:

Bob and I are laughing, because that was an excellent catch, [laughter] and I slipped that in at the end. And that's exactly where, anecdotally, we're hearing there's some decreases in the very short-term business that's going out in crude service -- six months or a year. We're hearing those rates are coming down. But we never participated in that anyway, so for the business we do in the long-term leases, we really haven't seen any decreases. But the increases are less numerous for sure than they were earlier this year.

Steve Barger:

Got it. So, it does feel like at the long end of the spectrum, it's just kind of plateauing, right now.

Brian Kenney:

Yes. It's hard to answer, whether we're at the peak or not. It's a loaded question. If you go at the 100,000 foot level, and you look at railcar loadings, they're still down from the prior peak. In fact, they're down from the post-recession peak in 2011. So, with a little help from the economy, you would think that rail traffic increases -- and that's great for railcar leasing long-term, but obviously there's more to the equation than that tank car supply.

And if you look at GATX's fleet -- it's once again, like a lot of questions we answer. It's on a car-type by car-type basis. And earlier in this call, we talked about grain and coal being very weak, so you're certainly not at the peak there. You're not at the peak in a lot of the hopper cars that are actually improving at this point, and I said coal is improving. But most of the freight cars side--it doesn't feel like we're anywhere near the peak. But I think the question really centers on tank cars, and that's why people are asking that. That's the color idea of -- in the quarter, there were less increases, definitely, than there were before.

Steve Barger:

Okay. Got it.

Brian Kenney:

But, as Bob pointed out, there's effective 100% utilization in the tank car industry right now, so it's hard -- absolutely, you're at the peak there, because it cannot get any better. [Laughter] But on the other hand, manufacturing backlog for tank cars is still out 18 months or more, so it's hard to see a rapid decline at this point, as well.

You don't know if we're at the peak, but the beauty about the term structure of our fleet is that, as Bob alluded to earlier, even if rates have peaked out in tank cars, and even if they decrease somewhat, given that term structure of our fleet, you'll see revenue increases on the tank car side for quite some time. And that's due to the average expiring rate on our portfolio, and as well as locking in all of those low rates during the 2009 to 2011 environment.

Steve Barger:

Right

Brian Kenney:

So, I think, as Bob said, we have some runway here.

Steve Barger:

In terms of -- I hear you on the lead time from the OEMs still being far out, but as you've been out in the market -- just looking at new cars, if you've put any quote activity out there, has there been any decrease in the new car pricing on the tank car side, or is that still staying firm?

Brian Kenney:

No, it's firm.

Steve Barger:

Okay. You added a little over 2,000 cars in the quarter. Were some of those from secondary deals, or did you just take a higher number of new cars this quarter?

Bob Lyons:

We did have a couple of secondary market deals where we bought railcars in the market. About 800 of those cars were from the Trinity order -- so the committed order that we have. And the balance, a number of those were on the secondary market, including a distribution from our Southern Capital joint venture, for about 400 cars. They had been jointly owned before, and now we own those 100%.

Steve Barger:

Okay. Last quarter on the call, we talked about the increase in non-traditional or new buyers coming into the market. Over time, if industry perceptions change about the attractiveness of owning cars for some of those guys, do you think there may be an opportunity at some point to do a sale-leaseback or to buy some of those cars, and lease them back to those companies, if they may want to get them off their balance sheet? Have you ever thought about that or talked about it with any of those companies?

Brian Kenney:

You're talking more about customers buying cars?

Steve Barger:

Yes. People that are buying cars right now -- that for the short-term opportunity, that they may not want that car in the future.

Brian Kenney:

Yeah. Depending on the car type and what service, definitely. In fact, we do a lot of business with our existing customers. It's a focus of ours, because a lot of the big ones own and lease from a number of other lessors, and we are constantly focused on how can we price some of those cars out of your hands. So, we do do sale-leasebacks with existing customers, yes.

Steve Barger:

Okay, great. My last question. You talked about grain cars a little bit already, but as I look at -- it seems like a lot of acres have been planted this year, the weather seems fairly favorable for growing. Do you expect that that's going to drive rates further down through the year or in the next year, and can you talk about the state of the grain fleet in general? Has it been underinvested in? Do people need to buy cars, and where are we in that overall fleet?

Brian Kenney:

No. I think it's still in a period of oversupply right now. And, I think, despite the good harvest this year, I think we probably won't see any strength -- that's what our fleet guys are telling us -- until probably next year. As the excess starts to go away, there's attrition in the fleet, the stockpiles come down. So they're really looking at probably a stronger market next year.

Steve Barger:

Got you. Okay, thanks. Thanks for the time.

Operator:

And from Longbow Research, our next question comes from Matt Brooklier.

Matt Brooklier:

Hi, thanks. Good morning. Can you talk to your CapEx expectations for 2013?

Bob Lyons:

Sure. We came last year, just to kind of level set, we did, we had $777 million, exactly, of portfolio investments last year. Coming into this year, we had about $450 million committed, with the balance being discretionary investments that we would look to make during the course of the year. So, we felt a good year this year would be back in that $700 million to $800 million range, and through the first six months --

Jennifer Van Aken:

Over $470 million.

Bob Lyons:

Yes. We've had a very solid first half of the year. I would point out that roughly $100 million of the $470 million was for the split of the joint venture that we did. We talked about in Portfolio Management, where we split that marine investment --

Matt Brooklier:

Right

Bob Lyons:

-- so that won't repeat. But all in all, on course to be up in that range that we thought, coming into the year.

Matt Brooklier:

Okay, relatively healthy year. And then, repurchase some stock in the quarter. How should we think about share repurchases, going forward for the remainder of the year?

Bob Lyons:

Sure. Well, currently under the existing authorization, we only -- we have just less than $20 million left, under that existing authorization. So that had originally been $200 million. So over the course of the last few years, we've -- we now are very close to fully utilizing that authorization for opportunistic repurchase, and that's something that, the extent to which that authorization gets increased or addressed again will be a Board-level discussion, at the right time.

Matt Brooklier:

Okay, and you've talked to, obviously, the tank car market. We talked a little bit about coal and grain cars. Has there been any change outside of those car type categories? Has there been any change, in terms of demand in the second quarter? Or if you look in the second half of this year, is there some momentum in other railcar types that we have yet to talk about?

Brian Kenney:

I don't think there's really much to mention, other than what we've already talked about.

Matt Brooklier:

Okay

Bob Lyons:

Yes, I'd agree. Nothing noteworthy.

Matt Brooklier:

Okay. We've heard the story, Bob, about the covered hoppers for plastic pellets, but I'm guessing that's a little bit of an out-year story. Have heard of some construction-related equipment that's starting to pick up -- just curious if you're feeling the same thing.

Brian Kenney:

Well, we'd agree with your comment on the hoppers and the plastic pellets being more of a long-term positive. Center beams' a good example of something that looked a lot better earlier in the year, the rails started to add some. They may have gotten out a little ahead of themselves -- that's leveled off little bit

Matt Brooklier:

Okay

Brian Kenney:

But it is stronger, for sure, than it was a year ago. Car-type by car-type, I think we've hit most of them. There's a little weakness in steel cars right now. So once again, it's a choppy market from a freight car side, and as I've said, it certainly doesn't feel like the peak there.

Matt Brooklier:

Okay, that's helpful. Thank you.

Bob Lyons:

Thank you.

Operator:

At this time, there are no further questions in the queue. I'll turn the call back to you Ms. Van Aken.

Jennifer Van Aken:

Thanks everyone for your participation on the call this morning. I will be available this afternoon to answer any additional questions. Thanks.

Operator:

Ladies and gentlemen, that does conclude today's presentation. We thank you for your participation.