GATX Corporation

2019 First Quarter Conference Call — April 24, 2019

Operator:

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

Jennifer McManus:

Good morning, everyone, and thank you for joining GATX's 2019 First Quarter Earnings Call. I'm joined today by Brian Kenney, President and CEO; Tom Ellman, Executive Vice President and CFO; and Bob Lyons, 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 2018. GATX assumes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

Before I provide a brief commentary on the quarter, I'd like to remind everyone that our Annual Shareholders' Meeting will be held on Monday, April 29. It will be in downtown Chicago at the Willis Tower, and the meeting begins at 12:00 p.m. Central Time. Slides from Brian Kenney's presentation will be posted to our website at www.gatx.com.

Earlier today, GATX reported 2019 first quarter net income of $41.5 million or $1.12 per diluted share. This compares to 2018 first quarter net income of $76.3 million or $1.98 per diluted share. Our first quarter results are reflective of an operating environment in Rail North America consistent with our expectations coming into the year. Rail North America's fleet utilization remained high at 99.4% at the end of the first quarter, and our renewal success rate was 83.6%. During the quarter, the renewal rate change of GATX's Lease Price Index was positive 5.2% with an average renewal term of 39 months.

We continued to successfully place new railcars from our committed supply agreements with a diverse customer base. We have already placed over 8,200 railcars from our 2014 Trinity supply agreement and over 350 railcars from our 2018 Trinity supply agreement. Additionally, we placed over 760 railcars from our 2018 ARI supply agreement. Our earliest available scheduled delivery under our supply agreements is in the first quarter of 2020.

During the quarter, Rail North America's remarketing income was approximately $9.8 million. As noted in the earnings release, our 2019 full-year remarketing expectations remain unchanged from prior guidance.

Within Rail International, the European railcar leasing market remained strong. GATX Rail Europe is seeing steady demand across the fleet with utilization at an historic high of 98.9%. Rail International's investment volume was approximately $33 million during the first quarter.

Portfolio Management's results were primarily driven by the excellent operating performance of the Rolls-Royce & Partners Finance affiliates. We are expecting 2019 to be another excellent year for investment volume.

American Steamship Company's sailing season started in late March, and they are off to a good start on the Great Lakes. We anticipate 11 vessels in service in 2019.

GATX investment volume in the quarter was approximately $147 million. We were also active under our share repurchase authorization during the quarter, buying back more than 529,000 shares for approximately $40 million.

Those are the prepared remarks. I'll hand it over the operator so we can open up for Q&A.

QUESTION AND ANSWER

Operator:

(Operator Instructions) We'll take our first question from Allison Poliniak of Wells Fargo.

Allison Poliniak:

Hi, guys. Good morning. Can we touch on maintenance and what are your expectations? Are you still in that high single digits for the year? How should that trend throughout the quarter -- the next few quarters?

Bob Lyons:

Sure, Allison. Good morning, it's Bob Lyons. So, we came into the year and -- I believe back in January, Tom and Brian and Jen laid out that maintenance expense would be up 7% to 10% in 2019 over 2018. That was due to a combination of increased activity and also increased compliance activity that we have scheduled for the year. Through the first quarter now, that guidance of plus 7% to 10% for 2019 remains intact. I think we're on track for that. And we had a fairly good quarter in terms of tackling some of the compliance work that's on the docket for the full year.

Allison Poliniak:

Great. And then could you remind us, the North American Rail, that other revenue, what's in there? It was up pretty sizably from a year ago. I just -- trying to figure out what drove that this quarter.

Tom Ellman:

Hi, this is Tom Ellman, and I'll comment on that and then I'll turn it over to Bob for some additional color. Primarily, that relates -- that increase relates to two separate items. The first of which is that we had some cars that came back with considerable damage caused by the customer and the -- part of our lease provides us with the ability to recover those costs. We actually ended up scrapping those cars. So, if you look down in the scrap line, you'll see that, that actually was a net loss for the quarter, which is unusual for us and driven by those cars.

The other part of that increase or the other half of that increase, is due to some revenue that we received related to maintenance. Some of the maintenance that comes into our shops is either customer responsibility as part of the full-service lease or something the customer asks us to do, and we're able to rebill that to the customer. I mean, that comes in on a very lumpy basis, not something that you can predict accurately quarter to quarter.

Bob Lyons:

Yeah, I think Tom covered it very well. That customer liability revenue, or repair revenue, is really dependent on the volume of work and the content and so it can bump around quarter to quarter. And the only other comment I'd make with regards to the penalty payment received, as Tom mentioned, it was largely offset by a scrap loss. So, from a segment profit standpoint, you had two separate line items with an unusual level of activity, but really net-net, no real impact on -- no material impact at all on segment profit or EPS for the quarter.

Allison Poliniak:

Great. That's helpful. And then just last -- LPI turning positive, good news. Is there anything that skewed that number? Was it a car type mix? I know that the average term came down as well. Any color there that you can give us?

Brian Kenney:

Actually, Allison, it's Brian. I can take that one. So, we did expect the positive change in the LPI during the first quarter. But once again, as I said in the past, the LPI change is not a great quarterly measure because it frequently exhibits quarter-to-quarter volatility and that really depends on the volume of various car types in the LPI that renew in a given quarter. And that's exactly what happened in the first quarter. So, as an example, we had some coal renewals -- a very small number of coal renewals that came off very low rate leases that were renewed at a couple of hundred dollars a month, which of course is a huge percentage increase. But it gets -- even though it's a small number of renewals that gets put into the LPI according to the weight of coal cars in our fleet. So, that's why we always say disregard it for the quarter; it's better to look at it annually because of the law of larger numbers. And I'd say we're right where we said we would be coming into the year.

Allison Poliniak:

Great, thanks. That’s helpful.

Operator:

We'll take our next question from Justin Long of Stephens.

Justin Long:

Thanks, and good morning. So, I wanted to start with a question on the sequential trend you've seen in lease rates overall and then what that trend looks like in tank and versus freight cars as well. I think the guidance at the start of the year was for a stable rate environment in 2019. So, just curious if your outlook on that front has changed?

Bob Lyons:

Good morning, Justin, Q4 to Q1, overall, lease rates were essentially flat, but we'll take it separately. Tank was positive, Q4 to Q1. For that to occur, we need stable demand, which we had from our customers on the tank car side. We also have a relatively extended backlog in terms of tank cars to be built, so the next available space, really, if somebody wants new tank cars is early in 2020 -- that's across the industry. So, for tank cars coming up for renewal, we have a little bit more leverage in pricing. And we've seen that in positive lease rate movement Q4 to Q1 and really broad based across the tank car fleet, not concentrated in any one particular car type.

Freight's been more challenging. Rates have been -- Q4 to Q1 are down a little bit. We see a little bit more hesitancy or cautiousness, I would say, among the freight car customers, and the backlogs aren't nearly as long, so you don't have that same leverage that you might on the tank car side.

Justin Long:

Okay, that's helpful. And then kind of going back to the 2019 guidance. I know the EPS outlook didn't change, but I was curious if there were any moving pieces within that outlook that changed significantly that you'd highlight? I know you've mentioned remarketing -- the outlook there is unchanged and maintenance should still be up 7% to 10%. Is there anything that you would note that's changed versus what you've expected at the start of the year?

Tom Ellman:

Justin, this is Tom. And the short answer to that question is, no -- that we expect quarter-to-quarter variation in several items, but our overall expectation for the year remains unchanged.

Justin Long:

Okay. And then just lastly, I wanted to ask about the announcement we got last week with Greenbrier purchasing ARI's manufacturing business. Does that have any impact on the long-term order that you placed with ARI last year? I'm just curious if that commitment will all transfer to Greenbrier after that deal closes? Or, if you have an option to alter that agreement because of the change in control?

Brian Kenney:

Yeah. Justin, it's Brian. I can handle that and let Tom chime in since he did negotiate that agreement. But we anticipated a change of control transaction might be possible when we were negotiating the ARI supply agreement. So, with that possibility in mind, we sought terms that would protect us from a supply and cost perspective in the event of a change in control. So I would just say we're covered contractually in those areas that the Greenbrier deal was consummated.

Tom Ellman:

Nothing really to add. I think Brian covered it.

Justin Long:

Okay, great. That’s helpful. I appreciate the time.

Operator:

Thank you. We'll take our next question from Mike Baudendistel of Stifel.

Mike Baudendistel:

Thank you. Just wanted to ask you if the railroads in the last year or so being more aggressive about imposing accessorials for holding onto pieces of equipment, and now the STB is having a hearing on the accessorials, maybe cracking down on that. Is that the type of thing that's impactful enough to be meaningful on your business?

Bob Lyons:

We haven't really seen any significant impact in terms of car demand from our customer base. Clearly, there is a consternation among certain customers, users of the rails, some dissatisfaction for some of the challenges that have come about through implementation of PSR. But as it relates to our business, no significant change.

Mike Baudendistel:

Got it. And then wanted to ask you, on your balance sheet, you have this quarter listed the rights-of-use assets that you're leasing. Can you just explain what those are, since that's a new thing?

Jennifer McManus:

Hi, Mike. Yeah, that's actually related to the adoption of the lease -- the new lease accounting standard as of 1/1/19. So the right-of-use assets there is -- it represents all of our leases as a lessee -- all of our operating leases as a lessee. And what you should note there is that the majority of those are sale leasebacks that we had historically been disclosing in our off-balance sheet disclosures. So, what you'll really see is a flip from that to now it's on our balance sheet. There's a little bit of a difference because now we also have a right-of-use assets for other leases. For example, corporate office headquarter lease would be on there as well.

Mike Baudendistel:

Got it. That makes sense. Thank you.

Operator:

We'll take our next question from Matt Elkott of Cowen.

Matt Elkott:

Good morning. Thank you. I just wanted to dig a little deeper on the tank car front. I think the last time we talked about the DOT-117s, you guys had maybe a couple or a few thousand of those. I was just wondering if you added any or if you have plans to add any as part of your agreements with Trinity or ARI. And since you have secured this capacity, how that positions you guys over the next couple of years? It looks like the lease rate outlook for tank cars is looking good for the foreseeable future.

Bob Lyons:

Matt, it's Bob Lyons. So, for any tank cars we'll take delivery of, they'll be the state-of-the-art DOT-117Js. We will continue to spread our new car deliveries across a number of different car types, commodities and end customers. We don't anticipate, nor would we be well served by trying to predict any specific commodity market and development and weight -- and go heavily into one particular car type. I think you know that's not our strategy. It's not served anybody well in the industry over the years. Our fleet remains highly diversified. We'll continue to add lots of different tank car types.

And again, we are in good shape both with the ARI and the Trinity orders running through 2023. We have ample access to the tank cars. We'll need roughly 2,400 a year between those two orders plus some freight cars on top of that, and the ARI order put us in a real good delivery position with a lot of flexibility.

Matt Elkott:

Okay. That's helpful. So -- can you can give us the number that you have in the fleet right now? The DOT-117Js, is it still around 2,000 cars?

Jennifer McManus:

We have about 2,400, Matt.

Matt Ellkott:

2,400. Yeah. Okay. And I know the -- to retrofit a CPC-1232, it doesn't really cost that much, only $5,000 or $6000. Is that something that you guys will not consider? You'll stick to the DOT-117Js?

Bob Lyons:

Our retrofit activity has been fairly limited. And...

Tom Ellman:

Yeah. So for the -- I just want to be sure we know what you're talking about there, Matt. So for the -- for a legacy car, we have stated several times that we have no plans to retrofit those.

For the CPC-1232, you've got to differentiate between the jacketed car and the non-jacketed car. The jacketed car is a relatively inexpensive retrofit and not only do we plan to do those, we have done those. The non-jacketed car is a much more expensive retrofit, and we've commented that we'll take a look at that, depends on individual situation.

Matt Elkott:

Okay. And ...

Bob Lyons:

I'd also add ...

Matt Elkott:

Yes. Go ahead.

Bob Lyons:

I'm sorry, Matt, I was just going to say, I'd add, relative to the industry where there have been, as Tom mentioned, there actually have been legacy cars retrofit, we have done none of those compared to roughly 10,000 done by others.

Matt Elkott:

Got it. And just one last question. Can you remind us how many cars you have coming off lease this year? And I don't know if you've provided it before, I don't think you have, but if you can give us a breakout of how many of those are freight versus tank?

Bob Lyons:

Through the balance of the year, we have about 15,000 cars left to renew roughly, and it's split relatively evenly between tank and freight. And no significant concentration in any one particular car type within either of those categories. And I'd add, a very low exposure, whether it be some of the more challenged car types, such as crude or sand or ethanol, the numbers are very, very low.

Matt Elkott:

Perfect. Thank you very much.

Operator:

Thank you. We'll take our next question from Steve O'Hara of Sidoti & Company.

Steve O'Hara:

Hi, good morning. Just on the -- your comments about utilization being extremely high, I'm just curious. I mean, you expect utilization to fall and maybe that's related to expecting maintenance to go a little higher throughout the year?

Bob Lyons:

No, we would expect utilization to remain relatively high. You might see 0.5 basis -- 0.5% or 1% tick off of that depending on what happens here in the second half of the year. But we anticipated, coming into the year, utilization will remain in the high 90s; it has. And that's already been factored into how we thought about the overall maintenance expense -- net maintenance expense going up 7% to 10% for the full year.

Steve O'Hara:

Okay, okay. And then just on the -- I guess, relative to your comfort level around the order book that's out there and then the cars in storage, I mean that's ticking up. I'm just wondering about your feelings around those items. I mean, I think maybe a year ago, you guys were fairly downsy about the order book that was out there and relative to demand in cars and storage. I mean, it seems like it's been pretty much a 180 on that front in terms of the commentary that I've heard. I mean, which would seem pretty positive. Is that -- am I reading that wrong?

Bob Lyons:

Yeah. I wouldn't necessarily say it's been a 180. I mean, our concern has always been, and continues to be, that the backlog can get extended out. That there -- despite an environment here over the course of the last 6 or 7 years where rail traffic -- car load traffic, has been relatively flat, we've continued to have net fleet growth every year. That makes it challenging in the lease market for sure.

And if you look at the number of cars in storage, this quarter, again, it ticked up a little bit. We believe a good number of those cars really are related to sand. Again, we don't have a big exposure there. And it would be a little bit difficult to look just at this first quarter number in terms of the industry cars in storage because we also had a lot of weather impacts during the course of the quarter which slows down some of the movement of those cars and they could tick into the idle category, even if they're on lease and in use.

Steve O'Hara:

Okay, all right. Thank you. And then maybe just last one on the asset disposition gains. There's no change in your outlook there. I think it was approaching 2018's level. Is that still the right way to think about it?

Bob Lyons:

Yes. Secondary market remains very active, especially if you have high-quality assets on good leases with good customers. We're continuing to see a lot of interest. And, fortunately, GATX has a lot of that. And -- so we continue to see very good interest in the assets we're putting out in the secondary market.

Steve O'Hara:

Okay, thank you very much.

Operator:

(Operator Instructions) We'll take our next question from Matthew Brooklier of Buckingham Research.

Matt Brooklier:

Hey, thanks and good morning. Bob, you mentioned that the secondary railcar market is relatively healthy here. And you guys reiterated your expectations for gains on sales. For the year, can you give us a little bit of color? And I know this is difficult. Obviously, it depends on when portfolios are out in the market when they get acquired. But, any sense as to the asset disposition gains when those are potentially booked through the remainder of this year?

Bob Lyons:

It's difficult to predict on a quarterly basis. I would look at the next three quarters on a fairly ratable basis. But it can move around depending on other portfolios that are in the market, the level of activity and interest and desire, expediency to close from some of our buyers. They move around a little bit, but I think probably trying to think about that ratably over the next three is probably reasonable.

Matt Brooklier:

Okay. Is it fair to say there is more interest on the tank side of things versus freight cars just given kind of the other trends that are happening right now?

Bob Lyons:

No, not necessarily. We tend to sell more freight cars than we do tank cars. And there you have a bigger universe of buyers for those cars. Tank cars tend to be more complicated, more service oriented. And so you normally have a bigger buyer universe on the freight side.

Matt Brooklier:

Okay, that's helpful. And then any weather impacts in the quarter? I think most likely you would have called it out in the press release, but any weather impact in the first quarter and maybe in second quarter, considering the flooding that we have right now in the Midwest?

Bob Lyons:

Well, I'll answer on the rail side. Nothing in particular, but if -- clearly, if you listen to the Class I railroads and read their reports, they had tremendous weather challenges in the first quarter, whether it'd be record cold and snow and then flooding. So there were a lot of challenges and hence an environment where we feel like -- the underlying demand feels very consistent with where we were in the fourth quarter, no significant change. Even with that, car loads on a year-over-year basis, or sequential basis for the Class Is, were down. A good portion of that is weather related. But as it relates to our business specifically, no. On the rail side, I'll let Brian comment on ASC.

Brian Kenney:

Yeah, the other place you see weather impacts is that American Steamship with ice, especially as you come out in spring. They are experiencing delays, especially in Eastern Lake Superior and Eastern Lake Erie, but 7 vessels went out in March and the rest got out in April. So we're in good shape now.

Matt Brooklier:

That's good to hear. I appreciate the time.

Operator:

We'll take our last question from Justin Bergner of G. Research.

Justin Bergner:

Good morning, Brian, Bob and Tom. Just to start -- if railcar loadings remain somewhat anemic for this year, what is the key driver that's sort of going to allow utilization to stay in that 99% level?

Bob Lyons:

Well, we came into the year expecting at least on our -- from our standpoint, fairly stable carload activity. So, our high utilization or expectation for high 90s utilization already baked in a fairly benign carload market. The key, Justin, as you know, is having the fleet that we have highly diversified across car type, customer and commodity on long-term lease and having no significant exposure to one particular car type in any given quarter or year, as they roll over has put us in a very good position. It's always been our guiding philosophy, it continues to be the case, and we work really hard for those renewals. It's a challenging market, less so on renewals than on new car placements.

But still, you have to work very hard, you have to have strong customer relationships and great maintenance and service to back it up. That's -- the success of our commercial organization has enabled us to keep that utilization high.

Justin Bergner:

Okay, that's very good and helpful. With respect to the tank car lease rates -- if you can't line up a new lease until the first quarter of 2020, at least with GATX, why are tank car lease rates climbing even more sequentially? Or are most people sort of who have needs before 2020 are already kind of set with those needs

Bob Lyons:

I just want to clarify -- that's for a new car placement. Our next new car availability is in the early part of 2020, March and April of 2020. So, we can't allocate new cars to anybody today.

Cars that are rolling over that are up for renewal because of that and because that's also a bit of an industry phenomenon too, there's no new car near-term availability. If somebody's rolling over a lease today, they don't have a lot of alternatives, they can't go get new cars to replace an existing car. So, you get a little bit more leverage on the lease rate discussion.

Justin Bergner:

Okay, got it. But that wouldn't sort of jibe with an even higher increase sequentially in tank car lease rates?

Bob Lyons:

Well, our customers are pretty -- yeah our customers are pretty savvy. And they lease from others. They also may own their own cars. Just like we don't want to be beholden to any one car type or customer -- typically, they don't want to be held hostage by any one lessor. So, they're pretty smart about how they ladder their maturities and how they diversify their suppliers. So, we don't have unfettered right to go raise rates or ability to go raise rates without doing some damage or taking some utilization risk.

Justin Bergner:

Okay, understood. With respect to the repurchases, it was a pretty healthy number this quarter. Was any of that sort of catch-up for some of the blackout periods last year? Or anything driving the sort of higher run rate repurchases?

Tom Ellman:

So, for last year our guidance going into 2018 was we expected to be somewhere in the $100 million range, this is for 2018, and we ended up coming in at $115 million. You're correct that we were blacked out in the middle of the year, but we did more at the end of the year to catch up for that.

For 2019, we expect to be somewhere in the $150 million range. And so our $40 million that we did in the first quarter is sort of right on line with that expectation.

Justin Bergner:

Okay, great. And then lastly, any comments -- outside your specific contract with ARI. Any comments, sort of, on how if the -- assuming the Greenbrier-ARI deal goes through, how it, sort of, might change the dynamic for the leasing industry longer term?

Brian Kenney:

Yeah. Justin, it's Brian. Really, it was just announced last week, so we're just looking at it now, looking at the numbers and trying to determine what the long-term effect it would have on GATX, if there’s any. So it's too early to tell. We don't know if the deal is going be consummated. So let's -- more to come.

Justin Bergner:

Alright, thanks.

Operator:

At this time, we have no further questions. I'll turn it back to Jennifer McManus for closing remarks.

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. This concludes today's conference. You may now disconnect.