GATX | GATX Corporation

2015 Second Quarter Conference Call July 23, 2015

Operator:

Good day and welcome to the GATX Second-Quarter Conference Call. Today's conference is being recorded. And at this time, I would like to turn the call over to Chris LaHurd. Please go ahead, Sir.

Chris LaHurd:

Hello, everyone, and good morning. Thanks for attending the Second-Quarter 2015 Earnings Conference Call. This is Chris LaHurd, GATX's new Director of Investor Relations. I recently assumed the role from Jennifer Van Aken, who's transitioned on to another position within the Company. With me today are Brian Kenney, President and Chief Executive Officer, and Bob Lyons, Executive Vice President and Chief Financial Officer.

Before we begin, 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 2014 Form 10K 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.

Today, GATX reported 2015 second-quarter net income of $45.4 million, or $1.03 per diluted share. This compares to 2014 second-quarter net income of $53.1 million, or $1.15 per diluted share. Year-to-date 2015, we reported net income of $107.6 million, or $2.42 per diluted share. This compares to net income of $95.2 million, or $2.05 per diluted share for the same period of 2014.

We had strong performance in the second quarter. Three key highlights of the quarter include an increased Lease Price Index for North American Rail, complemented by a very high renewal success rate and significant improvements to the boxcar fleet's utilization rate; stable lease revenue from GATX Rail Europe, in spite of a challenging macroeconomic environment there; and solid performance from Rolls-Royce and Partners Finance.

Let me now address each segment in more detail.

Rail North America's fleet utilization was 99.3% at the end of the second quarter. During the quarter, the renewal rate change of GATX's Lease Price Index was 36.3%, and our renewal success rate remained very high at 84%.

The average renewal term for cars in the Lease Price Index was 54 months. This shorter renewal term relative to the prior quarter stemmed from weakness in coal cars, which have been under pressure for some time, and cars in flammable service, due to regulatory uncertainty and low oil prices. Aside from these specific car-type headwinds, the remainder of our fleet experienced strong demand at attractive terms and rates, with certain car types remaining at historically high lease rates.

As noted in this morning's press release, the utilization rate on the boxcar fleet has increased from 78.8% upon acquisition in March 2014, to 97.3% at the end of the second quarter. While scrapping certain idle cars has helped boost utilization, the main driver has been our success in moving idle cars into active, long-term service.

Another notable development during the second quarter were the recently enacted flammable tank car regulatory changes. Although these changes will take some time to fully develop and play out, GATX is well positioned to address these regulation changes, with fewer than 1,400 tank cars requiring modifications or retirement by 2023.

The secondary market for railcars remains active. Rail North America's asset remarketing income was $5 million during the quarter, compared to nearly $36 million in the prior quarter, the difference driven by timing of sale package releases. We still expect full-year remarketing income to be in-line with the 2014 numbers.

Within Rail International, the European tank car leasing market remains stable. GATX Rail Europe is seeing steady demand across the fleet. Rail International's investment volume was more than $27 million during the second quarter, as GRE continues to take delivery of new tank cars.

American Steamship Company had a challenging first half of the year, facing extreme weather conditions, operating delays, and a meaningful reduction in demand for iron ore shipments on the Great Lakes; they are currently operating 12 vessels.

Portfolio Management's results were driven primarily by the solid performance of Rolls-Royce and Partners Finance affiliates.

Finally, and lastly, GATX repurchased nearly 727,000 shares for approximately $41 million during the second quarter. At the end of the quarter, there was $57.4 million remaining under our $250 million repurchase authorization.

Those are our prepared remarks. I'll hand it over to the operator so we can open it up for questions.

QUESTION AND ANSWER

Operator:

(Operator Instructions) We'll take our first question from Matt Brooklier with Longbow Research.

Matt Brooklier:

Thanks, and good morning. So you talked to overall demand for railcars in North America, and you mentioned weakness in coal. I think we already knew that story, and also some weakness around flammable service tank cars. I'm just curious to get a little bit more color in terms of demand in other car types at this point in time. And I'm curious to hear if there is any other areas of-- related to energy that could be feeling some weakness currently?

Brian Kenney:

Sure. It's Brian. As you said, 30,000-gallon tank cars in flammable liquid service have been very weak, but really, that's been weak over the last 18 months; you've heard us talk about it. First, it was the uncertainty about regulations, but primarily, it's really been the overproduction and the moderning demand with the downturn in the crude-by-rail traffic.

But even with that rate decline in the 30,000 tank cars, the rates are historically strong. And across most tank car types, we are focused on increasing pricing and extending terms still. So, yes, 30,000-gallon tank cars are weak, but there's -- I would say the rest of the fleet is hanging in there pretty well. An example of a tank car that is doing well, for instance, would be acid cars.

On the freight car side, it's always hard to generalize given the diverse markets, but beyond coal, which you mentioned, small cube covered hoppers, as we predicted, are also weak, and pricing there has slipped in the first half of 2015 as that demand has gone down.

But outside of that, the chemical market, the food market, the fertilizer market -- they're all hanging in there pretty well. Another example of a freight car that's doing very well right now is our boxcar fleet. You've mentioned the tank car and freight car types that are struggling, but the rest of the fleet is hanging in there very well.

Matt Brooklier:

Okay, good to hear. And I know it's a smaller percentage and you have less exposure to the crude market, but curious to hear your thoughts on how much potential slack there is in that market given crude price correction.

Brian Kenney:

I can't pin that down for you, but as you know, if you listen to our calls, we think there's considerable overproduction in that market over the last two years and coming in the future. And that's why we've avoided, to a large extent -- we only have 2,800, 2,900 cars in crude service because we think that market has been overserved and will be overserved for quite some time. So a lot of slack.

Matt Brooklier:

Okay. And then have you -- are people taking action? We have regulations -- have you seen any changes in the tank car market? Are people repositioning equipment out of crude maybe into some other flammables or maybe even into some nonflammable categories? And I'm just trying to get a sense for how the market is reacting now that we have regulations.

Brian Kenney:

We have the regulations as of May 1st, but remember, since that market was already weak, I don't know that any of the weakness right now is really due to those final regulations. As I said, rates were already down on those car types.

As far as term, perhaps. Obviously, you're not going to extend, on renewal, a tank car lease from one of those flammable cars beyond that modification date, so that might have had some impact on term. But I think for the most part, the impact on the 30,000-gallon tank car fleet and other flammable cars has been just market forces.

Matt Brooklier:

Okay.

Brian Kenney:

And as far as the conversation with customers on what we are going to do as far as retrofit, what we've been saying still holds. We're very unlikely to retrofit those DOT-111 legacy cars. That just doesn't make sense for us. And we've seen no conversation or desire from our customers to try to retrofit those legacy cars. I'd say, right now, they are in the analysis phase. In some cases, they have some time to decide here to see how regulations finally turn out because there is a lot of challenges to them as well as the market before they have to make a decision. But right now, that activity on retrofit, as we predicted, is very light.

Matt Brooklier:

Okay. I will pass it along. Thank you for the time.

Operator:

Our next question will come from Justin Long with Stephens. Please go ahead.

Justin Long:

Thanks, and good morning guys. I wanted to follow up first on the earlier question about the lease rate environment. You mentioned 30,000-gallon tank cars and frac sand being a little bit weaker. Is there any order of magnitude you could give in terms of the lease rate decline we've seen in the industry for those two car types over the course of the year? And it sounds like everything else is pretty stable, but correct me if I'm wrong on that.

Brian Kenney:

Yes, everything else is generally stable. I'd say things have come off the peak, but outside of pull 30s and small cube covered hoppers, maybe a little bit off record highs, but still historically quite strong, to the point where we'd like to extend term on those car types.

As far as some industry color on rates for the car types you mentioned, coal is down dramatically. I think in the industry, probably we were seeing rates in the 400s and 500s, and it's now down in the 200s. For sand, it really hasn't come off that much in the industry. Probably down 10% to 15%. And for the 30s, obviously, it's down pretty significantly. I think year-over-year for the industry, it's probably down in the neighborhood of 25%. Still, once again, if you look at the absolute rates, it's still pretty strong, even for 30s and small cube. And if we have any renewals, we'd consider extending term.

Now, that's the other point I'd like to make about our fleet and not the industry is -- especially on the small cubes -- we have very little in the way of exposure. In fact, this year I think there's literally no exposure or single-digit exposure, and through the end of next year, maybe a couple hundred cars. So we've positioned the fleet very well in anticipation of this downturn to have it hold up very well.

Justin Long:

Great, that's really helpful color. I wanted to also just take a step back. If you look at the railcar equipment stocks right now -- and there's been a significant pullback in the group -- investors seem to be suggesting this is the peak in the market and demand should start to decline in the next several quarters. But based on talking to your customers, do you think that that sentiment and outlook for the market is similar, or are they more optimistic about where we go from here?

Brian Kenney:

As I said, we have virtually no customers telling us that they're going to return cars out of the existing fleet. As far as new car orders -- and that backlog that is out there -- that is definitely more challenging and very competitive. But if you look at GATX's fleet as opposed to the industry fleet, we've intentionally -- we've talked about it at nauseam in prior calls -- we've kept it very diversified. We constantly stress that. It's a very diverse fleet from a car type, commodity type, and customer perspective. That serves to insulate us very well due to a downturn in any one sector. It's just hard for a down -- the crude cars are a great example. We have only 2,800 crude cars in our fleet out of almost 125,000 cars. It's very hard for one car type to take us down.

The other thing I'd point to for our fleet is our diligent term management. We've talked about that, too, where when times are good, as they have been the last few years, we have extended term pretty dramatically, in some cases giving up rate in exchange for term. And that also serves to insulate us somewhat.

So what I'd look at for GATX's fleet is the overall economic activity since it's such a diversified fleet. And therefore, I think it's going to hold up pretty well as long as the economy does okay. Right now, economic indicators are okay. If you want to look at data points for how GATX's fleet might do, there's a lot of them out there, but I would really look at GDP growth, railcar manufacturing backlog, and car loadings as three good indicators of how our fleet will perform.

Justin Long:

Great, that's helpful. I just wanted to ask one more. On the coal market, you guys have a pretty solid track record of timing the cyclicality within the railcar market for different car types. Where do you think we stand in terms of the coal car cycle? Obviously, it's very weak right now, but is this the bottom here? Is there more room to go? What is your latest take on that market? And at what point would you say we've hit bottom, it's maybe time to invest?

Brian Kenney:

I'd say it's very unlikely for us to invest in new coal cars going forward, just because of the long-term outlook for that car. As far as where we are in that cycle, I don't think we have a -- it's hard to be optimistic about it right now. I think it'll be very challenged, fleet type for the industry and for us, at least for the remainder of our visibility to the end of this year, for instance. So I think it's hard to say that it's at the bottom.

Justin Long:

Okay. Fair enough. (Multiple Speakers)

Brian Kenney:

Our expectation -- Sure.

Operator:

And our next question will come from Art Hatfield with Raymond James. Your line is open.

Art Hatfield:

Afternoon or morning I don't know what's going on. Brian, your comments about the outlook and how the [unintelligible], three things you pointed to. GDP has been -- at first quarter wasn't good. Second quarter, probably a little bit better. First half of the year so far, car loadings haven't been great. There's been pockets of help, but overall, most of the downward revision is coal, and we've touched on that. But outside of that, it's been mixed. And the backlog is close to historical highs on the freight car side --

excuse me, on the railcar side. Given those three makeups, should we be concerned about the go-forward and the possibility that there will be excess supply within the railcar market and that could lead to pressure on lease rates?

Brian Kenney:

Yeah, absolutely. We think there is going to be excess supply in a number of different markets. But as far as the overall diversified fleet of GATX, as long as economic activity hangs in there, I think it'll perform okay overtime. But there's no question -- and we have talked about it on this call and in prior calls -- between the uncertainty in crude oil and its effect on the frac sand market and small cube covered hoppers and coal. It's -- absolutely, those markets are weak, and there's oversupply.

As far as the rest of the fleet, it really depends on economic activity and where people are going to put their cars. Now, that backlog is so big out there that you could see people try to reframe those orders and try to put them into other service. That's the risk going forward. I think you've hit on the right thing. There's a big backlog out there, and the question for us, even for our fleet which is so diversified, is what happens with that supply? Does it get cancelled? Does it get -- try to put into other markets and make things more competitive for us? But for right now, as you can see, with 99% utilization and a 36% LPI increase, things are going really well.

Bob Lyons:

Art, the other thing I'd mention, too, is to not lose sight of what has transpired here over the last few years in terms of our commercial organization being incredibly successful and stretching term and capitalizing on an incredibly strong lease rate market. You don't want to lose sight too much of the embedded cash flow in the business and the leases that have been put to bed for a very long period of time at very high rates.

Art Hatfield:

That color is extremely helpful. I think you guys have done a great job, and specifically thinking about GATX, the diversification is very helpful. And what you said about term, that's helpful for us.

The other thing I wanted to ask you about was the maintenance expense number in Q2 dropped off quite a bit. Have you gotten through a little bit of a maintenance bubble, and should we see that number continue to trend down, or does it flatline at these levels?

Bob Lyons:

I wouldn't count on it to trend down, Art, in the second quarter. We did see that number come off a bit. Some of that was due to fewer wheel set replacements in the second quarter versus the first quarter. A little bit of that is seasonal.

We also incurred some boxcar expenses into service costs in the first quarter, and you saw those cars actually go on lease during the second quarter. So that also contributed to that drop. So I wouldn't trend line it down. As a matter of fact, we probably will see that number go up a little bit during the second half of the year as some of those variance pieces level out.

Art Hatfield:

Okay. That is helpful. Can you talk a little bit about the dynamics of the boxcar market? You guys have been shrinking that fleet and getting much better utilization, and I would assume you are getting better revenue per car. We've seen some stories about tightness in the market. We've also, surprisingly, seen some orders in the marketplace. How do you think about the boxcar market going forward? And given the cost structure of your fleet, how well positioned are you to compete against some of this new equipment that may enter the market?

Brian Kenney:

I am very pleased with the boxcar fleet performance. We knew we would be able to improve performance of that fleet, but going from 79% utilization at acquisition to 97% at the end of the second quarter in just 15 months is even beyond my expectations.

Yes, we've scrapped about 1,000 cars, but we've also sold a number of cars. I think we're approaching taking 2,400 idle cars and putting them into service. We've been very successful on getting those cars utilized and converting per diem leases to fixed rate or guaranteed per diem, and at very attractive rates and locking them in for term. It's done very well.

And, yes, there has been a new car order out there. I believe it was 3,500 cars from TTX. But that's -- I wouldn't say it's a different car type, but really, it is a different asset. Those are obviously brand new 60-foot, 286,000-gross railroad cars. Ours are extremely old. They started out at 37 years when we purchased them, and they're 50-foot, 220,000-gross rail load. So even with this order, the supply of boxcars in the industry will continue to decline over the next few years. Our investment thesis still holds -- which is, the number of cars will continue to decline. Our customers are very worried about the availability of boxcars, but the underlining commodities that travel on those cars, that demand is pretty stable.

The other thing on that new car, as far as us, we don't think the lease rates that are available in the market really justify that investment, at least not for us. So we don't mind competing against that car with our cost basis. The other thing to think about -- and I'm saying it's almost a different asset -- is for many of our customers, their infrastructure is really optimized around our 50-foot car, and that 60-foot car is less preferred.

Art Hatfield:

Okay.

Brian Kenney:

We feel really good about boxcar performance and our ability to compete in this market.

Art Hatfield:

A couple of questions to follow on to that. One, do you care to comment on what percentage of the fleet is still per diem? And given the age of the fleet, should we expect a continued decline in the size of the fleet as it ages relative to what we've seen over the last year, or will that stabilize to some degree?

Brian Kenney:

Well, there were 4,300 cars that were idle when we purchased this fleet, and between putting cars to work, selling, and scrapping them, we're only down to 500 idle cars now.

Art Hatfield:

Okay.

Brian Kenney:

Yes, they will roll out due to age, but as far as rolling out or being scrapped due to idle, there's just not that many idle cars left. As far as the number of per diem cars, yes, it has decreased, but it's still a significant portion of the fleet, and will be because you want to have that diversity within the boxcar fleet, as well. So like I said, we're thrilled with this performance thus far.

Art Hatfield:

Thank you. One last one. I'm sorry to take up so much time, but operating lease expense in North America -- can you refresh my memory on what's gone on there over the last year and a half? It has come off significantly and appears to be coming down quite a bit this year. Is that just a function of how the car ownership is structured within the fleet?

Bob Lyons:

That's correct, Art. So operating lease expense is associated with cars that historically we have done some form of sale leaseback on --

Art Hatfield:

Yeah.

Bob Lyons:

--and leased those cars in. So what you see on the operating lease expense line is basically akin to interest or the financing and ownership costs associated with that. Over time, we have purchased in as the early buyout options become available on those leases. We've purchased those cars and refinanced them at much lower rates just directly off our own balance sheet.

Art Hatfield:

Okay. So that would be a function of -- well, you've done a good job on your balance sheet, so is it fair to think about that just straightlining that, and as that changes, adjust accordingly?

Bob Lyons:

It will continue to come down. We're not doing any significant sale leasebacks at this current time, and we'll continue to buy those cars in and finance them directly.

Art Hatfield:

Okay, perfect. Thanks for the time this morning.

Bob Lyons:

Sure.

Operator:

And our next question comes from Mike Baudendistel with Stifel. Please go ahead.

Mike Baudendistel:

Thanks and good morning. Just wanted to ask you on the railcar industry data that just came out the other day, the tank cars in backlog is about 46,000. Do you have any estimate of how many of those cars in backlog are for crude or flammable liquid service versus the smaller ones that maybe would compete more directly with you?

Brian Kenney:

Well, the estimates we had were around 80%. I don't know what that number is now. But don't get too enamored with that number because if that demand is not there, they'll try to place other tank car orders and put them into other service. So I wouldn't get too excited about the fact that our fleet is deployed in service other than crude and other (unintelligible) have earmarked it for crude. If it's not there, they'll try to put into other service or try to have a different kind of car.

Mike Baudendistel:

Okay. Then historically, you've talked about lease rates being high when railcar OEM backlogs are elevated like they are now. But since they're so much higher than they were at the peak of the last cycle, what level would the backlogs have to be in the industry? Now they're currently 136,000. What level would they have to be before lease rates would typically soften?

Brian Kenney:

I don't know that I can answer that specifically. It would have to be much shorter than it is now. Right now, if you look at the backlog, it is hard to get your hands on a new car anytime soon, so you're not going to give up your existing car. And lease rates are -- there's still a significant differential between new car lease rates for cars that deliver next year and what you can get on an older car. That's why the fleet's doing so well. It's hard to give you a specific number when that flips, but it's going to have to be a lot shorter than it is now.

Bob Lyons:

To Brian's point, too, I think, Mike, I'd just point out again the incredibly strong renewal success rate in the second quarter really, and in the first quarter, too. To that point, customers are not inclined to let go of cars that they have on lease today and are in the mindset of keeping control of those cars through a renewal.

Mike Baudendistel:

Good. And the other question I have is on duration -- at 54 months, I know you called out a few railcar types that were driving that number down. If you were to -- excluding coal and the other car types that you called out, are the durations still around 60 months or more, or is there a normalized number there?

Brian Kenney:

We should have done that math, but we try to not start doing that math because then you'd have to produce all kinds of different numbers. But just eyeballing this thing, if you take out those three car types and the reduction in term in them, the rest of the fleet hung in there very well and I'd say either was flat, in some cases, up.

Mike Baudendistel:

Okay, great. Those were my questions. Thank you.

Operator:

And our next question will come from Jordan Hymowitz with Philadelphia Financial. Your line is open.

Jordan Hymowitz:

Can you say what the rates offered to tank cars alone being put on in the quarter the months that they're being put on for?

Bob Lyons:

Pardon me, Jordan? I'm sorry. I didn't catch that.

Jordan Hymowitz:

Can you give the overall lease rates in the quarter for just the tank cars being put on?

Bob Lyons:

We don't break that out separately. The only external data point we give, Jordan, as you know, is the LPI number, and --

Brian Kenney:

And directionally on the LPI, tank cars were up still, even in this market, a lot more on a percentage basis than freight cars were.

Bob Lyons:

Correct. So that 36% is a combination of tank and freight, and tank would be higher than that.

Jordan Hymowitz:

Tank would actually be higher than freight.

Bob Lyons:

Yes.

Jordan Hymowitz:

Second, of the cars scrapped, can you break them down by types of cars that were scrapped?

Bob Lyons:

We don't break that out, either. I would say the mix of that is pretty reflective of the overall fleet, just given the fact that most of the scrapping that takes place in this type of environment is all age driven. There're some, obviously, boxcars that we scrap out, but we give you that number separately. But on the general fleet, it's reflective of the overall fleet.

Jordan Hymowitz:

Okay, thank you.

Bob Lyons:

Yeah.

Operator:

And our next question will come from Steve O'Hara with Sidoti & Company

Steve O'Hara:

Hi, good morning.

Brian Kenney/Bob Lyons:
Good morning.

Steve O'Hara:

I was wondering if you could talk about the current orders you have for deliveries and whether you have customers signed up to take those cars currently, stretching how far into the current order book that you have?

Brian Kenney:

Sure. We're sold out well into next year. I believe the first availability we have is April of 2016. And as I look at the composition of those orders, I see good diversity in car types and customers, and pretty strong economics, actually. Although, as I said, it's getting more competitive, but we're still sold out well in advance. In fact, we've even placed cars on the new order, the new Trinity order that starts in August of 2016, so we're doing pretty well.

Steve O'Hara:

Okay. And then just in terms of maybe the cycle and the way the fleet is -- the average duration of your portfolio -- assuming there's a downturn in the cycle or the economy, I would assume that you'd be able to continue to grow earnings for some period of time into a downturn given the length of -- or the strength of the LPI and the length of the average lease term. Can you talk about how that might work, or maybe I have that wrong? I'd appreciate it. Thank you.

Brian Kenney:

We can talk about what happened in the last cycle. So 2008, when the rest of the market, the economy, everything was collapsing, we had a record year. It takes a while to turn around the aircraft carrier. This time around, I'd say we've extended term even more dramatically than last time, so it'll be a slower turn. It's too early to give guidance for 2016 and beyond. I think you're right in assuming that over time, the average expiring rate in that LPI starts to increase, and if the market comes down dramatically, there will be a crossover. But where we're sitting there today, absolute rates would have to come down pretty dramatically for us to see a negative LPI in the near term here.

Steve O'Hara:

Okay. And then in terms of the -- you recently had a pretty big increase in your dividend relative to recent years, and it seems like you're very confident in the cash flow you have embedded in the portfolio and pretty bullish on that given that increase. Is that fair?

Brian Kenney:

That's fair, and it's to Bob's point that he's made a couple of times. With the term extension that we've had, we've locked in a decent amount of lease revenue and cash flow over the next couple of years. That was one of the major emphases of that dividend increase.

Bob Lyons:

If you look back just a few years ago, Steve, our committed cash flow or our committed lease income -- lease revenue from our North American Railcar portfolio just a few years ago was $2.3 billion. At the end of last year, it was just shy of $4 billion. And not only has it gone up sharply, it's extended, as Brian mentioned. So more of that cash flow will come in in years five and beyond. As we look out, yeah, there's some potential volatility or cyclicality associated with earnings, but the cash flow of the Company is incredibly strong, and we have excellent visibility into that, and that certainly helped drive our decision.

Steve O'Hara:

Okay, thank you very much.

Operator:

Our next question will come from James Goodfellow with Avondale Partners. Please go ahead.

James Goodfellow:

This is Jamie on for Kristine. I know we have talked about the potential pressures on the backlog, pressure potentially on lease rates and overall softness in the market that can flow through residuals. I was hoping you could speak to any early indications of what you're expecting on remarketing for the rest of the year and then into 2016, particularly -- even if it's just directionally or what you see in the dynamics of residuals there.

Bob Lyons:

Well, the remarketing income through the first half of the year has been particularly strong. We've already had $47 million of remarketing income through the first half of the year. All of last year, we did about just a little north of $70 [million.] We said for the full year 2015, we would be in line, roughly, with where we were last year. We still feel that way. So another extremely strong year from a remarketing perspective.

The packages we have out in the secondary market for sale, we're still seeing good activity on those, very good and diverse activity from a fairly wide pool of buyers. We don't see that abating anytime soon. It's too early to talk about 2016 at this point, but just keep in mind that even in up or down markets, we continue -- we have always historically found very good remarketing opportunities from a pretty good pool of buyers.

James Goodfellow:

Okay, that is helpful. And I was also hoping to run through the dynamics of what you are seeing in the Great Lakes freight. I know you mentioned some pressure on iron ore. Any thoughts, any expectations on what's going on in that market?

Bob Lyons:

Yes, it has been a challenging market, both weather-wise in the first half of the year, and then also continues to see pressure from the iron ore side and the steel side. We look at mill capacity utilization as one benchmark around the mills in the Great Lakes region. They're at 72% today. They were about 77% last year. And on a year-to-date basis, iron ore tonnage on the Great Lakes is down about 10% compared to the last five-year average. Those are pretty challenging dynamics to deal with. Typically, your highest margin move is a long-haul iron ore move. So while tonnage has hung in okay this year versus where we were last year, the mix of that tonnage has moved more towards coal and limestone, some of the -- and some shorter haul iron ore, lower margin.

However, when we look out through the balance of the year, last year, American Steamship's segment profit was right around $28 million. Year to date, we're at about $2.5 million or $3 [million] at American Steamship. They won't get all the way, we don't think, back to where they were last year from a segment profit standpoint, but they'll get along a large part of the way there. We are expecting much better performance from them in the second half of the year.

James Goodfellow:

Perfect, thanks. I will pass it on.

Operator:

(Operator Instructions) We'll go next to Steve Barger with KeyBanc Capital Markets. Please go ahead.

Steve Barger:

Hi, thanks for taking my questions. Brian, you talked about people being in the analysis phase for the tank rules, but when you think about the population of likely retrofits and the compliance timeline, do you have a guess as to when that activity picks up? And when it does, do think it'll affect availability across the market? Or do you think it'll be pretty seamless in terms of getting the cars in and out and into compliance?

Brian Kenney:

It remains to be seen, but there's a couple of things going on. First, there's a lot of legal and administrative challenges to the U.S. rule. The Canadian rule is not subject to challenge, but the U.S. rule is. And if you look, there's several challenges that have been filed in the DC Circuit Court of Appeals and with PHMSA, and the challenges focus on the modification deadlines, the ECP brakes, the high-hazard flammable train designation, and tank car standards.

In fact, if you even look two days ago, the Senate reached a bipartisan agreement on a new six-year highway reauthorization bill, and in that bill, there's a section on ECP brakes. And it doesn't repeal the mandate as the rails had been lobbying for, but it does say that the General Accounting Office has to do a study on them. So the DOT can take that study and change their view and either repeal or endorse the rule following that.

There's still a lot of uncertainty out there. I think that's what is driving the fact that things are still in the analysis phase, but eventually -- we're still having those conversations with customers, and eventually this will get settled. And what I anticipate is, if you look at orders across the industry, the first cars that should be retrofit or are the easiest to retrofit is that CP-1232 that's already jacketed.

Steve Barger:

Right.

Brian Kenney:

The second one will be CP-1232 that is not jacketed. And then you have all of the legacy cars. From our perspective, we don't think the legacy cars make sense at all, at least for GATX. Our fleet is generally older than the industry, and that cost is prohibitive. I think it's at least twice what PHMSA estimates, and if you have ECP brakes, it gets even more expensive and more challenging. I don't know that those cars ever get retrofit. I know a lot of people have geared up for massive amounts of retrofits. I don't know if that's going to happen. Only time will tell.

All I can answer it is for our fleet, and it's highly likely that's going to happen. I think what you'll see is people start to react as things become clear and as those deadlines approach. That first deadline is in that 2017 to '18 timeframe.

Steve Barger:

Right.

Brian Kenney:

So people are going to have to start to react before then.

Steve Barger:

Okay. And we're still fairly early in the oil down cycle. Is there any talk about distressed assets out there from car owners or small lessors, and if not, do you expect that can happen any time in the near future?

Brian Kenney:

No. I have not heard. Once again, if you look at industry utilization, not just ours at 99%, but I think industry utilization, in general, is still pretty high. I wouldn't say, or I certainly haven't heard of any distressed fleets out there. So could it come? Yes. I don't know that anybody is that focused in their fleet on crude, but it could come.

Steve Barger:

Or sand cars, right?

Brian Kenney:

Yeah, certainly. People are more exposed than we are, and I've beat our diversity to death, but whether it will be bad enough to take somebody down, I don't have a feel for that.

Steve Barger:

Right. Well, I get the question from investors all the time, so I'll just ask it for the record -- are you seeing any customers coming to you for contract modification, or do you expect to see that?

Brian Kenney:

No. We've had zero activity as far as customers coming to us to modify contracts, say they don't want deliveries, or honestly, even to this point, saying they want to return cars, existing cars.

Bob Lyons:

Steve, the other thing I would remind people of, and we've talked about this in conferences and whatnot, is if you reflect back to 2008 and 2009, the worst financial crisis in modern history, and probably the most challenging rail market anybody has seen in decades -- we didn't see a lot of that then. There were some requests, but we certainly didn't do anything that was uneconomical for GATX, and there was very few of those.

Brian Kenney:

The other thing I'd point out, it's not like we are immune from people when the market turns down to returning cars. It's just that we've restructured the fleet. I think I mentioned small cube covered hoppers earlier. We literally have single digits as far as expirations this year, so it's just not a conversation that's going to happen. Will coal cars be returned in our fleet? Yeah, sure, if the market stays like this.

Steve Barger:

Got you. Thanks, it's good color. Last question from me. Bob, given the cash flow visibility you have in coming years, we know that you want to be a buyer of distressed assets in the downturn when that happens, if that happens. And I know you want to have capacity to do that, but if you saw continued weakness in the stock, is there a level where you'd step in more aggressively just because you know the cash flow is there?

Bob Lyons:

Well, we always have stock repurchase as one of the options in front of us, along with our dividend and CapEx. If we look out over the course of the last -- to 2006, we've invested over $6.5 billion and grown the balance sheet very strong, while also returning over $1 billion to shareholders through stock repurchase -- about $625 million of stock repurchase during that time, and another close to $500 million in dividends. So we have numerous levers available to us. But yes, we are not hesitant to buy stock back and do so aggressively when the opportunity presents itself.

Steve Barger:

Very good. Thanks for the time.

Operator:

Our next question comes from Justin Bergner with Gabelli & Company

Justin Bergner:

Good morning, Brian. Good morning, Bob

Brian Kenney/Bob Lyons

Good morning.

Justin Bergner:

My first question was just a clarifying question. Can you remind us how many coal cars you have and how many small cube covered hoppers you have that are in frac sand service?

Chris LaHurd:

This is Chris. On the coal car front, we have about 7,500; small cubes, roughly 6,000. About 2,900 of those are in frac sand service.

Justin Bergner:

Okay, thank you. The second question I have relates to the rate of asset dispositions this quarter. I think everyone expected it to slow down. Perhaps the magnitude of the drop off is catching some people by surprise. Was there a factor that caused GATX to limit its amount of dispositions this quarter? Perhaps the fact that a lot of people are looking at these GE railcar assets and maybe you're better served to wait a quarter or two?

Bob Lyons:

No. There is nothing unique. If you look at our quarter-to-quarter remarketing over history, it's incredibly volatile. What it's driven by is the timing of us putting packages into the secondary market and closing on sales that are economic to GATX. We're trying to drive the best economic outcome, and we don't try to time sales in any way. We're doing the best thing for the shareholder long-term. And it could be very high in the first quarter -- one quarter, like it was in the first quarter, and lower in the second. It's just a matter of timing.

Brian Kenney:

We get that question a lot about do we use it to manage earnings, which is, obviously, we're not doing a very good job if we [laughter] -- because it's very volatile quarter to quarter. It really is driven, as Bob says, by economics. So don't look for run rates.

Justin Bergner:

I was just wondering if with the GE assets for sale, you figured buyers were looking at a lot of other things this quarter, but maybe not.

My final question relates to the Portfolio Management segment, and specifically, the affiliate earnings. I noticed there was a small decline in the affiliate earnings year-on-year. I was just curious if you might be able to provide any color there?

Bob Lyons:

Well, Rolls-Royce continues to perform extremely well. Their numbers also can bump around a little bit quarter to quarter because they also, within Rolls-Royce, they have some remarketing activity. Nothing of note there. I'd also add our shipping joint -- we have one remaining shipping joint venture, and those vessels continue to face some pressure in the marketplace that we've talked about in the past. So nothing of note there, Justin.

Justin Bergner:

Great, thank you very much. Best luck in the second half.

Bob Lyons:

Thank you.

Operator:

(Operator Instructions) We'll go next to Gregg Hillman with First Wilshire Securities Management. Your line is open.

Gregg Hillman:

Good morning, gentlemen. I had a more strategic-type question. I was wondering if you had the right balance between entrepreneurialism and controlling the Company? In other words, like, whether you can -- whether people further down the organization have the authority to develop businesses that could better utilize your capital rather than buying back your stock and getting higher returns on investment? It seems like you have a lot of great cash cows, but you're still in search of an emerging new growth business. I was wondering if there's any way you can change the organization so you can put more authority in the hands of people that have really good ideas?

Brian Kenney:

That's an interesting question. Our North American rail business, our European rail business has ample authority to invest where they see opportunities along the way. I think if you look at the growth in our fleet and capital employed especially over the last 10 years, it has been pretty strong given the underlying growth in the rail market. I don't think the structure of our organization is an issue there.

Gregg Hillman:

Okay. But how about just having an entirely new business that's somewhat -- it could be adjacent, like expanding your service offering, or maybe getting into a total different vertical as a way to grow the business and increase return on equity?

Brian Kenney:

The return on equity is very healthy, both from an industry perspective and historical perspective. As far as our growth into other verticals or other types of business, we're way more focused on taking what we have done successfully over the last 117 years and applying it to other markets.

We've grown our European fleet dramatically over the last decade. We're now in India, where we are one of the only two lessors in a very growth-oriented market with a lot of potential. And that's what we'd rather focus on rather than getting into unrelated businesses where we have no expertise.

Gregg Hillman:

Okay, thanks.

Operator:

And gentlemen, it appears that we have no questions remaining. I'd like to turn the conference back over to you.

Chris LaHurd:

I would like to thank everyone for their participation on the call. Please contact me with any follow-up questions. Thank you.

Operator:

Ladies and gentlemen, that does conclude today's conference. We thank you for your participation.