

Company Name: GATX Corporation (GATX)
Event: Stifel 2023 Transportation & Logistics Conference
Date: February 07, 2023

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

All right. So next up we have GATX and very excited for this one. I think at least in a number of years, this is the – this – well, this is the first time in a number of years you guys have been back at our conference. And so, first of all, thank you very much for that.

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Thank you.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

But maybe most people are going to be familiar, but maybe it would just – we could just start out with a quick rundown of who you are and what you do, and then we'll dive into the specifics.

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Sure. So first of all, my name is Tom Ellman. I'm the CFO of GATX, have been with the company for about 26 years, the last five of which as CFO, part of that I spent five years leading the North American Rail business. Do you need to rundown of GATX or just...

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Sure. Well, however you want to do it.

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

And GATX, if you're not familiar, has been around since 1898, started out a railcar leasing company, have been in a variety of other businesses since that time, but always sticking to the core. We have a little over a hundred thousand railcars in North America, but another 28,000 in Europe, about 6,000 in India. And then we have a joint venture with Rolls-Royce that leases about 400 aircraft spare engines. And then recently GATX started investing in engines for our own account. We own about 19 engines, valued at a little under \$500 million.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Perfect. So we were just or I was just in the rail intermodal session and there was a lot of conversation about how the rail – how and if rails are going to be able to actually grow. It's been a long time since you've seen railroads grow. You guys are forecasting a 10% increase in EPS, which I assume is not all sort of below the line stuff, right. So how is it that a company like

GATX can grow in an environment, first of all, that's pretty choppy from a macro level, but then secondarily in a rail industry that is not growing either?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yes. So we took people through how we were going to achieve our planned growth in 2023, walking through each of our segments. So as I just mentioned, our largest segment is Rail North America. Growth there is going to be driven primarily by what we see is continued increased lease rates. For the past 10 quarters lease rates in North America have gone up on an absolute basis. And the primary driver for that increase is the fact that shipper fleets are running very, very tight right now. And if someone is reluctant to give up a railcar, which they are, it really allows us to take those lease rates up and we think that environment is going to continue to be pretty strong in 2023. We're obviously going to have some headwinds from interest rates, but we're also going to see a continuation of the strong secondary market that we've seen in North America.

Last year, 2022, we had over \$100 million of gain on sales from railcars, and we expect that to be similar in 2023. So the combination of that strong lease rate environment and strong secondary market should overcome some of the headwinds in North America, but that's only part of the story. We also expect to see increase from our Rail International segment. I mentioned the relative strength of Rail North America, but if anything things are probably even stronger in the other two rail segments. In Europe, we expect to see continuation of a couple trends, which have been positive. Number one, in Europe, little bit ahead of North America, as far as the green movement, and trying to take traffic from the roads and putting it on the rails. But perhaps even more importantly are the supply-demand dynamics in Europe.

In North America, the industry has the capability to build about twice the replacement level. So the replacement level is something like 35,000 to 40,000 cars, and the industry can build on the order of 80,000 cars if going full out. So there is the potential to overbuild, which has driven the cycle historically. In contrast, in Europe, you don't have that. The replacement cycle is about 10,000 to 15,000 cars a year, which is also what the European rail market can build. So even through COVID you saw lease rates increase. And despite some of the challenges macro-economically in Europe, you have that same dynamic continuing. So we expect continue to increase lease rates.

In India, the growth is really driven primarily by our ability to continue to add assets. We started in the Indian market in 2012. GATX was the first company to introduce private leasing in India. Prior to that, all the cars were owned by the Indian Railways. So we worked with the Indian Government and the Indian Railways to introduce private leasing. It took us about five years to get to a thousand cars from 2012 to 2017, and we've been adding a thousand cars or more per year since then. So we're up to just under six thousand cars. We expect to add another thousand or two next year, so that rail international piece will also contribute growth.

And finally, Portfolio Management, which consists primarily of our aircraft spare engine leasing, two components. One will be our joint venture with Rolls-Royce. When COVID first hit, we told people we expected the industry to get back to pre-COVID levels in terms of passenger traffic

for wide-body engines, which is primarily what our fleet consists of, engines that serve international wide-body traffic, to get back to pre-COVID levels in the 2024 to 2025 timeframe. We still expect that to be true, and we're making progress. For 2022 passenger miles were about 28% below pre-COVID levels. So, we're on the right trend.

And those engines that I mentioned that we invested for, for our own account, we did five of those engines right at the end of 2022. So the full year impact of that investment will be another contributor. So it's really between what we see in Rail North America and the other parts of our businesses that's going to allow us to achieve that growth.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

So to that end, as you look at it, maybe – and this is always a question I think I like to ask people is how could you be wrong? Not trying to poke the bear here, but, you said people are very reluctant to let a railcar go, but in a weak environment, is that still hold or on the flip side, I mean, what are things that maybe you feel like, well, we didn't put this into our guidance, but if fingers crossed.

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah, so I want to differentiate because I want to differentiate between what could change 2023 financial results versus what are the kinds we look at – kinds of things we look at from an economic perspective. Because most of the things that could be different that would have an economic impact won't really hit until 2024 or beyond. So you mentioned the lease rate phenomenon. We have over 100,000 railcars in North America, but only about 20,000 expire in any year. So that means 80,000 of them, nothing's happening, they're just continuing to earn the same rent.

So we will definitely look at things like what's going on in the market, because the cumulative effect of that, those lease rate changes can be very powerful. But it's not something that's going to particularly move the needle in the near-term. Likewise, from a maintenance perspective if some of the initiatives that we've had to take maintenance activity and put it in our own service centers as opposed to the third-party network, which are, which can be done at a lower cost and more reliably than with the third-party network.

If that were to, we were unable to continue that, that would be something that would have an impact over the long-term, but not so much in the current year. In the current year in 2023, the main thing that could swing is the timing of those remarketing activities. I mentioned in Rail North America that we did 100 million – had \$100 million of gains on asset sales in 2022 and expected a similar level. Those are notoriously lumpy. They don't happen in a very programmatic and predictable way. So if we were wrong about the timing there, that would be something that would be more likely to impact the financial results.

And all those things can, can also work the other way. So you mentioned some of the conversations you had about the railroads. If there was this pivot to growth that people have been talking about in the wake of precision scheduled railroading and you actually saw an uptick in

loadings, that would be a very powerful, very good thing for dynamics in rail car leasing. And over time, you'd see a really powerful impact there, but it would take a while for that to work its way through the financial results, but seeing loadings go up and perhaps an even bigger increase in lease rates or more investment dollars would be something you'd look at in 2023.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Okay. So I guess maybe related to that and related to the fact that we're sort of in a little bit where we are in uncertain times railroading is a cyclical business. You're assist, you're connected at the very hip to railroading. Maybe talk through capital allocation, you're going to spend a lot of money. How do you contemplate or execute your capital program longer-term, but specifically now, what are you thinking about the right home for your – for the cash flow that you do generate?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah. So if you look historically, GATX typically invests somewhere between \$600 million and \$800 million a year. But over the last three years, that's been over \$1 billion a year. And we announced on our last earnings call that we expect us similarly to be above \$1 billion for 2023. And we're really doing that in all the different parts of the business.

The biggest piece is in Rail North America where our biggest amount of investment is through our dedicated supply agreements, long-term supply agreements, where we purchased 3,000 cars a year from Trinity. And that is buying space and then determining, which individual car type you buy as you work your way through the program.

In addition to that, we buy new cars in the spot market and we buy existing cars with leases attached. And this activity should be helped by some of the financial challenges. Typically, when interest rates are a little higher, people are a little more reluctant to put capital to work. That's the kind of environment that GATX typically does a little better investing.

And then the other pieces of investment are those areas I mentioned, the non-North American parts of the business, continues to be real attractive opportunities to put capital to work in Europe for the reasons I talked about. Specifically in Europe, you'll probably also see us put more capital to work on freight cars than tank cars.

Our European business has historically been more tank car focused. But a few years ago, we started really trying to deploy more capital on the freight car side, and we've had a lot of receptivity to that, because the two biggest players for freight cars in Europe are Ermewa and VTG and then a big falloff for number three. So a lot of customers are looking really like the idea of an another freight car alternative. So we'll keep doing that. I mentioned the new cars in India and then looking for additional opportunities to invest in aircraft engines for our own account we think will continue to be available. So all those sources are what should allow us to outperform from a capital perspective on what we've done historically.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Maybe keeping in line with that, have you – has the increased interest rate environment and economic uncertainty, are we at a point yet where some of those really juicy opportunities are starting to present themselves? Or do we need a little bit more blood in the street type situation before you think they become more enticing?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah, no. And really I want to differentiate because there's two different ways that you can think about portfolio acquisitions. There's every quarter leasing companies put out a book of rail cars with leases attached. GATX does it, our competitors do it, and those get purchased by people looking for different parts of the portfolio. That part of the market has been very strong for the last several years.

All indications are, it will continue to be, it's a key driver of what we've done on the asset sales side and also a source of investment on the other side and really don't see any particular change from what we've seen in the last couple years. When you talk about – I think you're alluding to more bigger portfolios, calling the ball exactly when that happens is virtually impossible.

If you look back to the Great Recession is guidance. GATX did a lot of investment right as we came out of the Great Recession did a lot in 2010, particularly with some of the Australian players that were exiting the market. We helped them to exit. And part of looking back with hindsight is people didn't really want to sell at the bottom. So by 2010 you could see the things were getting better, but still remembered the pain of the bottom.

This could be the kind of environment we're in now. I mentioned some of the strength of that existing car market. There are some reasons for optimism and perhaps anybody looking to sell could think, okay, maybe things are getting a little better. Maybe now it's a time, but that's pure speculation and really hard to say when something might actually happen.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Sort of sticking with that capital deployment part of the conversation. This is very capital intensive business and capital within the last six, nine months has gotten substantially more expensive, particularly on the debt side. How does that impact your investment decisions? And then likewise, how does it impact your ability to – or the competitive nature of the environment?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah. So, GATX really took advantage of many, many years of low cost of debt. Going back all the way to 2008 we took our average cost of debt from over 6% to under 4% today. We also termed out that debt took it from under four years, then to over eight years today. And we only have about 10% of our debt that's variable rate. So it's almost all fixed rate. And then our assets, less than 5% of our assets are encumbered. So it's almost all unsecured debt, so certainly have put ourselves in a position to be able to pursue opportunities.

When you think about what is high interest rate mean, there's good and bad, but for our business, net anything that makes a new car more expensive is good. If a new car's more expensive, people are a little less likely to build them, makes the existing assets worth more. It also makes the lease rate for a new car higher, which provides a ceiling on what an existing car lease rate can be, so another good opportunity.

On the investment side, clearly it makes your hurdle a little higher, but it makes everybody's hurdle a little higher so you don't feel like you're at a relative disadvantage. And then it can even help because for a customer that's debating that buy versus lease decision, this can help push them a little bit more towards the lease side. So most importantly, we feel like we're well positioned in this environment, which can generally lead to some opportunities to be able to pursue them.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

I want to back up to something you said a few questions ago as I was sitting here thinking about it. You mentioned the possibility of upside in the event that there truly is a pivot to growth. Have you seen any early indications to that in your business? Are people being willing to wear risk in that way?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah. So maybe not everybody knows, but the majority – vast majority of GATX's customers are shippers as opposed to the railroads themselves. And so most of the information we get on this topic is really what we're getting from our shipper customers. And I would describe the general sentiment as very much a show me perspective from the shippers, and what they really talk about more than pivoting to growth is, what's happening with rail service, right? Is it actually getting better? And these kinds of things that would make it better would be hiring more people, having more yards, doing things that would also be along the lines of a pivot to growth. And so I certainly would tell you we're here people talk about it. I would not say we're at the point where most of our shipper customers are telling us that they're actually seeing it.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Right. Okay. Well, that's a good data point for me there. Now sort of back in line with where we were or one of the things that you mentioned in area that you've been able to be successful is, is in your maintenance schedule. Just maybe could you talk through that? Have things fundamentally shifted for you? Or you're thinking about and doing things in a different way? Or maybe talk through that maintenance side of the business bit?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yes. So, over the last several years, we've seen our cost of maintenance go down. And the primary reason for that is, we made a lot of investments and a lot of process changes to allow our facilities to put more cars through them, to do more of the work in our own facilities. And on an incremental basis, that definitely helps you from a cost perspective because a lot of the cost in

those facilities are fixed. So the marginal cost of doing one more car is very low, but even on a fully costed basis, the cost to do maintenance in our own facility is lower than it is in the contract network. Probably more important than that though, is the commercial benefit. When customers are thinking about they have too many cars, they don't need to return cars to somebody, they certainly first and foremost think about what are my lease rates?

So, we have to be cost competitive. But once you're cost competitive, they think about things like service. And because we control our own maintenance, we can very reliably tell a customer when they're going to get that car back. So, if, and they're going to get it back more quickly than a lessor who has to use a third party provider. So as long as we price to market, that's one of the key things that really keeps GATX's utilization so high. For the last 10 years, we've been at 98% or 99% every year, even in the great recession, we only got down to 96%. And that, that service capability is really a key one as far as how much more we can get out of it.

One of the challenges that everybody's facing right now is inflation is going up. So we're going to have that headwind to overcome and what – and there absolutely is more we can do, more investment we can make, more process improvement we can do to drive even a little bit more work through our own facilities. But I think because of that offsetting pressure of inflation, it's probably going to be a case more of what can we do to keep that cost from going up too much as opposed to the last few years where you've seen it actually come down.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Okay. So the – in addition to, as we're focusing on things where there could be upside. You'd mentioned both India and then the aircraft engine leasing business. You're putting on – you are thinking cap here a little bit and saying, all right, well, five years, 10 years down the line, strategically where do you want GATX to be positioned as a company and maybe within those two growthy aspects of the business, how do you see that evolving?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah, so, one of the important things we do is we really avoid arbitrary goals along the lines of, let's get the Indian market to x number of cars. We are really motivated to do two things as a management team to put capital to work and earn attractive return on that capital. And so we're going to do that wherever we see the best opportunity. Having said that, if you look at what's going on in India, the factors that have allowed us to add those 1,000 cars to 2,000 cars a year should have some legs. I mean, the Indian economy should continue to grow. Today, the vast majority of railcars are owned by the Indian railways. And the Indian railways has lots of calls on their capital, lot of things they need to invest in. And it should only continue to be even more and more attractive to allow somebody else to make investments in that rolling stock.

Additionally, today, the Indian network is primarily a passenger network. So when a freight train has to compete with a passenger train, the passenger train gets priority. And that's one of the things that despite a tough road infrastructure encourages shipment by road. India is putting billions into a dedicated freight corridor, a line of car – of rails that will exclusively transport freight traffic that will be yet another factor that should provide some legs. So, again, don't want

to set an arbitrary goal, but there are some things that lead us to believe that should continue to be a source of growth.

Similarly, if you look at aircraft engines and I realize the humor of the statement when I say other than COVID. But other than COVID, if you look back since we made that investment, air passenger miles have doubled every 15 years. And airlines, when we got into that joint venture in 1998 leased about 10% of their aircraft spare engines; today it's over 50%. So an increasing market and increasing percent of leasing, that is a – that is a good trend.

And then every other crisis, the avian flu, the financial crisis, the industry bounced back incredibly quick and got back on that every 15-year doubling trajectory. It absolutely has taken longer with COVID, but it certainly appears as though that the passenger miles are coming back and there's no reason to believe ultimately that won't happen again. So much like India without an arbitrary goal amount, there's some things that should make you feel good about that long-term.

<<Benjamin Nolan, Analyst, Stifel Financial Corp.>>

Are there, to that end, are there any other markets and appreciating that there's probably competitive sensitivities to that, but as you're looking out there okay, India, and you talked about Europe and completely different, the aircrafts engine leasing business, are there any other places where you're like, boy, these business models are remarkably close to what our core competency is and we can do that?

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Yeah. No that's a great question. And railcar leasing and aircraft engines at first sound like they're very different, but they're both long live essential use assets where you're competing on service. I talked about the maintenance capability that we have in North America. Rolls-Royce, our partner provides that on the aircraft engine side. So this service competition on these assets that are going to intrinsically hold their value a long time. So that's the kind of thing we look for. And I didn't talk about it because it's relatively small, but in 2020 we made an investment in Trifleet, which is about the fifth largest tank container lessor in the world. It was about \$200 million, so fairly small in the scheme of our business, but had those same characteristics. They compete on service that they provide through their depots.

They have these long live assets that can be widely used. And importantly, part of the reason we made that investment is we knew GATX could bring something to Trifleet. Specifically, two things. One was relatively, it was a privately health company with relatively limited access to capital and some of the business they did was managing containers for others. Some of which was because that's a good business, some of which was because they didn't have the capital to pursue all the opportunities. So GATX brought that, but more importantly, commercially they're at various shippers. The same group that's making decisions about railcars is making decisions about tank containers.

So we thought we could leverage our commercial relationships in North America, in Europe, in India to help that business. So would we look for other – businesses that have those characteristics? Absolutely. But they're hard to find. So exactly when or how that would be hard to say, but an area of interest for sure.

<<Benjamin Nolan, Analyst, Stifel Financial Corp>>

So we have about less than a minute left. Well, first of all, let me just make sure. There we go. We have questions.

Q&A

<Q>: [Question Inaudible].

<A – Thomas A. Ellman>: Yeah. So if everybody didn't hear that the strengths of one type of rail car versus another, what I would tell you is that would've been a much more interesting question a couple years ago. Right now, and we even mentioned this on our last earning call, the vast, vast majority of car types are earning lease rates above their long-term averages. The cycle has progressed long enough that we're at that point. The one group that I would say that's still a bit behind everything else, though much better than it had been is anything energy related. Coal, sand some of the crude oil cars.

<Q>: [Question Inaudible].

<A – Thomas A. Ellman >: Yep. So question about retrofitting for other uses, it varies by car type. So a what is called a sand car is actually a small cube covered hopper. That same car can carry cement, it can carry roofing granules. So you don't need to do anything to put in another service. The problem is the scale. There was so much demand for sand in a short period of time, it's hard to find those other uses. I see, I'm getting a time's up. But coal cars, you can't do much with a coal car other than putting in coal and tank cars that carry crude oil have some other uses as is.

<<Benjamin Nolan, Analyst, Stifel Financial Corp>>

All right, great. Well, we are out of time, but again, I really appreciate you guys making the trip down along with me from Chicago. And again, thanks for coming and this has been very informative and I certainly appreciate it.

<<Thomas A. Ellman, Executive Vice President and Chief Financial Officer>>

Great, thank you.