GATX Corporation

2023 First-Quarter Conference Call **April 25, 2023**

Operator:

Good morning, ladies and gentlemen and welcome to the GATX 2023 First-Quarter Earnings Call. At this time, all participants are in a listen-only mode and please be advised that this call is being recorded. After the speakers' prepared remarks, there will be a question-and-answer session. (Operator Instructions). And at this time, I'll turn things over to Ms. Shari Hellerman, Head of Investor Relations. Shari, please go ahead.

Shari Hellerman:

Thank you, Beau. Good morning, everyone and thank you for joining GATX's 2023 first-quarter earnings call. I am 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 defer 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. GATX assumes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

Before I provide a quick recap of our first-quarter results, I'd like to reminder everyone that our Annual Shareholders' Meeting is scheduled on Friday, April 28 at 9:00 AM Central Time and will be held in a virtual-only meeting format.

Earlier today, GATX reported 2023 first-quarter net income of $77.4 million or $2.16 per diluted share. This compares to 2022 first-quarter net income of $75.8 million, or $2.10 per diluted share. 2023 and 2022 first-quarter results included net negative impact of $0.04 per diluted share and $0.24 per diluted share, respectively, from Tax Adjustments and Other Items. These items are detailed on Page 11 of our earnings release.

Now, I'll briefly address each segment. At Rail North America, fleet utilization remained high at 99.3% and the renewal success rate was 77.9%, reflecting continued strong demand for railcars currently in our fleet. The lease rate environment for existing railcars remains favorable, as evidenced by the renewal rate change of GATX's Lease Price Index of positive 34.3% for the quarter. We remain focused on our objective of lengthening lease terms and locking in attractive rates.

Additionally, we continue to successfully place new railcars from our committed supply agreements with a diverse customer base. We've placed over 4,600 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 nearly 1,500 railcars from our 2022 Trinity Supply Agreement. Our earliest available scheduled delivery under our supply agreement is in November 2023.

In our North American maintenance network, we continue to operate safely while achieving high levels of productivity across the shops in our network. We'll continue to direct the vast majority of work on our specialty freight and tank cars to our own network where we believe our experienced workforce gives us superior safety, quality and cost metrics.

The secondary market for railcars remains robust. Rail North America generated remarketing income of approximately $45 million for the quarter. As mentioned in the earnings release, we also identified attractive investment opportunities in the quarter and acquired over 1,000 cars in the secondary market. These cars are on long-term leases with attractive rates.

At Rail International, demand for railcars remains very strong and we continue to experience success in pushing up renewal lease rates for most car types. Rail International's first-quarter investment volume was over $81 million, as we took deliveries of nearly 1,000 new cars in the quarter.

Turning to Portfolio Management, first-quarter performance was driven by higher share of affiliates' earnings from RRPF, our aircraft spare engine joint venture with Rolls-Royce. Consistent with our expectations, the operating environment for RRPF is steadily improving, reflecting the ongoing recovery in international passenger air travel.

With the first-quarter environment very much in line with our expectations coming into the year, we continue to expect full-year earnings to be in the range of $6.50 to $6.90 per diluted share, excluding any impact from Tax Adjustments and Other Items.

And that concludes our prepared remarks. I'll hand it back to Beau, so we can open it up for questions.

QUESTION AND ANSWER

Operator:

(Operator Instructions) We'll take our first question this morning from Justin Long of Stephens.

Justin Long:

Thanks and good morning. I guess to start on the quarter -- if you set remarketing income aside, would you say the performance was relatively in line with what you expected? I think Shari, you just mentioned that. And in terms of the outlook going forward, is that relatively in line from a fundamental perspective versus what you thought at the beginning of the year? It seems like maybe the first quarter beat relative to the Street and was mainly a function of the timing of some of this remarketing income, but I'd love to get your thoughts?

Bob Lyons:

Good morning, Justin. It's Bob and that's a fair assessment. As you know, remarketing income can be pretty volatile quarter to quarter. So that does move around quite a bit as the year progresses. I would say, fundamentally, the environment is very much in line with what we expected coming into 2023 and that goes across Rail North America; Rolls-Royce, probably a little bit stronger there than we anticipated, but Trifleet, Rail International -- our Rail International business is all very much in line with what we expected.

Justin Long:

Got it. Thanks Bob. And to your point on Rolls-Royce, the contribution from that JV was fairly significant in the first quarter. Is there any way to help us think through that $28 million contribution and how much of that came from remarketing income? And, if I look at the full-year guidance you gave before on Portfolio Management, I think you were expecting $10 million to $15 million of improvement and we saw something north of that just from the JV, alone, in the first quarter. So, any updated thoughts there?

Tom Ellman:

Yeah, Justin, I'll break that down for you. So, the remarketing piece was about $16 million of that $28 million and about $12 million was Operating Income. As you already noted, and Bob confirmed, even in the Rolls-Royce JV, that remarketing piece moves around quite a bit.

So, while we continue on that trend that we've been talking about for a couple years of expecting to get back to pre-COVID levels in the 2024, 2025 timeframe, we're still on that trajectory. Maybe things are moving a little bit quicker than anticipated, but at this point, we're not really ready to change that full-year guidance for the JV.

Justin Long:

Got it. And, I guess last one from me is just on the absolute lease rate trends sequentially in the first quarter. Curious what you saw and any updated thoughts on how lease rates, on an absolute basis, trend going forward?

Tom Ellman:

So, as you know, we've been discussing steadily improving lease rates for about the past 2.5 years. When you get to this quarter in particular, most tank car types were up around 5% or so. Most freight car types were relatively flat and

energy-related freight car types were probably down about 10%.
But it's important to put that in context as you compare to a year ago, most tank car types are up around 20%. Most freight car types are up around 30% and those energy-related freight car types that are down sequentially, even those are up 30% or more versus a year ago.

So, it still remains a strong lease rate environment and we talked about this a little bit last quarter, just as time goes on and you have more and more quarters of those improving lease rates, the comparison gets a little bit harder. So, we're not totally surprised to see this trend happening, and as Bob mentioned on the very first question, everything is very much in line with our expectations.

Justin Long:

Great, very helpful. Thanks for the time.

Operator:

Thank you. We'll take our next question now from Matt Elkott of TD Cowen.

Matt Elkott:

Good morning, thank you. Just a quick follow up on the lease rate environment and the continued strength in it; are you guys a bit surprised? Is it time to be surprised by how resilient the lease rate strength has been, given the fact that rail volume is down 4% or 5%, intermodal is down 9%, and rail network fluidity is improving. So, in the near term, you would think those two factors would be headwinds to lease rates or is that -- has that been more than offset by interest rates being higher and tempering builds?

Bob Lyons:

Well, it's a combination -- not just interest rates, it's also new car costs to -- you have to keep that in mind in regards to the alternatives for the customers out there. So as those new car costs have continued to rise in a stated relatively heightened level, that gives leeway and latitude to kind of take up the lease rates on the existing cars and they need to go up. They need to go up for interest rates and they need to go up as a reflection of the new car alternative.

So not particularly surprised and again, I think it speaks to what we have seen in terms of a very bifurcated market where the existing cars that are in place -- customers are very keen to hold on to those. And so, as we move rates up to reflect high utilization, some overall fleet attrition over the course of the last couple years, as you mentioned -- rising interest rates, the new car costs, they're holding on to those cars.

Placing new cars under the Supply Agreement, particularly on the tank car side, is a bit more challenging, but fortunately we have a big commercial network and a big customer base and we're able to do that, but that is a heavier lift than renewals.

Tom Ellman:

And Matt, it always starts with that supply demand dynamic and that remains favorable for most car types. Industry cars in storage are under 18% and then if you look at the demand side, industry carloads are up about 2.5% versus a year ago. So, there are some positive factors offsetting some of the things you mentioned.

Matt Elkott:

Yeah. No, that makes sense and then just maybe kind of a longer-term question. I know, you guys have only repriced, I don't know, maybe 25 or one-third of your fleet since the lease rate recovery began just over two years ago. So, is it safe to assume then we should see lease revenue growth for a couple of years to come at least, given the fact that more repricing will happen and more of your fleet will be at higher levels?

Tom Ellman:

So, as you know, we always give guidance for the current year and we don't give too much beyond that. But, what I would say is the trends of strong lease rate environment and the comparison getting -- continuing to get a little bit better as you get a little further away from some of the upmarket. Those are positive trends

and the big part of the reason we express confidence in the lease rate environment in 2023.

Bob Lyons:

Yes, and I'd add Matt too. Yeah, we're very encouraged by the fact that we're able, right now, to put a lot of the renewals into the portfolio at attractive returns, or attractive rates right now at longer terms. And that's embedding a lot of high-quality, strong cash flow into the portfolio -- that'll pay dividends for years to come.

Matt Elkott:

Yeah, and then just finally Bob and Tom -- secondary market valuations, I know they've been very strong, but there's been some very slight cracks recently in certain car types. I think maybe related to housing and maybe slightly the consumer, centerbeams, and so on and so forth. What's the environment like from your perspective on the secondary market valuations?

Tom Ellman:

So, I would say the secondary market remains strong and we expect that to continue. Positive feelings about the market appear to be offsetting any negative impacts from higher interest rates. And it's interesting you mentioned some of the individual car types because one of the things we always point to is that we have the most diverse fleet in the industry. So, there's always a piece of our fleet that's going to be relatively attractive, even if there might be pockets where that's less true.

Bob Lyons:

And, to follow on that too, Matt, a point Shari mentioned in the opening comments is we had a very strong quarter on the buy side in the secondary market. One of the strongest I can recall in recent years, and again, that goes to the point Tom mentioned, that we can selectively identify opportunities.

When we see portfolios for sale from other leasing companies, we will bid individually in a very targeted basis on the car types that we want and we've seen as evidence in the first quarter, some really attractive opportunities to add a lot of cars north of 1,000 cars to the fleet that we bought in the secondary market.

Matt Elkott:

Now, that's good to see that you're still seeing pockets of opportunity in a pretty expensive secondary market. Now, do you guys think that there might be some bigger acquisition targets? I wouldn't imagine that if you're a lessor right now, this is an opportune time to look into if you want to exit the market to look into selling because valuations are high. And if you have any kind of debt refinancing needs in the future, you probably want to get out before that happens. So, could we see larger fleets go for sale?

Bob Lyons:

It's always a possibility, Matt. We're well dialed into most of the portfolios that are out there and the owners of those portfolios. So, we are trying to stay abreast of what's happening in the market. So, it's always a possibility and we will -- we'll always look, I think we'll always be in the mix in terms of those opportunities.

But we've also had the question as it relates to the banking industry right now where there are portfolios that are owned by banks; those portfolios aren't core to the bank. And given some of the pressures in that sector, might some of those portfolios shake loose? Certainly a possibility -- we haven't seen it yet.

Matt Elkott:

But you would ask -- you would be interested in those -- in joining in a bid for those fleets, right?

Bob Lyons:

It all comes down to the quality of the portfolio and valuation, those two things.

Matt Elkott:

Makes sense. Bob, Tom, Shari, thank you very much, I appreciate it.

Bob Lyons:

Thank you.

Operator:

Thank you. We go next now to Allison Poliniak at Wells Fargo.

Allison Poliniak:

Hi, good morning. Could we talk about maintenance expense? It seemed a bit -- a little bit more of a sequential uplift than we were expecting. Is there anything unusual there? I know you guys were thinking it would be up year on year, but it just seemed like a higher lift in the first quarter. Thanks.

Tom Ellman:

Yeah, so the maintenance expense is up, as you mentioned, about $7 million, but it's very much in line with our expectation -- just like everything else. The variance from the prior year is primarily due to the mix of repairs and a higher volume of repairs. Calling that exactly the way those -- that volume is going to come in and that mix is going to come in quarter to quarter is challenging. So, we really focus on the full year and we continue to believe that for the full year, net maintenance expense will be up $5 million to $10 million versus that 2022 range.

Allison Poliniak:

Got it. And then, this is probably being overly picky, but the renewal success rate dropped a tad. Anything in terms of the customer needs that you see are changing? I know it's still a very strong market, but are you starting to see maybe some incremental pockets at this point?

Tom Ellman:

Yeah, we really don't read anything into that single quarter. Again, we kind of look at the whole year and on a historical context; even this quarter is a pretty strong number. And if you look at where the utilization is -- what's going on with lease rates, the trends are, again, not to repeat myself, but very much in line with expectations.

Allison Poliniak:

Perfect, thank you.

Operator:

We go next now to Bascome Majors at Susquehanna.

Bascome Majors:

Can you talk a little bit about the cyclical versus the structural drivers of your lease pricing power, by that -- and by that, I guess what we mean here is, railroad volumes, certainly from the railroad outlook being a bit more muted from the Class 1s, as we look forward to the next few quarters, albeit maybe more concentrated in intermodal, which you don't have a ton of exposure to.

But your pricing power being quite strong from a combination of high asset prices, reducing excess car supply, high interest rates -- just, can you talk a little bit about how those come together in your view of the market and how that impacts your strategy as you look forward over the next, two, three, four quarters? Thank you.

Bob Lyons:

Sure Bascome, and I'll start and -- as we've talked about over the course of the last couple years as there has been fleet attrition, in general, across the North American network, the recovery in rates has really been more than -- one that's been driven by the supply side than it has on the demand side. So, as we've seen total fleet counts come down, utilization goes up -- that along with interest rates and the price of new cars has been the primary driver to the rate lift.

What we haven't seen is material carload growth, and that would certainly be welcome and we think about carload growth potentially coming from a couple areas. One, just from economic activity and the other being the customers moving more product by rail and shifting from truck and hopefully service levels improve.

We believe there is freight on the sidelines that can go from truck to rail. We hear that from our customers all the time, that they would move more by rail if service levels improved. So, we think there's some pent-up demand there. So today, to date, I would break it in kind of again, slice things into two levels. It's been a supply side recovery so far and we're looking forward to the demand side of it kicking in as well.

Bascome Majors:

Thank you for the time; that's all for me.

Operator:

We'll go next now to Brendan McCarthy at Sidoti.

Brendan McCarthy:

Hi, yes, my question has actually already been answered just now. Thank you.

Operator:

Thank you, Mr. McCarthy. We'll go next now to Justin Bergner at Gabelli Funds.

Justin Bergner:

Hi, Bob. Hi, Tom. Hi, Shari.

Tom Ellman:

Hi.

Shari Hellerman:

Good morning

Justin Bergner:

I think I heard you mention that maybe within your unchanged EPS guidance, you expect North American rail to be a touch better. Did I hear that correctly? And if so, what would be the driver there?

Bob Lyons:

Actually, we reference more RRPF kind of fundamentally being a little bit, or Rolls-Royce, being a little bit better than we anticipated and maybe that's more fundamental. The rest of the businesses whether it's Rail North America, Rail Europe, India and Trifleet -- kind of all performing as planned.

Justin Bergner:

OK, thank you. And that would be sort of on the non-gains on asset sales side that, I guess $12 million-ish number for the quarter that Tom --

Bob Lyons:

Correct. Right. Just kind of looking at the base business.

Justin Bergner:

OK. I think some of the rails spoke to, improving productivity; if not during the whole first quarter as sort of we came out of the first -- as we came out of the first quarter. Are you seeing that and how is that impacting lease rates sequentially? Is it starting to constrain them in any way?

Tom Ellman:

Yeah, so most of the shippers that we talked to remain skeptical about near term improvements in rail service. Most shippers, as Bob mentioned, would probably like to ship a little bit more by rail if the service improved, but they haven't seen the levels of sustained improvement to make that happen. I would say they're encouraged by some of the talking points from the railroads, but would like to see more action, particularly on the first mile and last mile.

Justin Bergner:

OK, that helpful. And then lastly, there was a sequential sort of year-on-year increase in the profitability of the Other segment, mostly on the Other Income and Expense line. Is there anything that we should be aware of there that's driving that? Is that likely to continue?

Tom Ellman:

Yeah. So that Other segment includes both Trifleet and true Other, items that aren't any

part of the -- any part of any other segment. So, Trifleet was up a little bit. It was up a little over $0.5 million and that's rough -- and that's basically due to some improvements in utilization and lease rates.

So, the majority of it was the true other, Other, and that's about $2 million each from two different things. One is the interest allocation that we do. We allocate that to our various segments based on their target leverage. And when we do that, you can end up with a slight over- or under-allocation and the remainder goes in that other piece and gets, in this case, interest income associated with it.

The other part of it is pension accounting. When you look at pension accounting, you're looking at interest expense and you're looking at net expected return on pension assets. When you do that, that again can go either direction. So, together those things are about a little over $4 million of positive. That is not something that I would look for a particular trend to occur because it can go any direction.

Justin Bergner:

OK, thank for clarifying; nice quarter.

Bob Lyons:

Thank you.

Operator:

Thank you. We'll take a follow-up question now from Bascome Majors.

Bascome Majors:

Yeah, thanks for taking the follow-up here. As we look out, if we get to mid-year and it feels like there's an upward sort of momentum to the guidance. Can you talk about the most likely drivers of what could give you the comfort to raise that, if from where you sit today. And, specifically, to the cadence -- do you have any visibility into the lumpiness of the North American gains on sale, whether the books will be more concentrated in 2Q, 3Q, 4Q, as we think about modelling going forward? Thank you.

Tom Ellman:

Yeah. So Bascome, purely as a mathematical exercise, the item that is most likely to provide a material upside or downside to guidance does relate to those secondary market activities just because of the scale and the lumpiness. But what we really tend to focus on due to the long-term nature of our business is what's going on with utilization, what's going on with lease rates, and there we would see any kind of variance from expectation show up in the operating statistic before it would show up in the financial results.

Having said all that, as we mentioned several times on the call, of those operating statistics are performing in line with expectations and as it relates specifically to the secondary market, we expect that to continue to be strong for the reasons we've given. Calling a cadence or timing on that, we've repeatedly noted, is very challenging and we don't really try to do it.

Bascome Majors:

Thank you.

Operator:

And Ms. Hellerman, it appears we have no further questions this morning. I'll turn the conference back to you.

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:

Thank you, Ms. Hellerman. Again, ladies and gentlemen, that will conclude this morning's GATX 2023 First-Quarter Earnings Call. We'd like to thank you all so much for joining us and wish you all a great day.