



2023 Second-Quarter Conference Call

July 25, 2023

Operator:

Hello and welcome to the GATX 2023 Second-Quarter Earnings Call. (Operator Instructions) I will now turn the conference over to Shari Hellerman, Head of Investor Relations. Please go ahead.

Shari Hellerman:

Thank you, Sarah. Good morning and thank you for joining GATX's 2023 Second-Quarter Earnings Call. I'm joined today by Bob Lyons, President and CEO; Tom Ellman, Executive Vice President and CFO; and Paul Titterton, 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 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 second-quarter net income of \$63.3 million or \$1.74 per diluted share. This compares to 2022 second quarter net income of \$2.6 million or \$0.07 per diluted share. The 2023 second-quarter results include a net positive impact of \$0.2 million or \$0.01 per diluted share from Tax Adjustments and Other Items. The 2022 second-quarter results include a net negative impact of \$35.9 million or \$1 per diluted share from Tax Adjustments and Other Items.

Year-to-date 2023, net income was \$140.7 million or \$3.87 per diluted share. This compares to \$78.4 million or \$2.18 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 \$44.4 million or \$1.23 per diluted share from Tax Adjustments and Other Items.

These items are detailed on Page 14 of our earnings release. Now I'll briefly address each segment.

Rail North America's fleet utilization remained high at 99.3% at quarter end, and our renewal success rate was 85.3%, which is reflective of the continued strong demand for our existing fleet in North America.

The renewal rate change of GATX's Lease Price Index was positive 33.1% for the quarter with an average renewal term of 61 months. Earlier this month, we announced a modification to the LPI calculation. The announcement and historical LPI data on a comparable basis are available on the GATX Investor Relations website.

We continue to successfully place new railcars from our committed supply agreements with a diverse customer base. We have 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 placed nearly 2,000 railcars from our 2022 Trinity Supply Agreement. Our earliest available scheduled delivery under our supply agreements is in the first quarter of 2024.

The secondary market for railcars in North America remains active. We generated remarketing income of \$30.8 million in the quarter and \$75.6 million year to date.

Consistent with our expectations, Rail International continues to perform well. Rail Europe's fleet utilization was 96.9% at the end of the second quarter. Despite some weakening in the intermodal sector in Europe, demand for the majority of railcar types in Europe and India remains strong, and we continue to experience success at pushing up renewal lease rates for many car types.

Additionally, we continue to take delivery of new cars in Europe and India, adding a combined total of nearly 1,000 cars during the second quarter. Year-to-date, Rail International's investment volume was over \$158 million.

Turning to Portfolio Management, second-quarter results were solid primarily driven by the performance at the Rolls-Royce & Partners Finance affiliates. The operating environment for RRPf continues to improve due to a broad-based recovery in demand for international air travel. In addition, we capitalized on attractive opportunities during the quarter and added nine aircraft spare engines for \$239 million to our wholly owned engine leasing portfolio.

Overall, GATX's total investment volume was over \$486 million for the second quarter and over \$873 million year to date.

Finally, as we noted in the release, reflecting year-to-date performance and our outlook for the remainder of the year, we expect 2023 full-year earnings to be in the upper end of, or modestly exceed, the previously announced guidance range of \$6.50 to \$6.90 per diluted share, excluding any impact from Tax Adjustments and Other Items. Variability around this guidance will be mostly driven by the timing of remarketing activities.

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

QUESTION AND ANSWER

Operator:

(Operator Instructions) Your first question comes from the line of Allison Poliniak with Wells Fargo.

Allison Poliniak:

Hi, good morning. Would you talk to -- I guess, lease fundamentals continue to remain very, very strong. It seems to be going against what we're hearing from the economic side. Any perspective that you can give us on the customers? Is it specific just to your fleet that you think? Is there concern about not having capacity if an inflection happens and this is softer? Just any thoughts that you have around that.

Paul Titterton:

Sure. Yeah, this is Paul Titterton speaking. I'll answer that, Allison. Thanks for the question. What we would say right now is that for our customers -- they continue to be interested in holding onto the cars that they have. I think that's the result of the fact that the fleet, despite perhaps some of the macro trends you're alluding to, has generally speaking, remained relatively tight.

We've talked about the reasons for that tightness that includes things like; for example, railroad velocity, includes the more limited new car production that we've seen, and it's also included some of the higher scrapping that we've seen.

So, the supply-side of the equation has continued to be fairly tight in the North American railcar fleet. As a result of that, we've seen customers, even though they may have some degree of macro uncertainty about their businesses, want to hold onto cars. And so, that's been a big factor in the performance of the existing fleet.

Allison Poliniak:

Great, that's helpful. And then maintenance seems a little bit elevated still, at least from Q1 and even into Q2. Anything unusual going there in terms of the mix? Is it programmatic? Just any color on that maintenance expense so far for the fleet. Thank you.

Paul Titterton:

Sure. There are a few drivers there. So, one is just we're seeing a higher volume of repair events than we saw last year. And that's due to a variety of reasons: some pull forward of compliance, some additional assignment work. There's sort of no one driver, but more events as well as the impact of inflation -- and the inflation really has come in two forms. There's the higher cost of AAR railroad repairs, and then there's also some of the higher costs internally.

And as well, some of that increased volume that we're seeing has driven more use of our contract shop network, which is, generally speaking, a higher cost option than going internal. What I will say, though, is none of that should offset the fact that the structural gains we made in our maintenance cost structure over the last four to five years remain. So really, this is just a phenomenon involving the volume we're seeing in this year. We continue to be very confident about our long-term advantage in terms of our structural maintenance costs.

Allison Poliniak:

Got it. Thanks, that's helpful. I'll pass it along.

Operator:

Your next question comes from the line of Justin Long with Stephens. Please go ahead.

Justin Long:

Thanks, and good morning. I was wondering if you could share the trend in absolute lease rates that you saw on a sequential basis in the second quarter? And then any color on what you're expecting for the progression of rates as we move into the back half?

Paul Titterton:

Okay. Yeah, this is Paul again. And what I will say is, right now, rates remain across the fleet, very, very strong. The sequential production -- progression, generally speaking, was in the low single digits. So, I would say a lot of the acceleration that we've seen has moderated.

But on an absolute basis, right now, we continue to see rates for most car types at or near all-time highs. And again, as I alluded earlier to when I answered Allison's question, the fleet remains tight. So, at this point, I would have to say more of the same story is the most likely outcome in the short to medium term.

Justin Long:

Got it, thanks. And, especially given the investment volume that we saw in the Portfolio Management segment in the quarter, I was wondering if you could talk about your longer-term strategy in terms of investing in wholly owned aircraft engines outside of the Rolls-Royce JV. And maybe you could just get us up to speed on how many wholly owned engines you have today? And just the pace and magnitude of growth we could be thinking about going forward?

Bob Lyons:

Yeah. Justin, this is Bob. And what I can tell you with regards to the investment volume in Portfolio Management, the wholly owned engines -- we bought in the second quarter, and then we closed on one additional one here in the third quarter. So, 10 engines total so far this year for roughly \$270 million. For 2023, that's the bulk of it. Our expectation based on Rolls' delivery schedules, what have you -- our investment for this year is largely completed on the directly owned.

What we like about the flexibility here is that we have the -- we have the ability to invest direct. We have the capacity to do it; we like the asset class. Obviously, we've been in it for 25-plus years. So, we can invest directly and we can also invest through RRP through the joint venture. They've done about \$100 million of investment volume this year. We would expect them to be somewhere in the range of \$200 million to \$250 million this year.

So, it's really -- the decision is a bit more opportunistic on really what Rolls' needs are in terms of their engine production line and whether it makes sense to invest through the joint venture or directly. We have the flexibility to do either.

We'd like to continue to grow the portfolio, but somewhere in that range that in terms of GATX's direct investments, somewhere in that \$200 million to \$300 million range is something

we can do on an annual basis directly, with no issue and would like to.

Tom Ellman:

And Justin, just for sizing where we are today, as of June 30, we had 28 engines that we wholly owned. And as Bob mentioned, one more early in July. So, 29, but 28 at the end of the quarter.

Bob Lyons:

I think, yes, in total dollar amount, that's just north of \$700 million, direct.

Justin Long:

Very helpful. I appreciate the time. Thanks.

Bob Lyons:

Thank you.

Operator:

Your next question comes from the line of Matt Elkott with TD Cowen. Please go ahead.

Matt Elkott:

Good morning. Thank you. Paul, just a quick follow-up first. You mentioned several railcar type lease rates are near all-time highs, that's in part, obviously related to inflation. We're not saying underlying demand conditions are near all-time highs.

Paul Titterton:

Yeah. I mean, we've said for a while that this is -- the phrase we've used is a supply-led recovery in the railcar market. So, the past upcycles we've seen have been very demand driven. We saw the ethanol boom, we saw the crude boom, the frac sand boom. This tight railcar market is different than the recent -- the cycles we've seen recently in the sense that this really is all about tightness of supply.

And again, the factors, just to repeat myself, it's really -- it's railroad velocity. It's new car prices and availability of new cars and then it's high scrap rates that we saw, particularly when steel pricing was a little bit higher than it was today. So really, those factors have contributed to the tight supply market, and that's really what's underpinning the lease rates we're seeing -- at least that's the view that we have.

Bob Lyons:

Yeah, and to your point, Matt, too, as we've mentioned in the past, we really haven't seen carload growth supporting demand here and certainly look forward to that being the case. But that has not been a driver today.

Matt Elkott:

Yeah. And you guys would be happy to know that GM complained about railcar shortages on their call this morning. [Laughter] I don't know if they've ever mentioned railcars before on their calls. [Laughter] We'll have to go back and check the transcript. Can you talk about your autorack exposure as well as tightness in any other car types that you're seeing firsthand or hearing from your customers?

Paul Titterton:

So, I'll say, in general, Matt, we don't get into specific car types. I will say we have been a significant participant in the investment in new multi-level auto carriers because, obviously, there is demand there, and we have a diversified fleet. So, you can expect that in any market where there's significant demand, we're going to participate as an investor. So -- and you're right, certainly, that's an area where I think a number of parties are investing to try to meet the demand that's out there for multi-level auto carriers.

Beyond that, again, we really don't like to get into specific fleets in terms of the supply and demand balance. Other than just to say, broadly speaking, right now, other than I would say the perennial laggards like, for example, small-cubes

for sand service -- we're seeing strength across most parts of the fleet.

Matt Elkott:

Got it. And then just one last one on the secondary market. Are there the same forces -- same supply forces in shippers' desire to hold onto assets that are contributing to lease rates being so strong? Are they also continuing to hold up secondary market valuations? Or have you seen any easing there as interest rates are high?

Paul Titterton:

So, I'll say this -- I'm not going to speculate on why because ultimately, I can't tell you why buyers buy or sellers sell. But what I will tell you is that valuations and demand in the secondary market have remained quite strong. So, in spite of interest rates, in spite of other headwinds, we continue to see a ready market in terms of buyers in the secondary market.

Bob Lyons:

Yeah, and Matt, I think if you recall, as we came into the year, we actually thought with rising interest rates, there was a possibility we would see some paring back at least among the buyer universe; that has not been the case.

Matt Elkott:

Yeah, fascinating. But even though the strength has continued, I would imagine that your opportunities to take advantage of that in the secondary market naturally diminish as you've taken nearly full advantage of it over the past 1.5 years or so.

Bob Lyons:

Well, actually, we -- through the first six months of the year, we've had one of the biggest -- one of the larger years we've had in terms of buying cars in the secondary market. We've had to be extremely selective in how we've done that, but we are finding channels and avenues for us to execute there as well.

Paul Titterton:

And I'll add, too -- this is Paul speaking again. On the sell side, we have continued to originate a great deal of high-quality business. So, in terms of exhausting opportunities on the sell side, that's not the case at all. We ultimately still have, I would say, quite a bit of dry powder to continue to sell as and when we see the opportunity to do so attractively.

Matt Elkott:

Thank you, guys; very much. I appreciate it.

Bob Lyons:

Thank you, Matt.

Operator:

Your next question comes from the line of Bascome Majors with Susquehanna. Please go ahead.

Bascome Majors:

Just to clarify on that last question on the secondary market in North America. Do you have any sense of the timing and magnitude of the books you print in the market and when we might see the P&L impact from that -- the second half of the year between 3Q and 4Q?

Bob Lyons:

It's always difficult to tell, Bascome. We do normally go to market with a book in the second half of the year. We'll do that this year. But as you may know, the book itself is comprised of a lot of different transactions, a lot of different car types, a lot of different lease riders.

And so, the potential buyer universe -- they can bid on all of that or they can selectively bid on individual transactions. And that's how we go through and evaluate to hold vs. sell. It takes a little bit of time. And then you get into the whole closing process and the timing of that and the lease approval in terms of selling the car. So, it takes a little bit of time. It's hard to predict.

What I can tell you is, based on everything we see, the market remains pretty robust. And we'll see what the package brings here in the second half of the year.

Bascome Majors:

Thank you for that. On the buy side from some of the larger portfolios that may or may not trade, has this environment seem to change that, particularly from a large fleet perspective? I'm just curious if you see opportunities coming up over the next one or two years as a buyer that just haven't been present over the last three or four years?

Bob Lyons:

Well, I think we're perpetually saying, it always seems like there should be some activity on the larger portfolio side over the coming year or two, and then it, time passes and it doesn't happen. And even with, for example, the beginning part of this year with all of the turmoil in the banking industry -- we thought, well, maybe there's an opportunity there with some of the mid- to smaller-sized rail portfolios embedded in some of the banks might come loose; we haven't seen that. So, should they happen? Probably. Will they? History would say it takes a lot more time than one might anticipate.

Bascome Majors:

Thank you for that. And last for me, maybe just a bigger picture question. But just looking at the quarterly stats you put out -- your average renewal terms over five years now. It's the first time it's been there since 2016. I mean, you're locking that in with an LPI over 30%. And one of the earlier questions, you talked about absolute lease rates still rising sequentially. They're not as fast as they were earlier this cycle.

But if I look back, the last time GATX was in this position in North America rail and that was a really favorable four-year period from the early- to mid-2010s. And I realize that analogous period bookends the crude-by-rail bonanza and that's unlikely to repeat for the tank car world

today. But as you step back, what feels similar to that type of backdrop for GATX? And what feels different as you look out to your opportunities over the next two to three years? Thank you.

Bob Lyons:

Well, I would say what feels similar is we are highly confident and very enthusiastic about the platforms and positions we have, both in North America, in Europe and India. We feel our rail business is in a great position in all of those markets to continue to grow and capitalize on opportunities.

And they just don't come consistently, right? There's a little bit more of a stair step in terms of the opportunities that may come our way. But anything that does, we're going to be in a great position to capitalize. So, I feel very good about that.

I also feel very good about the fact that our business -- our tank container leasing business that we bought a few years ago, Trifleet, has been an excellent addition to GATX -- one that we can continue to grow. It is organically growing in the high single digits, unlike some of the other markets we're in, from a unit perspective. So, there'll be opportunities there.

And the third thing I would mention is on the engine leasing business. Whether it's through our joint venture with Rolls-Royce or direct, there are substantial investment opportunities. And I can tell you, we feel very good about that asset class, given the fact that we've come through a pandemic when global air travel literally went to zero. I mean, nobody could have anticipated that situation. And yet, here we are coming out of that. The assets themselves have showed great stores of value, great resiliency. And we have an outstanding partner in Rolls-Royce that we can continue to grow with. So that's my general assessment with regards to North American rail, I'll look to Paul and see if you have anything to add, in terms of the dynamics.

Paul Titterton:

Yeah. I mean, it's -- not much to add, Bob. Thank you. I mean, as I said, fundamentally, we are in a tight market right now, which has been very good for us in terms of pricing and term. I think we've been successful so far this year even despite high asset prices, finding some attractive places to deploy capital in North American rail.

So fundamentally, we feel good about where we are positioned in the market right now. And as we always do, we can't predict the future. So, the terming out of the fleet, as you observed, is our key hedge against the uncertainty that we might face. So overall, I think we feel good about the positioning we have in Rail North America.

Tom Ellman:

And the only thing I'd add to that, Bascome, is the key difference is during that upcycle that you mentioned, we knew that there was overbuilding going on in crude oil cars. We knew there was overbuilding going on in small-cube covered hoppers. We don't have something analogous like that going on right now.

Bascome Majors:

Well, that sound pretty encouraging. Thanks very much for that comprehensive answer, guys.

Bob Lyons:

Thank you, Bascome.

Operator:

Your next question comes from the line of Justin Bergner with Gabelli Funds. Please go ahead.

Justin Bergner:

Good morning, Everyone. Hi, Bob. Hi Paul. Hi, Tom. Hi, Shari. First question would be on the Rolls-Royce joint venture. I think maybe sometime in the past quarters, you've sort of segregated how much of the increase in the segment profit year on year was coming from

higher remarketing income versus sort of operating the operation or leasing of the fleet. Could you maybe comment on that?

Tom Ellman:

Certainly. So, for the year-to-date numbers that we have, about 45% of the segment earnings are from operations and about 55% from remarketing.

Justin Bergner:

Okay, that's helpful. I got on a few minutes late, so I'm not sure if this was covered early on, but the guidance raised to at or above the high end of the \$6.50 to \$6.90 guide -- is the primary driver there, the higher remarketing income? Or are there other material drivers we should be aware of?

Tom Ellman:

Yeah. So, primarily, if you look segment by segment, things are proceeding pretty much as we anticipated coming into the year. We talked about -- in Paul's first answer, he talked about some positive news on the revenue side in Rail North America and some offsetting higher-than-expected maintenance primarily due to the volume of activity coming into the shops.

The one segment that clearly has overperformed is the Portfolio Management segment, and that's really driven by the positive performance that we've seen at our joint venture with Rolls-Royce. And in that, tying back to your first question, we're seeing better-than-expected performance in remarketing income and on the operations side as well. So that's the biggest one that's been different.

Bob Lyons:

Yeah, I'd say, Justin, coming into the year, as we came out of the back half of '22, we were still anticipating relatively slower recovery in global air travel than has occurred. We, and I think, and everybody else. But the most recent statistics show that domestic air travel is now at pre-pandemic levels and has exceeded pre-

pandemic levels. Anyone who's been at the airport lately, I think, can attest to that. And international travel is now already back to 90% of pre-pandemic levels. So that recovery has occurred faster than we thought.

Justin Bergner:

Got you. So, I realize you didn't increase the guide in the first quarter, but I guess are you suggesting then that your view on sort of remarketing income in Rail North America isn't materially higher sort of post-2Q versus post-1Q?

Bob Lyons:

That's correct.

Justin Bergner:

Okay, got you. Two more quick questions. On the velocity side, are you seeing any signs of sort of a step -- positive step change there? Or things continue to struggle at the major railroads?

Paul Titterton:

It's really a mixed story. I would say, in a different period, a different railroad will be up, a different railroad will be down. The overall trend right now, I would say -- and really when we talk about velocity, the velocity, there's dwell time and then there's also sort of first-mile, last-mile service quality.

And those three things, collectively, are what impacts the competitiveness of rail service for rail shippers. And what I would say there is, if the story remains mixed, it would -- we can't say that we see any particular overall improvement across the industry in the service package being offered by the railroads.

Justin Bergner:

Okay. And then lastly, one of the major suppliers of railcars in the industry got a big set of orders in recent months. And I was just curious if you had any thoughts as to why that

might have suddenly occurred. Maybe lower steel prices? And what that means if lower steel prices do lead to orders for new railcars if that could have any effect on the cycle as it relates to leasing and the tightness therein?

Paul Titterton:

It's really hard to say because ultimately, what drives an individual book of orders for a given builder may be just specific to the customers and the niches they're filling. So, I really -- I don't want to speculate on what might have driven those orders. It's really difficult for us to know.

Justin Bergner:

Okay, understood. I appreciate your taking all my questions.

Bob Lyons:

Thank you, Justin.

Operator:

And your final question comes from the line of Justin Long with Stephens.

Justin Long:

Thanks for taking the follow up. I just wanted to circle back on one data point around the utilization rate, in the European railcar fleet, that stepped down sequentially over the last couple of quarters. And I was wondering if you could provide a little bit more color on what's driving that and how you're thinking about utilization in that market going forward?

Bob Lyons:

Sure, Justin. This is Bob. I would say, broadly, across the fleet, utilization has held up extremely well, and we're still seeing pretty stable demand for most car types. The challenge spot has been in the intermodal market. We have just under 2,000 intermodal wagons in Europe. And that has been the spot that has

been the primary driver of that step-down in utilization.

The Eurozone economic growth has been pretty benign; negative expectations in some circles, flat overall. So, the environment for carload, or for carload demand, on the intermodal side is low. So that is the biggest driver now. We like those assets. We like the investments we've made there. They'll be great long-term holds for us, but we need to drive through this period right now of low demand for that particular car type.

Justin Long:

Okay, got it. That's help. Thanks, Bob.

Bob Lyons:

Okay.

Operator:

There are no further questions at this time. I will turn the call to Shari Hellerman.

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. You may now disconnect your lines.