GATX Corporation

2023 Third-Quarter Conference Call **October 24, 2023**

Operator:

Good morning. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the GATX Third-Quarter 2023 Earnings Conference Call. (Operator Instructions) Shari Hellerman, Head of Investor Relations, you may begin your conference.

Shari Hellerman:

Thank you, Rob. Good morning, and thank you for joining GATX's 2023 Third-Quarter Earnings Call. I'm joined today by Bob Lyons, President and CEO; and Tom Ellman, Executive Vice President and CFO.

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 included in our earnings release and those discussed in GATX's Form 10-K for 2022 and in our other filings with the SEC. GATX assumes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

Earlier today, GATX reported 2023 third-quarter net income of $52.5 million or $1.44 per diluted share. This compares to 2022 third-quarter net income of $29.1 million or $0.81 per diluted share. The 2022 third-quarter results include a net negative impact of $10.8 million or $0.31 per diluted share from Tax Adjustments and Other Items. Year-to-date 2023, net income was $193.2 million or $5.30 per diluted share. This compares to $107.5 million or $2.99 per diluted share for the same period in 2022.

The 2023 year-to-date results include a net negative impact of $1.1 million or $0.03 per diluted share from Tax Adjustments and Other Items. The 2022 year-to-date results include a net negative impact of $55.2 million or $1.54 per diluted share from Tax Adjustments and Other Items. These items are detailed in the supplemental information pages of our earnings release.

Now, I'll briefly address each of our business segments. At Rail North America, fleet utilization was 99.3% at the end of the quarter. Demand for the majority of car types in our existing fleet remains strong, and we continue to extend renewals at higher rates. The third-quarter renewal rate change of GATX's Lease Price Index was positive 33.4%, with an average renewal term of 65 months. Our renewal success rate remained very high at nearly 84% in the quarter.

We continue to successfully place new railcars from our committed supply agreements with a diverse customer base. We've placed all 4,800 railcars from our 2018 Trinity Supply Agreement. And we've placed all 7,650 railcars from our 2018 Greenbrier Supply Agreement. In addition, we've placed over 2,400 railcars from our 2022 Trinity Supply Agreement. Our earliest available scheduled delivery, under our supply agreements, is in the third quarter of 2024.

The secondary market for railcars in North America remains active. We generated remarketing income of approximately $13 million in the third quarter and over $88 million year to date.

Within Rail International, Rail Europe continued to experience increases in renewal lease rates versus expiring rates. Driven by stable demand for most car types, Rail Europe's fleet utilization remained healthy at 96%, although there is continuing softness in the European intermodal sector, which is the primary driver for the utilization dip at Rail Europe.

During the quarter, Rail Europe and Rail India continue to take delivery of new cars and grow the fleet. Rail Europe's third-quarter investment volume was nearly $130 million.

Turning to Portfolio Management, third-quarter results were driven primarily by the solid performance of the Rolls-Royce & Partners Finance affiliates. Our wholly owned aircraft engines portfolio also contributed to higher earnings. Global demand for aircraft spare engines is robust, as international air passenger traffic continues to recover.

As noted in the release, we continue to identify attractive investment opportunities across our global businesses in today's environment. Total investment volume was over $360 million in the third quarter and over $1.2 billion year to date.

Finally, reflecting favorable operating performance to date and our outlook for the remainder of the year, we expect 2023 full-year earnings to modestly exceed the high end of our previously announced guidance range of $6.50 to $6.90 per diluted share, excluding any impact from Tax Adjustments and Other Items.

And those are our prepared remarks. I'll hand it back to the operator so we can open it up for Q&A.

QUESTION AND ANSWER

Operator:

(Operator Instructions) And your first question comes from the line of Justin Long from Stephens. Your line is open.

Justin Long:

Thanks, and good morning. Maybe I'll start with a question on North American Rail. Could you talk about the trend in absolute lease rates that you saw on a sequential basis in the third quarter? And then anything you can share on your expectation for remarketing in the fourth quarter? Just curious what's baked into the guidance?

Tom Ellman:

Good morning. I'll take the first one and then turn it over to Bob for the second one. So, compared to the prior quarter, most tank car types were up a couple of percentage points in terms of lease rate. Most freight car types were relatively flat. The exception of that were coal and small-cube covered hoppers that were down about 5% to 10%.

Bob Lyons:

Yeah, and on remarketing income, Justin, it's always a little bit more difficult to predict coming into the fourth quarter just because of seller -- or I'm sorry, buyer activity in terms of timing. So, it gets a little difficult. Through the first nine months of the year, we're close to $90 million already in remarketing income. So, we'll see some more activity in the fourth quarter, but not on the same magnitude, if you annualize the last 3 quarters.

Justin Long:

Okay, great. That's helpful. And secondly, I wanted to ask about maintenance expense in both North America and the International business. It seems like we had a decent-sized step-up on a sequential basis. And in North America, if I go back to your expectations for maintenance expense at the beginning of the year, we're tracking pretty far ahead of that. So, I was just curious if you could give a little bit more color on what's driving this kind of magnitude of the increase and how to think about maintenance expense going forward?

Tom Ellman:

Justin, this is Tom. I'll once again take the Rail North America and then turn it over to Bob for International. As you stated, maintenance costs are higher than we expected coming into the year. This variance was driven by higher-than-expected volume, which was a result of a few more assignments of existing cars than we thought we would have and a little bit more compliance work coming in than we expected. This caused a percentage of maintenance that we do on our owned facilities to fall a bit from the recent history. However, it's important to note that the unit cost per repair on our owned facilities is in line with our expectations and very attractive relative to third-party alternatives. In fact, our relative advantage actually grows during times of limited industry capacity.

As you know, we always provide commentary on 2024 or the next year, during our January earnings call and we'll continue to do that. However, it's fair to say that one of our goals will be to increase the percentage of maintenance performed in our own facilities.

Bob Lyons:

Yeah, and on the International side, Justin, from an overall standpoint, the net maintenance expense is actually not -- it's coming in the range of what we had anticipated. We had very sharp inflationary impacts, as you might recall, during 2022. So, coming into 2023, we knew we would feel the full impact of that this year, both in terms of energy costs and labor costs being the two biggest drivers there. We've also had some FX headwinds as well. But overall, nothing material in terms of the deviation from what we expected coming into the year.

Justin Long:

Got it, thanks. I'll pass it on.

Operator:

Your next question comes from the line of Matt Elkott from TD Cowen. Your line is open.

Matt Elkott:

Good morning. Thank you. Good to see some of the strong metrics, utilization and rates and even the renewal success rate, although the renewal success rate did decline, can you guys talk a bit about this?

Tom Ellman:

Yeah, so, Matt, in terms of the given quarter, that can move around a little bit and the degree of precision that's implied there is really more than exists. A couple of transactions can move that. The important thing I'll note is a non-renewal does not necessarily mean a non-utilized car. And as you noted, the utilization remained very, very high which means that any car that for whatever reason, is not being renewed is being quickly put back to work.

Bob Lyons:

Yeah, and I would add to that, too. There are times, Matt, where -- especially in this type of rate environment, where certain customers may say no. And given the diversity of our fleet and our commercial capabilities, we're comfortable taking a car back and putting on lease with the next customer. So that would obviously impact your renewal success rate. But, in the end, any renewal success rate up in the zip code of where we're at today is really, really strong.

Matt Elkott:

That's very helpful. And then one more question. I believe Shari mentioned that the first available -- scheduled deliveries from your manufacturer suppliers is for 3Q. I believe, last quarter, you said first quarter. Am I correct? Or just any clarification on this would be good.

Shari Hellerman:
Yeah Matt, so it's third quarter of 2024, right now. And so, backlog for both tank and freight cars are about a year out.

Bob Lyons:

And, that's on our supply agreement, Matt.

Matt Elkott:

Okay, got it. Perfect. Thank you guys very much – appreciate it.

Operator:

Your next question comes from the line of Allison Poliniak from Wells Fargo. Your line is open.

Allison Poliniak:

Hi, good morning. I just want to go back to Europe, just on sort of that intermodal pressure that you're seeing reflected in the utilization side. Is that starting to stabilize for you? Or does it feel like it could take another leg down? Just trying to get a sense of where that is today.

Bob Lyons:

I don't know if it's going to take another leg down, Allison, but it's going to take a while to recover. We only have about 2,000 intermodal wagons in our fleet in Europe out of a fleet -- total fleet of over 29,000 wagons. So, it's a small minority of our fleet but it's the one that's under the most significant pressure. For example, we have roughly 1,100 idle wagons in

Europe, that's it. Over half of those are intermodal.

So, the market has faced a lot of pressure, as you would expect. It's the most economically sensitive and the economic environment in Europe is spotty across regions and pretty challenged, overall. I don't see that abating here in the next three to six months. It's going to take a while for that market to recover. But long term, we feel very good about the assets we own, they're relatively new. And in the push in Europe for more products from truck to rail, there will be a point where those assets are going to be fully utilized and good assets for GATX in the portfolio.

Allison Poliniak:

Got it, thank you. And then we've seen pretty strong diversification in terms of investment across your assets. Just any color on how you're thinking about that going forward? Does that start to shift maybe towards one asset versus another, just given some of the macro concerns here? Or just maybe kind of walk through how you're thinking about that? Thanks.

Bob Lyons:

Yeah, we continue to think very economically, Allison. So, we're going to deploy capital where we have our highest return opportunities. We're not pegging any particular percentage for Europe or any percentage for India or our engine leasing business, for example. That falls out of where we see the best return and the best opportunity. So fortunately, right now, we're seeing them across the board. As you said, it's pretty well diversified. I don't see that changing here in the near term.

Allison Poliniak:

Great, thank you.

Operator:

(Operator Instructions) Your next question comes from the line of Justin Bergner from Gabelli Funds. Your line is open.

Justin Bergner:

Good morning, Bob. Good morning, Tom. Good morning, Shari.

All:

Morning.

Justin Bergner:

The first question I have would just relate to some cleanup questions. Did you repurchase any shares in the quarter?

Tom Ellman:

We did not.

Justin Bergner:

Okay. And then secondly, the Other Revenue in Rail International, could you just clarify sort of what's in it and why it's been ticking up over the last year? Is that just commensurate with the growth of the International business?

Tom Ellman:

Yeah, Justin, my guess is you're actually referring to the Portfolio Management segment.

Justin Bergner:

I guess you can cover that as well, but I was asking about the International.

Tom Ellman:

Okay. So, in Portfolio Management, the key driver is the GEL engines. So, we've noted before that we have engines that are used to support the business in Rolls-Royce that has a -- that supports their Total Care Maintenance program. And this is a pool of engines that rather than being on a fixed lease to a single airline are leased to several different airlines to support that program. And because the accounting is a little bit different, that shows up as Other Revenue rather than Lease Revenue, and those engines, those 15 engines that support that pool have been added between the fourth quarter of 2022, in July of 2023, and

that's why you see the big step-up in the Portfolio Management segment.

Bob Lyons:

And on the International side, Justin, unlike in Rail North America, where Other Revenue primarily represents repair revenue that's -- those are repairs that we billed back to the customer. In International, it's a much smaller percentage of the overall revenue line, less than 5%. And it's really a myriad of items. Some of that is damage for railcar -- recovery on damage for railcars. It can be billbacks to customers; we have some interest income in there as well. So, there's a whole host of items in there, but nothing in particular and really should be no change in the trend line.

Justin Bergner:

Okay. If you had to handicap sort of what parts of your business are tracking ahead of your earlier guidance to allow you to come in modestly ahead, which segments of the business would you point us to?

Bob Lyons:

Yeah, I'll comment first and maybe if you want some additional color, Tom can weigh in too. But the big driver has been Portfolio Management, the engine leasing business. When we were in the depths of the pandemic and coming out of it last year, the expectation was for the global aerospace sector for air travel to really not fully recover, at the earliest, until 2024.

Domestic travel was above pre-pandemic levels already. International travel's at about 90% -- 97% of what it was pre-pandemic. So, the recovery there has been much faster. So, our utilization of engines has been higher than anticipated. Bad debt expense is lower than anticipated. All the things you'd expect to see in a recovery just occurred much quicker than anyone anticipated. And we've been able to deploy capital directly into engines at a pace above what we originally thought. So, you're seeing that pick up in our Other Revenue within Portfolio Management, as Tom mentioned.

Justin Bergner:

Great, thank you. If I could just get one last one in. The higher interest rate environment, how does that sort of affect the dynamic between higher lease rates and higher cost of capital?

Tom Ellman:

So, you really got to think about that in two different ways. So, for the existing fleet, the interest rate environment actually has very little impact. That's sort of a car type by car type, what's the supply-demand dynamic. And that's really what drives the rate environment on any of those existing cars.

On a new investment where you have the ability to decide to invest or not to invest obviously, higher interest rates make your threshold a little bit higher for total investment and a little bit more challenging to invest in that kind of environment unless you can get the lease rate. It's important to note though that that overall dynamic is helpful because if it makes that new car more expensive, it makes the alternative of renewing an existing car more attractive and that's really the primary benefit that you get.

Justin Bergner:

Thanks, that very helpful. I appreciate you taking my questions.

Bob Lyons:

Thank you.

Operator:

Your next question comes from the line of Brendan McCarthy from Sidoti. Your line is open.

Brendan McCarthy:

Yes, good morning and thank you for taking my questions. I just have a quick question on the Balance Sheet. It looks like Recourse Leverage had a very small increase to 3.2 from 3.1 where it's been in the past handful of quarters. I think I recall the company's aim is to stay under the investment-grade cap of like 3.5. But are you

comfortable with that metric approaching 3.5? Or how can we think about the debt level?

Tom Ellman:

Yeah, so certainly, we're very comfortable with where it is. One of our key criteria always is ensuring consistent access to attractively priced capital. So, we're in constant communication with the rating agencies about where they're comfortable on their various metrics. And it's very clear that they're comfortable below that 3.5 to 1 level and certainly could be comfortable with something even higher for the right situation and the right environment.

Brendan McCarthy:

Got it, thank you. That's helpful. And then one last one for me. I think we've talked about this metric before in the past, but I'm wondering if you can shed light on to the percentage of the lease portfolio that has been repriced at higher rates since you've been able to meaningfully increase lease rates since roughly early 2022.

Tom Ellman:

Yeah, so, it's very difficult to precisely predict -- or not to predict, but precisely indicate how much of the fleet has repriced into a more attractive environment. We've mentioned for a while now that sequential lease rates were up quarter-over-quarter. We're going on like three years of that situation occurring, but that was from a pretty low base. And if you look at when lease rates started to get up over that long-term average, it was somewhere in the 2022-time frame.

So, looking at it from that perspective, you might say about 1/3 of the fleet has repriced in an attractive environment. But if you wanted to go back to when the lease rates increased, you'd have a higher percentage and if you wanted to say, when did we start feeling good about extending lease term, we might have a slightly lower percentage. So, it's hard to really give you an absolute number there.

Bob Lyons:

Yeah, and I would just add to, in terms of the runway we have for positive differential, we have a lot of runway and being able to lock cars in for 5- to 6-year terms at these rates at positive differentials, we are embedding a lot of high-quality cash flow into the portfolio.

Brendan McCarthy:

Great, that's very helpful. Thanks everybody.

Bob Lyons:

Thank you.

Operator:

Your next question comes from the line of Bascome Majors from Susquehanna. Your line is open.

Bascome Majors:

Bob, to follow up on that last question, what is the shape of the expiring rate of your North American portfolio as we go forward 1-, 2-, 3-years? Understanding that that portfolio may change and this won't hold?

Tom Ellman:

Yeah, so, as you know, we provide guidance at the January earnings call every year, and we'll give some information about the expiration profile going forward. If you looked at us over a long period of time, you'd see that in some of the lower years, it's 13,000 to 15,000 railcars expiring. Some of the higher years, it's a little over 20,000. So, we'll give more exact guidance in January, but it's -- that gives you some kind of range of where you might expect it.

Bascome Majors:

But from a rate perspective, does the expiring rate go down similar up next year in the North American portfolio?

Bob Lyons:

Yeah, it's -- we will get into that in January, Bascome; we will lay that out for you. But, as I said previously, in terms of my confidence level and positive differential, there's a lot of runway there.

Bascome Majors:

Thank you for that. And just -- we don't talk as much about that concept on the International book. Is there anything unique there? Should we think fairly pro rata similar cyclical economics to kind of the tops down directional view we just talked about in North America?

Bob Lyons:

Yeah, the actual lease terms in Europe are much shorter, typically than they are in North America. That's been the case for decades. It's really hard just from a commercial standpoint to move the needle much on term. So, you see a greater percentage of the fleet rolling over each year in Europe. But also, historically, the lease rate variability is much lower than it is in North America. That tends to be a single-digit up or down percentage-wise. Good environment, bad environment, you don't see the rate swings like you do in North America.

We're certainly pushing rates higher because in certain car types in Europe right now, the environment's in our favor to do that. But nothing on the magnitude that you would see in North America, for example, an LPI of plus 33%. A really good renewal in Europe is in the 5% to 10% plus range and a bad day if a couple of percentage points off.

Bascome Majors:

Thank you for that clarification. Just one last one. The -- you've talked pretty constructively about your momentum in a lot of your businesses, both last quarter and this quarter. As we look into next year without necessarily getting into quantitative guidance, but what keeps you up at night? What are the risks in your continuing to deliver the kind of results we've seen from you over the last couple of years here? Just curious where we should watch and sharpen our pencils on downside potential? Thank you.

Bob Lyons:

Sure. Well, from a -- I'll go back to a question that came up previously in the call with regards to the one area of outperformance. This year has really been Portfolio Management on the engine side. But what's encouraging to me is behind that, whether it's Rail International, Rail Europe, Trifleet, what have you, India, we have continued to build a really solid foundation for the future here. Whether it's managing the existing lease portfolio and certainly through the investment volume that we're seeing last year and this year. We're putting a lot of capital to work and really attractive returns for GATX for our shareholders for the long term. So, I feel very good about that. I feel really good about where the business is today, how it's been managed and the position we're in.

What keeps me awake at night is the bigger macro factors that are outside of GATX's control. And we've seen a number of those in the last couple of years, whether it's the pandemic, the war in Ukraine, kind of the unpredictable macro things are what keep me awake at night. But I guess what allows me to go back to sleep at night is we've been through those for 125 years. And we have the business in a really, really stable, strong foundation right now that we can respond accordingly, whatever macro challenges are thrown our way.

Tom Ellman:

And Bascome, I would say, to some degree, you answered your own question -- when you talked about that we've been talking constructively about each segment and then Bob reminded that the investment volume has been strong across all those segments. So, one of the sources of resiliency and strength is that there's really some reason for optimism across all those segments.

Bascome Majors:

Thank you, Bob. Thank you, Tom.

Bob Lyons:

Thank you.

Operator:

And we have reached the end of our question-and-answer session. Ms. Shari Hellerman, I turn the call back over to you for some final closing remarks.

Shari Hellerman:

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:

This concludes today's conference call. Thank you for your participation. You may now disconnect.