2013 Fourth Quarter Conference Call January 23, 2014

Operator:

Well good day, ladies and gentlemen, and welcome to the GATX Fourth-Quarter Conference Call. Today's conference is being recorded and I will now turn the conference over to Ms. Jennifer Van Aken. Please go ahead, Ms. Van Aken.

Jennifer Van Aken:

Thank you, Kelsey, and good morning, everyone. Thanks for joining us for the fourth-quarter and 2013 year-end conference call. With me today are Brian Kenney, President and CEO of GATX Corporation; Bob Lyons, Executive Vice President and Chief Financial Officer; and Tom Ellman, Executive Vice President and President, Rail North America. Tom is joining us to provide additional insight on questions you may have regarding the North American rail industry.

As a reminder, any forward-looking statement made on this call represents our best judgment as to what may occur in the future. We have based these forward-looking statements on information currently available and disclaim any intention or obligation to update or revise these statements to reflect subsequent events or circumstances. The Company's actual results will depend on a number of competitive and economic factors, some of which may be outside the control of the Company. For more information, refer to our 2012 Form 10-K/A for a discussion of these factors. You can find this report, as well as other information about the Company, on our website, www.gatx.com.

I will give a brief overview of the results provided in our press release earlier this morning, and then Brian will comment on some key areas for GATX in the year ahead. After that, we will open it up for questions.

Today, we reported 2013 fourth quarter net income of $53.3 million, or a $1.14 per diluted share. This compares to 2012 fourth quarter net income of $29.7 million, or $0.62 per diluted share, which includes a benefit from Tax Adjustments and Other Items of $2.8 million, or $0.06 per diluted share. Details relating to Tax Adjustments and Other Items are on Page 12 of this morning's press release.

For the full-year 2013, net income was $169.3 million, or $3.59 per diluted share, including a benefit of $4.5 million, or $0.09 per diluted share, from Tax Adjustments and Other Items. By comparison, 2012 net income was $137.3 million, or $2.88 per diluted share, including a benefit of $3.5 million, or $0.07 per diluted share, from Tax Adjustments and Other Items.

The fourth quarter and full-year 2013 results are reflective of the robust demand for tank cars in North America. Rail North America's fleet statistics were strong despite facing some challenges in the freight car market. Utilization was approximately 98% throughout the year and we achieved very strong lease rate increases on long-term renewals. In the fourth quarter, the renewal rate change of GATX's Lease Price Index was a record high 37.1%, resulting in the full-year renewal rate change of the LPI of 34.5%. We continue to optimize our fleet through railcar sales, generating more than $50 million in asset remarketing income. We were also active on the investment side as we found opportunities to purchase railcars outside of our existing supply agreement. Investment volume was over $500 million in 2013.

Within Rail International, GATX Rail Europe faced a weaker operating environment. Fleet utilization was solid, though, ending the year at 96.8%. 2013 was another big investment year for GRE, with investment volume of more than $160 million, reflecting our strategy to continue strengthening our platform in this attractive market.

American Steamship Company operated 13 vessels and carried 28.8 million net tons of cargo in 2013, compared with 14 vessels that carried 29.7 million net tons in 2012. Segment profit was lower compared to 2012, however, as we moved less iron ore and operations were negatively impacted by conditions on the Great Lakes.

Portfolio Management's improved year-over-year results were due to improved results from the Rolls-Royce and Partners Finance affiliates and the absence of an impairment related to the sale of a joint venture in the prior year. The Rolls-Royce joint ventures continued to post very strong results and today the engine portfolio is nearly $2.5 billion in net book value.

In the coming year, leases on approximately 20,000 railcars are scheduled for renewal in North America, and we expect the renewal rate change of the Lease Price Index to be in the 30% to 35% range again in 2014. Due to continued scheduled compliance work in North America, we expect maintenance expense to increase from 2013. We also anticipate somewhat lower asset remarketing income following a very robust 2013. We anticipate an improvement in the European railcar leasing market and remain focused on identifying additional investment opportunities internationally.

ASC is expected to move more cargo in the coming year, and we're hopeful the current ice cover will have a positive impact on water levels.

In Portfolio Management, we anticipate another strong year from the Rolls-Royce affiliates, but slightly less asset remarketing income from the owned portfolio.

Considering these items, we currently expect 2014 earnings to be in the range of $3.85 to $4.05 per diluted share, excluding any impact from Tax Adjustments and Other Items. And with that overview, I'll turn it over to Brian.

Brian Kenney:

Thanks, Jennifer. I'm going to assume everybody's read the press release. And Jennifer just summarized our 2013 performance and 2014 outlook, so I won't rehash those details except to say that I'm extremely pleased with the way we performed both financially and strategically over the last few years. Especially in context of serving an industry in which volume as measured in railcar loadings still has not recovered to a level seen prior to the prior recession.

So given the diversity of our fleet, broader-based economic growth which stimulates more rail traffic, will allow us to produce even better performance. And I'm saying that coming off a year in which we produced record earnings per share. So obviously, we remain very optimistic about our business.

But this morning I have three topics I want to quickly address, and those of you who know GATX well will not be surprised to learn that two of them are of the challenging variety, and that's the kind we always want to make sure our investors are aware of. So the first factor I want to discuss is the tank car regulatory environment.

Over the last six months, there have been a number of accidents involving the rail transportation of crude oil, especially originating in the Bakken region of North Dakota, and that started with that tragic accident in July 2013 with the crude train derailment in the town of Lac-Mégantic, Quebec.

There have been three other serious derailments of crude trains since then in North Dakota and New Brunswick, Canada and in Alabama, as well as some other less severe derailments. And obviously, these accidents have naturally resulted in more intense focus from the general public, from the regulators, and of course, from the industry on the safe transportation of crude oil and other flammable liquids by rail.

As an industry, we recognized a few years ago that the increased transportation of ethanol and crude oil in these unit trains warranted a re-examination of existing tank car design for cars in this type of service. Thus, the industry approached PHMSA, so the Pipeline and Hazardous Material Safety Administration. They were approached in May 2011 and they were asked to rule on a new enhanced tank car design involving thicker steel, head shields, and enhanced rollover protection. Unfortunately, it was not a priority for PHMSA at that point in time, so instead of waiting for them to act, the industry moved ahead and adopted the sturdier tank car design and that new car has been built as a standard since October 2011.

So after the accidents in 2013, back in September, PHMSA announced they were seeking public comment for 60 days on their advanced notice of proposed rule-making, and that concerned the safe transportation of hazardous material by rail including the

DOT-111 tank car. So numerous comments have been submitted by interested parties, including those with the Railway Supply Institute of which GATX is a member. Left to its normal process, the PHMSA rule-making could easily take a year or more but, obviously, there's intense external pressure on PHMSA to move more quickly.

And you see examples of that in the press all the time, you saw probably last week there was a meeting between Transportation Secretary Foxx and executives from the rail and petroleum industries concerning the safety of crude-by-rail transportation. And actually, media reports that the Secretary appeared to set some expectations for a 30-day response coming out of that meeting.

So you can see, as a result there's a tremendous amount of uncertainty around what new regulations, if any, might be enacted for tank cars in flammable liquids service, the timing of any regulations, and, of course, what the impact might be on the GATX fleet. But our position really hasn't changed.

We support any tank car design that would meaningfully improve the safe transportation of flammable liquids by rail, but we also believe that these regulations need to be comprehensive. They should address railroad operating procedures, they should be based on scientific data, and they need to be comprehensive enough to avoid unintended consequences such as the shifting of this traffic to less safe modes of transportations, like the highways.

The second factor I'd like to touch on is our maintenance compliance bubble; our fleet is in the midst of that. I discussed this on last year's call as well as throughout 2013, and if you were able to listen, you know we used the term “compliance bubble” to refer to the increase in the variety of regulatory inspections and repairs that are required on our North American fleet over the next few years, especially in and predominantly on tank cars. These inspections are largely mandated by time and age. So this bubble we actually formed when we purchased a large amount of cars, tank cars, 15 years ago. So in 2013, we completed compliance work on approximately 7,500 cars in our fleet and that was a large increase from 2012.

And more importantly, we had a sizable increase in tank qualification compliance events in 2013, and that's that periodic structural inspection and repair of the tank itself. Tank qualification is generally the most expensive and costly compliance event, and performing this inspection on over 4,000 cars in 2013 was that major driver in net maintenance increasing by 12% from the prior year.

In 2014, we again expect an increase in both total compliance events and tank car qualifications, and that should drive an increase in net maintenance of around 10%. Beyond 2014, based on the current schedule, we expect a decrease in the number of tank qualifications, eventually getting back below the 2013 level by around 2017. I say based on the current schedule because, obviously, we're very active in the market. We buy new cars -- we buy used cars, we sell cars and, obviously, your schedule depends on the composition of your fleet. And compliance work really isn't the only driver of maintenance expense for GATX. And equally important factors include renewal success percentage, railroad repairs, and other factors, but I wanted to give you a good feel for where we are in the compliance bubble, which is right in the middle.

The last topic, before we go to questions, I want to briefly address is today's announcement of the dividend increase and the share repurchase authorization. As you know, if you've dealt with us over the years, we zealously guard both our access to and our cost of capital. It's our lifeblood in order to grow our fleet and our asset base.

So the Board declared the dividend and approved the repurchase armed with the knowledge that the long-term, very high-quality committed cash flow that we've locked in over the last few years in our North American rail business will help us achieve our objectives of both earning that good return for our shareholders and maintaining a strong capital structure, and we fully intend to do both in the years ahead.

So that's all I had. So let's go ahead and open up the questions, Operator?

QUESTION AND ANSWER

Operator:

Absolutely. (Operator Instructions) We'll go first to Justin Long with Stephens.

Justin Long:

Thanks and good morning. Congratulations on the quarter and outlook. My first question was on the share buyback. I was just curious what your timeline was on this program being exhausted? And also, I was wondering what you're factoring in to 2014 guidance in terms of share buybacks as well?

Bob Lyons:

Sure. Good morning, Justin, it's Bob Lyons. The $250 million authorization that we put in place, you can -- our assumption on that is that there's enough capacity there for a multi-year plan. A one- or up to a two-year plan gives us enough capacity. And for purposes of budgeting, you can assume that that was split evenly between '14 and '15. And, obviously, that is subject to change. Could be accelerated, could be decelerated, depending on investment opportunities that we see in the marketplace. And that we'll continue to maintain a very solid capital structure as Brian already referenced. So the baseline assumption is about half each year, roughly.

Justin Long:

Great. That's helpful. My second question was on the tank car, potential tank car retrofit. If we end up seeing this happen, which it sounds like it's pretty likely, can you just talk about how that will play out in terms of the costs you will incur versus what will be passed on to the customer through a potential rate increase or some type of clause in your contract?

Brian Kenney:

Sure. I'll give you probably an unsatisfying answer on the first part of the question [Laughter] and I'll let Tom address the customer part of it. But the fact is, we don't know if there's going to be a retrofit or what it should be. So it's hard to estimate the cost. And that's the unsatisfying answer. There's still a lot of science and engineering that needs to go on to see what's possible, especially with the older cars. So for instance, I measured -- I mentioned a high-flow pressure relief valve that has been recommended for cars. That hasn't been perfected yet.

One of the proposals out there in response to the PHMSA advanced notice of proposed rule-making is should you jacket the older cars? We don't know if that's feasible from an engineering standpoint and that work is going on.

So as that work is performed, we're going to have a better idea of what retrofit is appropriate, if any, and what it will cost, but the unsatisfying answer is it could be very low or it could be tens of thousands of dollars in the extreme. So we really have to let PHMSA work through the process and figure out what retrofit, if any, makes sense. As far as the customer, Tom?

Tom Ellman:

Thanks, Brian. I don't, for obvious reasons -- I don't want to get into the specifics about the contracts we have with our customers but, in general, there is an ability to adjust the lease rate for changes in regulatory requirements. And one of the things we've been focused on for quite some time when we talk about on every call is the lengthening of the lease terms in the tank car market. So that timeframe gives us a lot of time to recover whatever regulatory costs may be imposed on the existing fleet.

Justin Long:

Okay. That makes sense. And is there any opportunity for you to benefit from a tank car retrofit or would you just frame it up as it's a net neutral if you're able to pass through the cost like you were saying, Tom? Or maybe a slight headwind if you incurred a portion of that retrofit costs?

Tom Ellman:

Yes. From a maintenance perspective our primary objective is to maintain our own fleet. So any kind of opportunity that might come from doing maintenance work on upgrading the fleet, probably you shouldn't give a lot of weight to that. What happens with the market dynamics overall in a regulatory or phase out situation, there's too many iterations to really make a call on what could happen there, but there's a lot of factors. What do we have to do with our own fleet? What would that mean for the transportation of energy? Of crude? What are the second-order effects on other car types? So a lot of permutations to look at.

Justin Long:

Okay. That's fair. And I'll just close with one last question. Just bigger picture -- so Trinity continues to ramp a JV they announced last year. And in December, we also got an announcement regarding their strategic agreement with Element. It seems like there's really an appetite in the market to increase exposure to leased railcar assets. And with that in mind, I just wanted to get your bigger picture view on how you feel about the competitive landscape and the amount of leased railcar capacity that appears to be coming on in the market?

Tom Ellman:

From a tank car perspective, it's certainly true that the capacity to produce tank cars has been going up. In 2013, we expect that a little over 20,000 tank cars will be delivered. And it could approach 30,000 tank cars in 2014. So there certainly has been increased investment in this area, as you would expect, with backlogs going out as far as they are; generally, into the late 2015 timeframe. So I'm not sure if that's where you're going with your question, but that's certainly what's been happening with capacity coming in.

Brian Kenney:

Yeah, and we'll also say -- having been in this business as a long-term player for over 100 years and as have the other major players in this business -- in good times, and it's been very good times in tank cars, you do tend to see people try to get into the business and of course it looks very attractive. But in challenging times, generally, they try to get out as well. So, it's unclear whether any of these are long-term players -- and we're satisfied with the way we're positioned.

Justin Long:

Okay. Great. I'll leave it at that and pass it along. Thanks for the time this morning.

Operator:

Moving on to Matt Brooklier with Longbow Research.

Matt Brooklier:

Hello, good morning. So, just wanted to get your overall sense on the tank car market in the fourth quarter from a lease rate perspective? If you could provide some color, directionally, where lease rates moved? And then maybe your thoughts on tank lease rates that potentially baked into your 2014 guidance?

Tom Ellman:

Okay. This is Tom again. And I think Bob will have some additional comments. Jennifer talked about some of the numbers; specifically, the Lease Price Index that we use to show what rates are doing overall. And obviously, that number has been very strong in the 30% range and we expect that going forward. In tank cars, it's been pretty broadly based. We spend a lot of time talking about exactly what's going on in crude oil and energy, but the fact of the matter is because of the extreme demand in that area, it's difficult to produce cars for other services.

So across the entire market, the supply-demand situation is allowing us to get those high lease rates. Equally importantly is the long lease term. We provided some information about being in excess of 60 months. And we would expect that on the tank car side to continue.

Moving over to the freight car side, one of the things we've been talking about is a hopefulness of a general strengthening in that market and we’re starting to see that. The covered hopper market, thanks to the strong harvest, is much stronger than it was earlier in 2013. We continue to see strength in the small-cube covered hopper market, which is what is used for sand and cement. And we're starting to see building occurring in the plastic pellet and other chemical markets. Companies have been talking for a while now on the increased investment that will happen due to less expensive energy, and we're now seeing people starting to order cars for those services.

Bob Lyons:

Matt, the only point I'll add to Tom's comments with regards to the LPI as you saw where it came out for the full-year 2013, right in that mid-30% range; and looking forward and taking that into consideration with our estimates, we would expect the LPI to be in that same range again in 2014. So, a very attractive market for us.

Matt Brooklier:

Okay. I guess the question being on tanks, specifically, do you think we've peaked out here in terms of lease rates and do things level off from here moving forward? Do they stay where they are? What is your sense on the direction of tank lease rates?

Bob Lyons:

Yes, Matt. I'll answer real quick and then let Tom add color. As we talked about at the end of the third quarter, the tank car numbers already had leveled off at that point --

Matt Brooklier:

Okay.

Bob Lyons:

-- So on the back half of the year -- and we've factored that into our outlook already.

Matt Brooklier:

Okay.

Bob Lyons:

I don't know if Tom wants to add anything else.

Tom Ellman:

No, Bob said it perfectly. On a quarter-over-quarter basis, you're definitely seeing leveling, but in any kind of historical context, extremely strong numbers.

Brian Kenney:

It's still well above expiring rates.

Matt Brooklier:

Right. Okay. Understood. And then if you could talk to your expectations for CapEx? And 2014 -- how you're looking at the year and potentially adding additional equipment aside from what you've already committed to?

Bob Lyons:

Sure. We finished 2013 with consolidated investments of roughly $860 million. Just over $500 million of that was in North American rail. You can find that deep in the supplemental pages of the press release. As we look forward into 2014 -- first of all, in that $860 million, that included about $100 million, roughly, related to a joint venture that we bought out --

Matt Brooklier:

Right.

Bob Lyons:

-- in Marine, and so that was really an abnormal investment. So you'd be looking at the mid-$700 million levels, which is right about where we were in 2012, and we'd expect 2014 to be in that same range. So -- and fairly consistent across the segments, as well.

With Rail North America, as I said this year being just over $500 million, our assumption right now is that number comes down just slightly, but really it's subject to opportunities we can find in the secondary market, too. So, another very solid investment year on the horizon is our expectation for 2014.

Matt Brooklier:

Got you. Okay. Appreciate the time and the color.

Bob Lyons:

Thank you.

Operator:
(Operator Instructions) We'll move on to Art Hatfield with Raymond James.

Art Hatfield:

Hello. Good morning, everyone. One clarification. As I hear you correctly, you're saying that really in the back half of 2013, tank car -- absolute tank car rates have appeared to have plateaued at this point in time? Is that -- did I hear you correctly on that?

Tom Ellman:

Yes. As we've talked about before, when we say tank car rates, we're talking a lot of different tank car types.

Art Hatfield:

Correct.

Tom Ellman:

But it's certainly the rate of change is much, much smaller than you've seen through 2012 and the earlier part of 2013.

Art Hatfield:

Did you see any segments within the market that showed any weakness?

Tom Ellman:

Well, I mean if you're talking tank cars, no. We've talked for several quarters about the challenges in coal and they continue.

Art Hatfield:

Okay. Fair enough. As I look at some of your metrics, the back half of 2013, the North America -- and this is all directly related to North America, but the fleet is shrinking just a little bit and I understand you guys are always opportunistic about playing in the secondary market with selling cars out of the fleet. But the announcement of the increase in the dividend, some of the other commentary, the share repurchase program, and as long as I've known you guys, you're always looking at the next cycle. Is there anything to read in the actions or some of your commentary today that maybe you're starting to look out and see that investment opportunities in some of your core markets here in North America are starting to lag? Particularly on the new investment side? And that you guys are starting to think about how to position yourselves for a potential downturn a year or two out?

Brian Kenney:

That's an interesting question. I think it's definitely more challenging for investment in North America due to asset prices being so high. Fortunately, we have our Committed Purchase program in place and we're still taking deliveries. So volume there will still be high. And our commercial team has found ways to buy other cars in the market. But there is no question that it is extremely challenging right now to make those transactions make sense. For every transaction in the secondary market that we close, there's probably 10 that we look at and we say it's too expensive. So, yes, that's more challenging, but I don't think you should read anything into these, into the dividend and share repurchase authorization, other than we've been able to lock down a tremendous amount of committed cash flow over the last couple of years.

Bob Lyons:

Yes. Just to add to that point, Art, too – definitely, if you looked at the last two or three years what we've been able to do in rate and term and lock that in for a very extended period of time, the cash flow generation capabilities of the Company continue to go up.

Art Hatfield:

Right.

Bob Lyons:

In 2013 alone, our cash from operations was over $400 million. Just a couple years ago that was about $250 million.

Art Hatfield:

Right

Bob Lyons:

And it's locked in now for a very long period of time.

Art Hatfield:

Okay. So it really is just a function of what you've been able to do with your contractual business over the last couple years and that cash flow that's locked in, and maybe new investment is more difficult to accrue right now, but that's really not the reason for the share repurchase and the dividend?

Bob Lyons:

That's correct. And as I said before, we're estimating or assuming right now that our investment volume for 2014 will be -- call it in the mid-$700 million range.

Art Hatfield:

Yes.

Bob Lyons:

That's the third fairly healthy year in a row. That's a big investment year. And we're able to do that and execute on a share repurchase and pay the dividend, returned that capital to shareholders, too, while keeping the capital structure in a very solid position.

Art Hatfield:

Of the $700 million how much of -- is that committed mean contractually you're obligated to take delivery of those assets, or is that the plan?

Bob Lyons:

Well, we're committed under the Trinity order.

Art Hatfield:

On that one. But --

Bob Lyons:

Yes and that's the biggest in terms of commitment. Beyond that, there's not a significant amount committed and, really, very little in North America. There is some in Europe. We're anticipating Europe to have another investment year in the mid-$150 million to $160 million range -- and a good portion of that is committed.

Art Hatfield:

Okay.

Bob Lyons:

We took advantage of the opportunity there to place an order -- advanced order for tank cars, and then in North America as you know well, we have the Trinity order.

Art Hatfield:

Yes. No, that's helpful. Thank you. Just a couple last ones. One quick one, hopefully, and I know a lot of investors ask us this about this all the time, but have you seen weakness in lease rates, specifically related to crude-by-rail in the fourth quarter?

Tom Ellman:

No. We haven't. What you've seen is inquiries are still coming in for new cars for crude-by-rail. The rate of those inquiries might have slowed a bit, but the car types are still very much in demand. An important point, though, is the way we've been lengthening lease terms. We just don't have that many remarketing opportunities.

Brian Kenney:

It's fair to say, though, that the spot business that other lessors were more focused on has receded dramatically, I think. So the very, very short-term business that Tom and his team never participate in.

Art Hatfield:

And you think that's just a function of the railcar manufacturers finally catching up a little bit with demand that initially topped as a result to growth of crude-by-rail?

Tom Ellman:

Yes. And just to amplify Brian's point because that was very helpful because I missed the point of your question. In the short-term market, there's been a dramatic decrease in lease rates for crude-by-rail and exactly the reason I think you're pointing to, Art, is that there is more cars available for it than they previously had been.

Art Hatfield:

Could you quantify that, say a year-over-year decline in that market, or is that even a reasonable comparison?

Bob Lyons:

It's a little bit difficult to make that call because it's not a market we participate in. We're not bidding one- or two-year leases like others are, but --

Art Hatfield:

Right.

Bob Lyons:

-- pretty substantial drop.

Art Hatfield:

Okay. That's fair.

Bob Lyons:

From what we've, anecdotally, what we picked up in the market.

Art Hatfield:

And finally, you guys addressed this very well at the beginning. And I know I'm going to ask you a question you don't have an answer to, but I'm going to ask it anyways. And I know that the whole regulatory thing is really up in the air and maybe first derivative impact to other car types or second derivative impact to other car types and regulations -- could you ballpark today within your fleet maybe a range of what the number of cars you think may be impacted by the new regs?

Brian Kenney:

It's such a fluid, uncertain situation and the focus of everybody seems to change week to week, but very, very broadly speaking, GATX has approximately 12,000 cars in flammable service. As we've said in the past, the cars most at risk are the older, non-jacketed general service cars that have been involved in these crude-by-rail accidents.

Art Hatfield:

Right.

Brian Kenney:

And we have less than 7,000 of those, so that's another data point. So 12,000, 7,000, and then, ultimately, if there are any regulatory changes and it focuses on certain commodities like crude and ethanol, then it's a much lower number. So once again, an unsatisfying answer. I seem to give a lot of those, but at its broadest, we have 12,000 cars in flammable service then you go down from there depending on the focus of the ultimate regulation.

Art Hatfield:

No, actually, Brian, that was a lot more helpful than I thought you'd be able to be. Just final follow-up to that and then I'll get out of your hair. Have you gamed the potential scenarios and do you see a potential situation where the regulations are so severe that maybe you back away from some of these markets?

Brian Kenney:

Well, to some extent, I should let Tom handle that, but we're not a huge player, for instance, in the crude-by-rail business relative to our competitors anyway. But, Tom?

Tom Ellman:

That's exactly right. One of the things we stress over and over again is with the supply agreement, the diversity and the assets that we have, the crude-by-rail phenomenon -- we have order of magnitude 2,000 cars that are in crude service. So it's not an area that we're real big in to start with. Regardless of what happens to anything, when we're making investments, we're going to be very, very focused and disciplined on not over-investing in any one single area.

Bob Lyons:

The other thing I'd add, Art, very quickly, is you see a lot of different data points thrown around out in the marketplace on what a retrofit might cost, and at this point –

Art Hatfield:

Right

Bob Lyons:

-- I don't even know how people are coming up with those assumptions –

Art Hatfield:

Right

Bob Lyons:

-- but they range from whatever, $5,000 to $80,000. $80,000, economically, you're not going to make that investment --

Art Hatfield:

Right.

Bob Lyons:

-- back into the car.

Art Hatfield:

Right.

Bob Lyons:

So I wouldn't extrapolate that kind of number anywhere.

Art Hatfield:

That's all very helpful. Thanks for your time today. Have a good one.

Bob Lyons:

Thanks, Art.

Operator:

Steve O'Hara with Sidoti & Company has the next question.

Steve O'Hara:

Good morning.

Bob Lyons:

Good morning.

Steve O'Hara:

Along the lines of the regulatory changes, is there potential here for this to, depending on how quickly things get done, is there potential here for this to squeeze rates on other car types, or maybe force some marginal players out of the business? Maybe fringe players? I know it's a highly consolidated industry, but I'm just wondering your thoughts on that, if you could?

Tom Ellman:

Yeah. And I don't know which part of it to take first, but as far as what this might do to the competitive landscape -- in the tank car market, as you noted, it is a highly consolidated industry. And the major players are going to be facing this issue and they're going to have a different level of their fleet that's exposed to it. I wouldn't expect anything that comes out of this to dramatically change who the players are. As far as what it does to lease rates, again, it all comes down to what a final regulation might be. And are certain cars allowed to operate that could be perceived to have different levels of utility based on how exposed they are to a potential regulation? It could happen. Exactly how to quantify that, though, at this point, is impossible.

Steve O'Hara:

Okay. Is there any -- is there historical context maybe you could point to?

Bob Lyons:

I don't think anything of this significance or that has received this amount of attention at all, at least in modern history.

Steve O'Hara:

Okay. Thank you.

Operator:

Moving on to Craig Wiese with Bema Capital Group.

Craig Wiese:

Hello there. Thank you for taking my call. I just was hoping to clarify another question related to this whole regulatory question. I appreciate that you've done what you can to insulate yourself from potential regulations and that there's a very small portion of the fleet that's older and dedicated to flammable service. But if we get these regulations that require retrofitting, whether it's significant or small, does that end up leading to a reallocation of the industry's fleet to the other tanker car markets and, thus, pressure those rates even if you're not directly affected? Is there a secondary effect here?

Tom Ellman:

Yes. That's a great question and a helpful reminder of how specialized tank cars are. Within the car types that carry crude and ethanol, if you had something where less rail traffic was going to move -- less crude oil traffic was going to move, yes, it would put pressure on the car types that carry those commodities. But large portions of the tank car fleet would be unaffected because there's no ability to move between the commodities they carry and crude oil and ethanol. For context, the GATX fleet, about 10% of the tank car fleet that we have are the car types that most often carry crude and ethanol today. So that would be the piece that whatever the impact is, you'd be looking for the biggest impact. If you really want to model out complexity, there could certainly be a second-order impact on new cars, because if people had to build a bunch of replacement car types for the specific crude and ethanol car, there'd be less capacity to build other car types and there could be impact on those lease rates. But for the existing cars, it's really going to be limited to the car types that can carry crude and ethanol.

Craig Wiese:

So just to be clear, those 10% cannot be repurposed for any other tanker car purpose other than crude?

Tom Ellman:

No, no, incorrect. There's a variety of commodities that carry that can go in that car type. Again, just for context in the GATX fleet, a little over half of them are in either crude or ethanol. A little over half of them are in a variety of commodities. What I meant is if for whatever reason this car type, and generally it's a 30,000-gallon car type, 30,000-gallon cars could not flow into other commodities. You wouldn't all of a sudden have a glut of vegetable oil because those cars can't carry vegetable oil.

Brian Kenney:

But I'd also add that if they go after all flammable liquids in this service, then you're limited in how you can re-deploy those cars. So that's why it's important to look at the whole range of numbers we've thrown out -- until regulations become clear.

Craig Wiese:

So they can go to some other purposes but not all of the purposes and we're not sure what are the purposes they can be reallocated to?

Tom Ellman:

That's true.

Brian Kenney:

Exactly.

Tom Ellman:

Yes

Craig Wiese:

Okay, thanks.

Operator:

Steve Barger with KeyBanc Capital has the next question.

Steve Barger:

Hello, good morning, guys.

Bob Lyons:

Good morning.

Steve Barger:

You talked about some improvements in the freight market and following up on the point about specialization of tank cars -- are the non-petroleum tank car customers that may be traditional buyers being pushed into leases because of new car pricing or have they deferred purchases because of pricing? Just trying to get a sense of how much pent-up demand there is or opportunity on the non-petroleum side?

Tom Ellman:

Yes. I think the biggest source of demand on the non-petroleum side is really much more from the backlogs were just so long it was difficult for them to pull the trigger on ordering the tank car. If backlogs come in a little bit, then you'd see more ordering there. We have not seen in the non-petroleum car types any material movement in and out of relative ownership position. A given customer might make some changes there, but broadly based, it's been very consistent with history.

Steve Barger:

Just so I understand, you do think that as petroleum car orders moderate and backlogs come in that some of the non-petroleum tank car buyers will come to the market?

Tom Ellman:

I think they will, but it's important to keep in mind the relative magnitudes of those markets. Historically, a good tank car year was 10,000 to 12,000 cars, and we're talking about 30,000 car levels. So while the "everything else" would help for a period of time, it's not enough to replace the demand that if and when the petroleum boom goes away, you would see an overall decline in demand.

Steve Barger:

Oh, sure. Sure. And, Bob, just a modeling question, how should we think about gross margin in portfolio management given the current portfolio and improved performance? And the Rolls finance affiliate, for the last couple of years have been either low 30% or high 30% range -- is that a reasonable way to think about it going forward in that mid-30s?

Bob Lyons:

Well, we're assuming in 2014 that Portfolio Management's total segment profit actually will decline modestly. They had a pretty good year in terms of remarketing activity. We're not anticipating that again in 2014. So that will back off. It may come down by half of what it was this year just within Portfolio Management. A little bit of that will be offset by Rolls-Royce, but they had an extremely strong year this year and we're not anticipating that rate of growth within Rolls-Royce to continue. They'll continue to perform extremely well and contribute significantly, but not enough to offset that drop in remarketing income.

Steve Barger:

Got it. And sorry if I missed this, but did you talked about your expected tax rate for 2014?

Bob Lyons:

No. Happy to cover that, though. Our effective tax rate when you normalize this year was about 29%. And for 2014, we're actually expecting that to go up a little bit on the 30% to 31% range, due to the proportion of -- greater proportion of income generated here in North America which is our highest tax jurisdiction.

Steve Barger:

Thanks very much. That's all I have.

Bob Lyons:

Thank you

Operator:

And we'll now hear from Gian Magrini with GAMCO Investors.

Gian Magrini:

Yes, good morning, everyone, and thank you for taking my question. Just a quick one and I know you already made some comments on this topic, but is there anything else besides the improving outlook that is driving you to initiate the today $250 million repurchase announcement? Just seems a little sort of out of charter for you guys.

Bob Lyons:

Obviously, the biggest thing is our expectation of the growing cash flow and the embedded cash flow that we put into the business here in the last couple of years. We see that continuing to grow going forward. We have the ability to continue to invest and at times invest aggressively in our core markets. And be able to return a significant amount of capital back to shareholders at the same time -- so nothing other than our outlook.

Gian Magrini:

Understood. Just a very quick follow-up on this, and just to complete the scenario, I guess. So if someone were to make an offer for your Company, under which circumstances would you be required to disclose it to the public?

Brian Kenney:

Under what circumstances? I don't know …

Bob Lyons:

The General Counsel isn't here -- we don't know the answer to that.

Brian Kenney:

We say what we always say which is, if anybody ever makes a credible offer for GATX, we'll do what's absolutely in the best interest of our shareholder, period.

Gian Magrini:

Understood. Thank you very much.

Operator:

And our next question will come from Mike Baudendistel with Stifel.

Mike Baudendistel:

Thanks and good morning. Wanted to ask a question on one of the comments on the freight cars you mentioned earlier in the call. The comments on strengthening in small-cube covered hoppers and plastic pellet outlook -- do you view those as being investable areas given the equipment prices are?

Tom Ellman:

Certainly. And in fact, in the small-cube covered hopper market, we've been making investments. Pellet car investment has been pretty slow for the industry as a whole until very recently. And we'll make the same decision there we do with every car type which is current lease rates, long-term expectations versus the current price. So -- but those are good solid car types that make up material portions of our fleet.

Mike Baudendistel:

Good. And the Lease Price Index being in the 30% range 2014, are you still facing comparisons with the expiring leases still being at recessionary levels or do you start to face expiring leases that are a little bit higher rate in 2014?

Bob Lyons:

That will come in 2015. They start to move up a little bit, and actually, 2014 we still have a pretty favorable comparison and then it starts to move up a little bit, which makes sense given the lease cycle.

Mike Baudendistel:

Great. That's helpful. And then one more on the tank car regulations, I don't think I've heard you comment on the capacity in the shops to perform those retrofits? Do you have any opinion on if there's say, a $15,000 retrofit on a certain car type? Just what capacity is in the marketplace to perform those retrofits and over what period of time is reasonable for regulators to give you?

Brian Kenney:

Well, generally speaking, we talked about the compliance bubble that GATX is in. So capacity is constrained and we're trying to add capacity in our shops over the next couple of years, but the industry -- tank car industry as a whole, also has a compliance bubble out there that actually starts a little later and peaks a little later than ours, so I think it will be very constrained if our retrofit is required on the entire tank car fleet. In fact, that's one of the challenges we're trying to bring up to people is -- as you consider retrofits and timing, if there are any retrofits, you really have to consider the capacity out there in the network and the ability to do that because you don't want to lose this traffic, in the meantime, to a less safe mode of transportation -- and that can happen if you try to ram it through too quickly.

Mike Baudendistel:

Great. That makes sense. Thanks for the time.

Operator:

We have no further questions.

Jennifer Van Aken:

Okay. I'd like to thank everyone for your participation on the call this morning and I will be available this afternoon if there's any follow-ups. Thank you.

Operator:

Thank you. And again, ladies and gentlemen, that does conclude our conference for today. We thank you all for your participation.