

TEXTAINER: BOXED AND SHIPPING TO FIVE-BAGGER LAND

- Container leasing industry at cyclical trough, signs of recovery materializing, Mr. Market is asleep at the wheel. Now is the time to get in.
- Largely owned by retail income investors accustomed to 5-10% yields, the poor recent financials and (prudent) near-complete dividend cuts explain the massive decline in container stocks and Mr. Market's pessimism.
- Textainer is the best play in container leasing right now.
- Attractive valuation relative to book value, comps, and maintenance FCF.
- Risks include 2018-19 refinancings, various threats to world trade, and a global economic slowdown.

Company	Textainer
Listing	TGH
Average Daily USD liquidity	\$2.8mm
Current Price	\$9.20
52 week low / high	\$7.31 / 20.38
5 year low / high	\$7.31 / 43.06
Market Cap	\$526mm
P/E	20.2
P/B	0.45
Debt/Equity	3.72
3 Year Expected Total Return	199%
Total Return Range	(11%) - 409%

Business Overview

Textainer (TGH) has been in business since 1979 or 37 years. Prior to the recent merger between TAL and Triton (TRTN), it was the largest intermodal container leasing company in the world with 3.2mm TEU ("twenty-foot equivalent unit") fleet as of Q2 2016. The company's fleet consists mostly of standard dry freight boxes, but they have increasingly been buying reefers (refrigerated boxes) in recent years and this plus other specialized units like tankers now make up 22% of the fleet. In the past, most of the fleet was owned by other container investors and Textainer managed these containers in exchange for a management fee. Today, the company owns 81% of its fleet and growing. The company is headquartered in Bermuda, mainly to avoid taxes and usually boasts a mid-single digit corporate tax rate. It operates out of 14 offices and 400 depots worldwide and has 160 employees. Tencor, a South African container and logistics public company, has had a significant ownership interest in Textainer since 1986. Today, Tencor owns just under 48%. Textainer manages some containers for Tencor and receives a management fee. In the past, there have been some arbitrage [opportunities](#) between Tencor and Textainer stocks that some readers may be interested in. Of note and particular importance to this article's investment thesis, Textainer has been consistently profitable for 29 years and has a history of being a big dividend payer, similar to a REIT or MLP in reputation, though not corporate structure.

Investment Thesis

Read about the history of the container. Look at the financials of the container leasing companies over the last 10-20 years. The industry is clearly at or very near a cyclical trough right now. Financial trends look horrible and some companies in the industry have all but completely cut their dividends, which has shocked the dividend growth retail investors who largely owned these names and were accustomed to getting 5-8% yields from these stocks. This has resulted in a massive decline in the publicly-traded container stocks and undue pessimism

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on the part of Mr. Market. The way to get the incredible trough-to-peak returns in cyclical is to monitor them when they are hitting new lows and the financials are worsening, looking for signs of a turnaround materializing. They won't be in the financials yet. By then it is too late. They will be things like industry supply/demand improving, input costs rising, etc. Usually there is a period of time between when these signs appear and when the market recognizes. Sometimes this period is almost non-existent. Other times it can last several months. It is always a very attractive time to invest though because you are getting the stock at rock-bottom prices despite the de-risking as you've already seen things start to turn. I believe we are at that moment in the container leasing industry and am recommending Textainer stock as a way to play it. I also own shares of CAI (CAI). Of the bunch, Textainer is the most attractive right now given its superior long-term track record of near 20% returns on equity and competitively low price at less than half of book value. With some simple arithmetic, it is very easy to see the strong return potential over the next few years. Like anything, there is risk here related to refinancing needs in 2018-19, threats to world trade like the rise of protectionism, terrorism, and war, and the risk of a major global economic slowdown. However, I think the reward far outweighs the risk to the point where we could assume a 50% chance of complete loss and this would still be worth betting on. Yet I don't think that's reasonably likely, which makes this all the more compelling.

Industry Overview

Container shipping and the intermodal container were first used on April 26, 1956 aboard the Ideal-X, which sailed from Newark to Houston hauling 58 aluminum truck bodies. Malcom McLean, a self-made entrepreneur who built one of the largest trucking companies in the US at the time, was behind this. He was not the first to envision container shipping, but the first to execute. The first decade was one of pitching, some investment, and some implementation. It was a slow beginning though, similar to the incandescent lightbulb which was used in just 3% of US homes 20 years after Thomas Edison invented it in 1879. Ports needed to be outfitted with massive cranes to load and unload the containers, whereas previously longshoremen had done most of the loading and unloading of breakbulk cargo. They also needed to be more accessible for trucks to enter and exit, as a ship remained at port for about 24 hours, compared to a week previously. They needed to be deeper water ports to support the larger containerships. Such was all the infrastructure buildout that had to occur. Also, at this time there was no intermodal container standard.

In 1965, an intermodal container standard was achieved through many international committees and much arguing. This also marked almost 10 years from the first containership voyage, and there was more infrastructure in place. In my mind, this marks the first major growth milestone for container shipping and the beginning of container leasing. Would-be lessors were not comfortable entering the space until there was standardization.

The next milestone, which I believe marks the beginning of the "modern" container shipping era began in 1980. In 1980, Congress passed two separate laws which deregulated trucking and railroads in the US. It freed interstate truckers to carry almost anything almost anywhere at whatever rates they could negotiate. The ICC lost its role approving rail rates, except for a few commodities such as coal and chemicals. Also around 1980, just-in-time manufacturing was originated by Toyota (TM) in Japan. 1980 also marked nearly 25 years since the beginning of

container shipping, meaning that even more infrastructure was established. By this time, massive ports in Singapore, Hong Kong, Rotterdam in the Netherlands, Long Beach and Newark in the US, and Tokyo in Japan had been built and several waves of containerships had come to market. The new containerships were no longer refurbished military ships from WW2. These were built for one thing: to move containers.

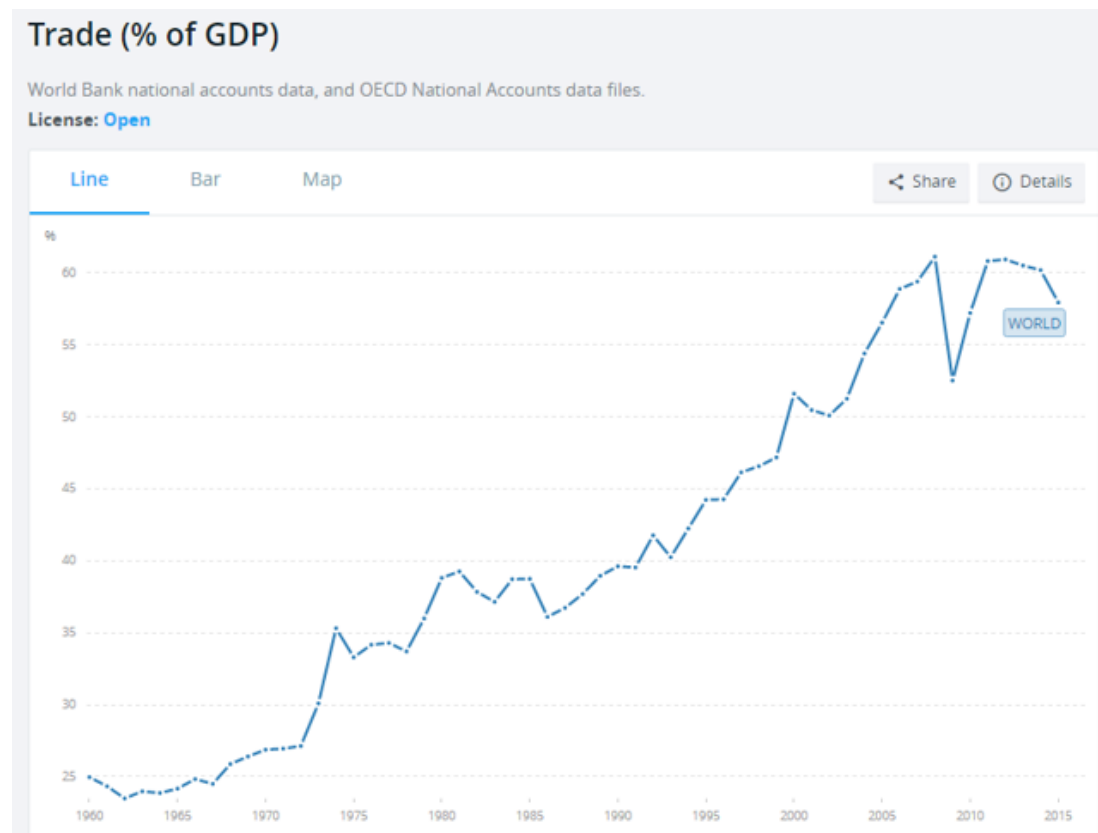
Here's some data to visualize the spread of containerization:

Year	Global Container Fleet Size (TEU)*
1956	Few dozen
1970	~1mm
1990	6mm
2000	15mm
2016	~40mm

* in TEU, actual containers, not containership capacity

Sources: [Drewry](#) and [World Leasing Yearbook](#)

I should not forget to explain why containerization is so attractive and why it has been a major force in globalization:



Source: [World Bank](#)

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Globalization over 5 centuries (1500-2011)

Shown is the sum of world exports and imports as a share of world GDP (%)
The individual series are labeled with the source of the data



Data sources: Kiasing and Milonis (2014), Estevadeordal, Frantz and Taylor (2003) and the Penn World Tables Version 8.1
The interactive data visualization is available at OurWorldinData.org. There you find the raw data and more visualizations on this topic.

Licensed under CC-BY-SA by the author Max Roser.

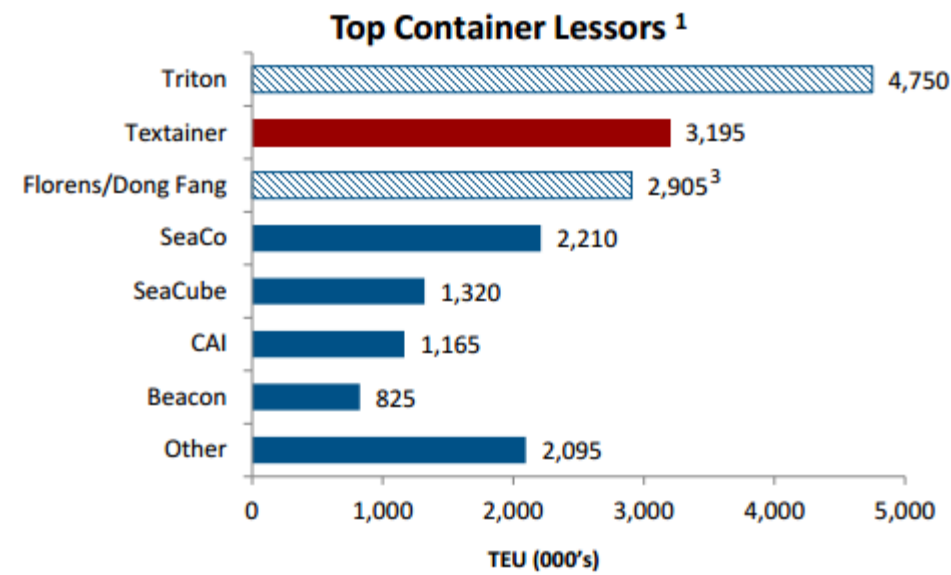
Source: [Our World in Data](http://OurWorldinData.org)

Before the container, cargo was stored in small crates and bags and loaded and unloaded by longshoremen. These laborers were expensive and the process took longer. A ship was at port for like a week, meaning the port could handle less shipments per year. Breakbulk storage was not as dense because things couldn't be stacked and confined as well so ships didn't couldn't carry as much. When everything was off the ship, loading onto a truck was equally labor intensive. Because the cargo was accessible, theft was pervasive and costly. All told, containerization has reduced shipping costs by at least 50% and made shipping much, much faster, which has made it feasible for products and intermediate goods to be shipped internationally that previously couldn't have been.

In the beginning, shipping companies owned most of the containers, but when standardization came in 1965, leasing began. The rationale for leasing is that shipping companies focus capital investment on new ships, which can costs hundreds of millions of dollars apiece, often don't have the financial strength to be able to afford to purchase containers, and desire the flexibility of leases. With lease structures, like master leases, a shipping company can use a container for a trip and end the lease right there so that it doesn't have to carry an empty box back when there's a trade imbalance which there often is on major routes. This flexibility and better fleet management through modern computing has reduced the box to slot ratio (number of containers to total container capacity on all containerships globally) over time. Over the past

decade, box-to-slot has ranged from 1.8-2x and isn't really expected to go much lower. Just under 2 boxes are out there for each one the ship can hold. One is on the ship and the other is on a truck, train, or at port filled and ready to be picked up. As far as liner vs. lessor share of container ownership, the equilibrium is just under 50% being owned by lessors. Between 1980 and 2016, lessor share has ranged from 41% to 54%, and since 2000 it's been narrower at 41-49% (Source: [Drewry](#)).

Of the 40mm TEU in the global container fleet today, about 18.5mm or 46% is owned by lessors. Market share among lessors is shown below:



Source: [TGH August 2016 Investor Presentation](#)

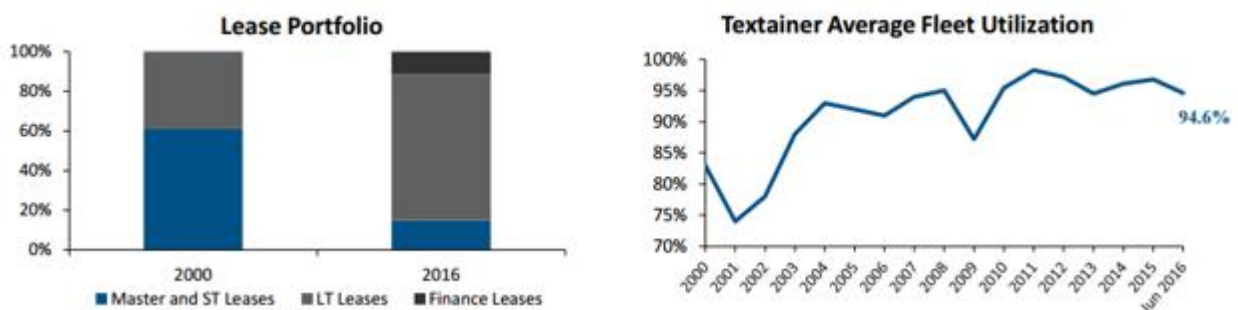
Clearly it's a very consolidated industry, and it's only become more so recently. Textainer was the biggest player until TAL and Triton merged this year. SeaCo and Cronos in China also combined in the last 2 years. Textainer has 17.3% market share, the top 3 players have 59% market share, and the top 7 players individually broken out above have nearly 90% market share.

I'd also like to discuss some trends in the industry over the past 10-15 years. One significant one is the shift toward long-term, more hands off leases. Textainer and its competitors have gone from being service providers to financials. [World Leasing Yearbook](#) says it best:

Over the past decade or so, container leasing has become more mainstream and apart from a few listed companies, container lessors are owned by private equity investors or pension funds. Over time, the character of container leasing has changed dramatically. Initially, container lessors were true service providers that offered liner companies boxes on short-term leases in case of temporary (local) equipment shortage. Contracts were mainly "spot market" or "master lease" (offering the lessee the option to off-hire containers under certain pre-agreed conditions). Lease rates - or "per diems" - were relatively high and fleet utilization was low.

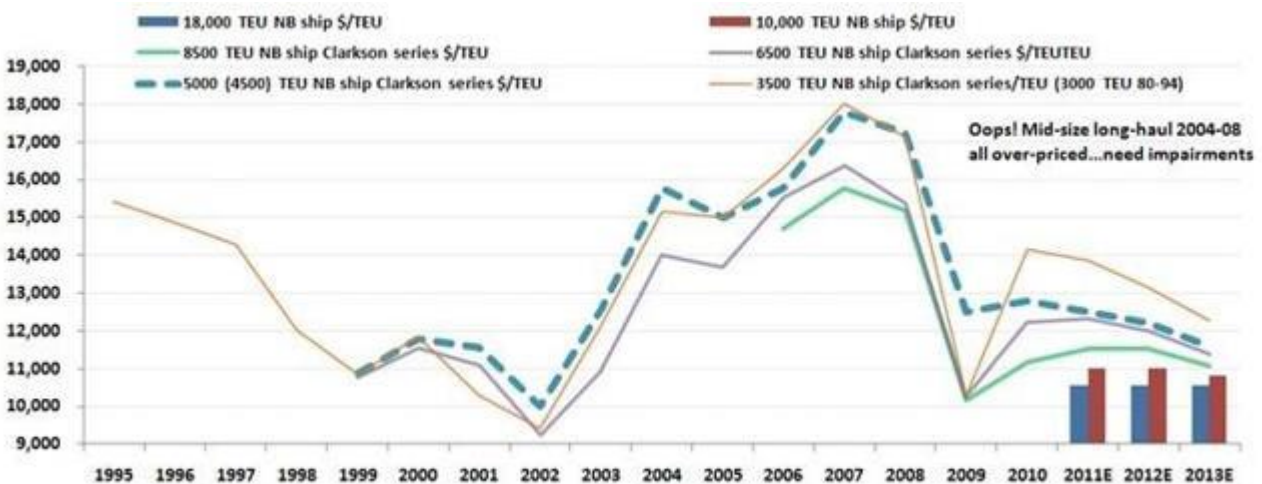
Container leasing in the early days was a relatively labor intensive activity. Gradually the character of the business changed. Liners became better managers of their box-fleets and the flexibility offered by spot- and master-leases became less relevant. Lessors transformed from service oriented suppliers to quasi financiers focused on the lowest "per diems". Buying equipment at the lowest possible price, achieving economies of scale in their own operations and ensuring the lowest possible funding cost became the main success factors for lessors. To compensate for the significantly lower per diems, the long term lease contracts ensured a significantly higher equipment utilization.

Textainer has dramatically shifted their portfolio to long-term using a ladder strategy similar to fixed income managers, where no more than 9% of the fleet comes off lease in any given year. This has led to much higher utilization over the last few cycles in the 90s, whereas previously there were times when utilization dropped below 80%:



Source: [TGH August 2016 Investor Presentation](#)

Ships and ports and even boxes to some extent (now some 9'6" height and 45' length containers compared to 8'6" and 20/40' standards respectively) are becoming bigger and bigger. There is a race for scale, scale, and more scale to decrease per-container shipping costs on the major routes. 20 years ago the biggest ships carried 3000 TEU, today there are some behemoths that carry over 19,000:



Shipping costs per TEU by ship size, Source: [SCMO.net](#)

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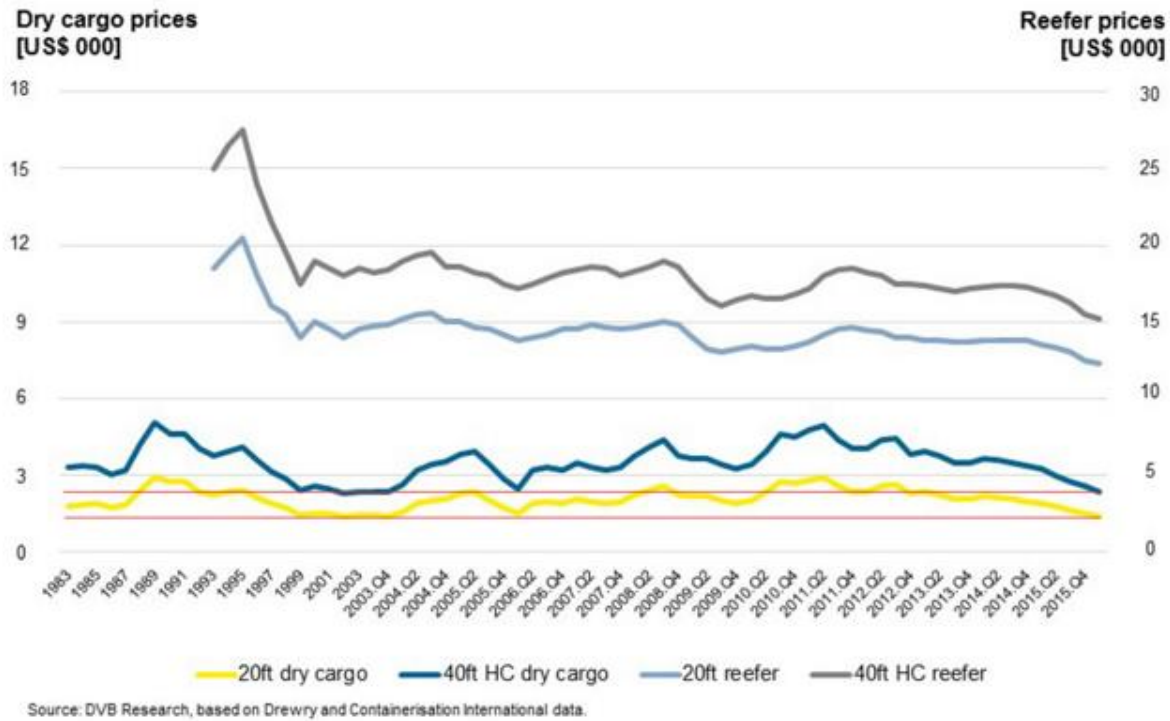


[MSC Oscar, capacity 19,224 TEU](#)

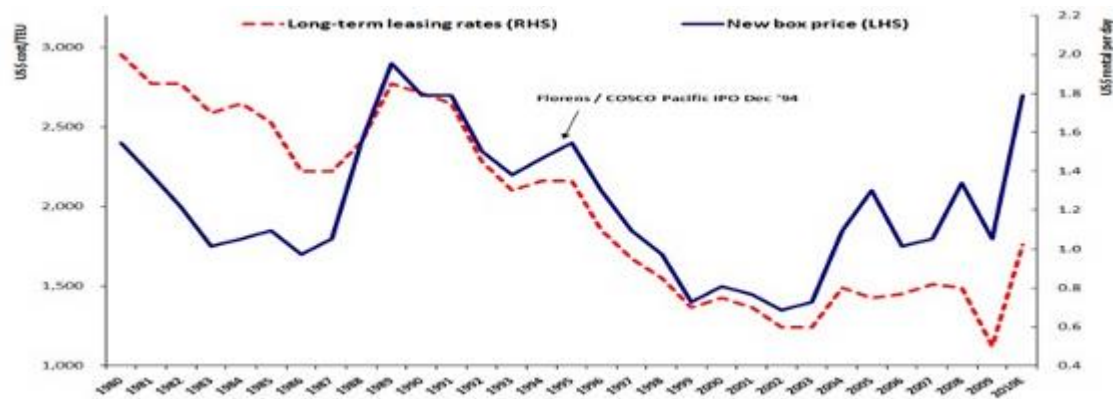
There's Blood in the Streets

The container leasing industry is most definitely cyclical. Many factors affect leasing rates, new box prices, and residual values, and all three are highly correlated. Among other factors are steel prices, new boxes manufactured, old containers retired, and initial cash investment returns (per diem leasing rates / new box prices).

Prior to now, the worst trough in the history of container leasing was at the turn of the millennium, when new container prices remained at basement levels for about 4 years from 1999-2003:

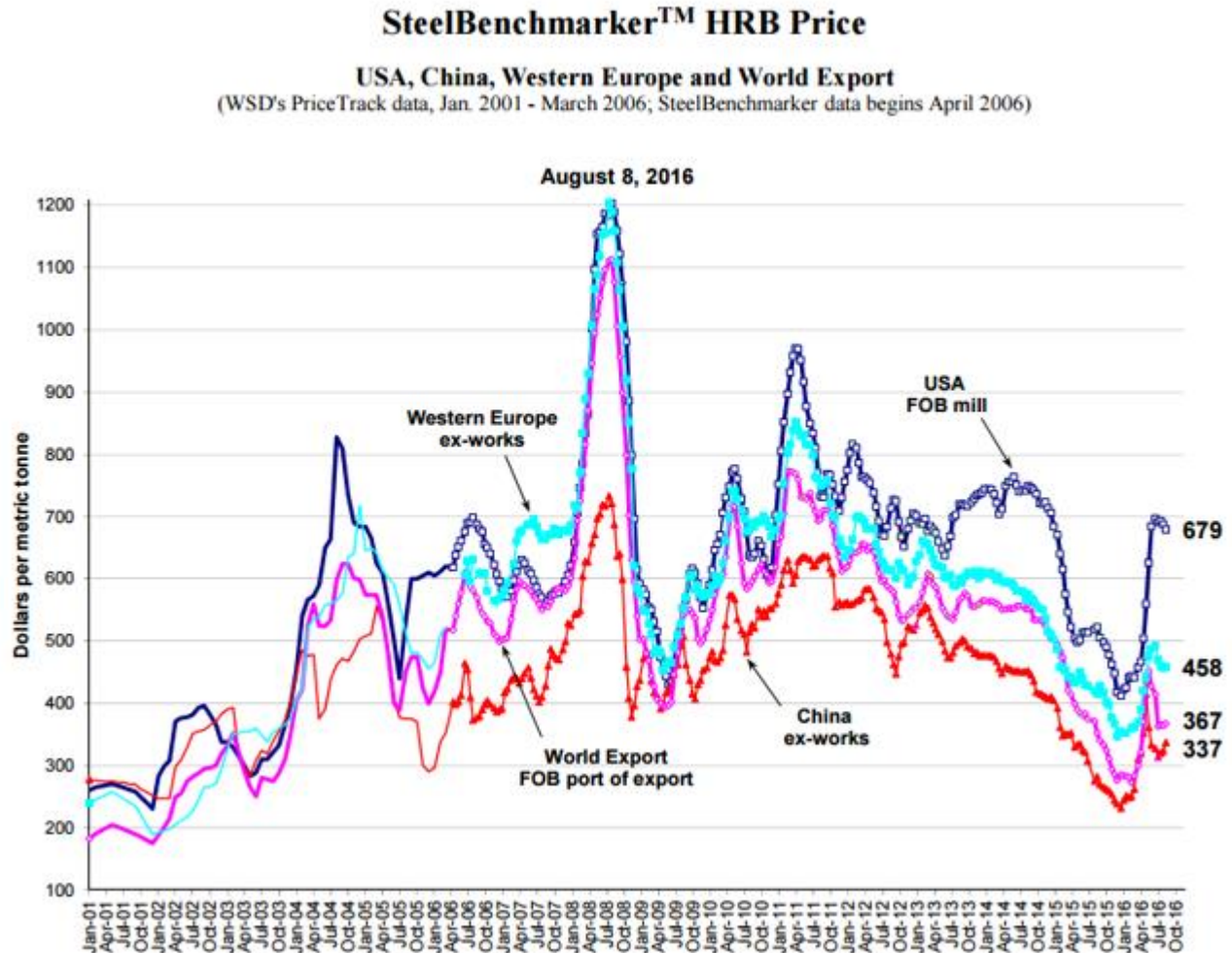


Source: [World Leasing Yearbook](#)



Source: [SCMO.net](#)

Back then, steel prices were very low - lower than they are today:



Source: [Steel Benchmarker](#)

The low steel prices allowed box manufacturers to make decent margins despite low new container prices and so they continued to produce, and at increasing levels, until mid-2000 when production was curtailed fairly dramatically, but not *completely*, which was the reason for the persistence of the low prices:



Source: SCMO.net

High container production plus low steel prices = a bad time for container lessors.

There was another panic in the industry in 2008-09 with the global financial crisis, but I wouldn't call it a trough because container lessors didn't really suffer much. There is a difference between an industry wide selloff and an actual industry cycle trough. Container stocks certainly sold off in '09, but the decline was short-lived and business results didn't suffer much:



Textainer's ROE by year from 2007 to 2010 is 17%, 18%, 18%, and 21%. They reported net gains on sale of used containers in each year. It had the potential to be bad, but ended up being little more than a minor setback.

World trade and container traffic declined in 2009 and there were concerns that this would cause a glut of unneeded containers in the container market. However, steel prices shot up without much change in the prices of new containers because no one was buying them, making manufacturing strongly uneconomical for the Chinese manufacturers. The manufacturers furloughed most of their workforce, shut down their factories, and hardly any containers were produced from the 4th quarter of 2008 through 2009. This, along with ordinary course retirements of old containers led to a 4% decline in the world container fleet in 2009. At the same time, worldwide container traffic surprised bigtime to the upside. Instead of declining further, it grew 12% in 2010 and 8.6% in 2011. This created great demand for containers, but it took supply a while to catch up. Due to the extended furloughs, the Chinese manufacturers lost about 60% of their skilled workforce. Many of these employees moved to the nascent smartphone and consumer electronics manufacturing industry in China. This caused a major shortage of containers from 2010-2012 that, at the time, Textainer management called unprecedented. There was also increased demand for leased containers (vs. own) from the major shipping companies, as they were in shaky financial condition and leasing required less capital.

Our customers are picking up containers, all over the world, as many as they can get their hands on. The new containers that are coming out of the factory are being committed to long term leases basically before they're even built.

- [TGH Q1 2010 Conference Call](#)

2011 was Textainer's most profitable year in the 15 years we have data for on an ROA basis. 2002, the first year I have data for was its least profitable... that is until 2016.

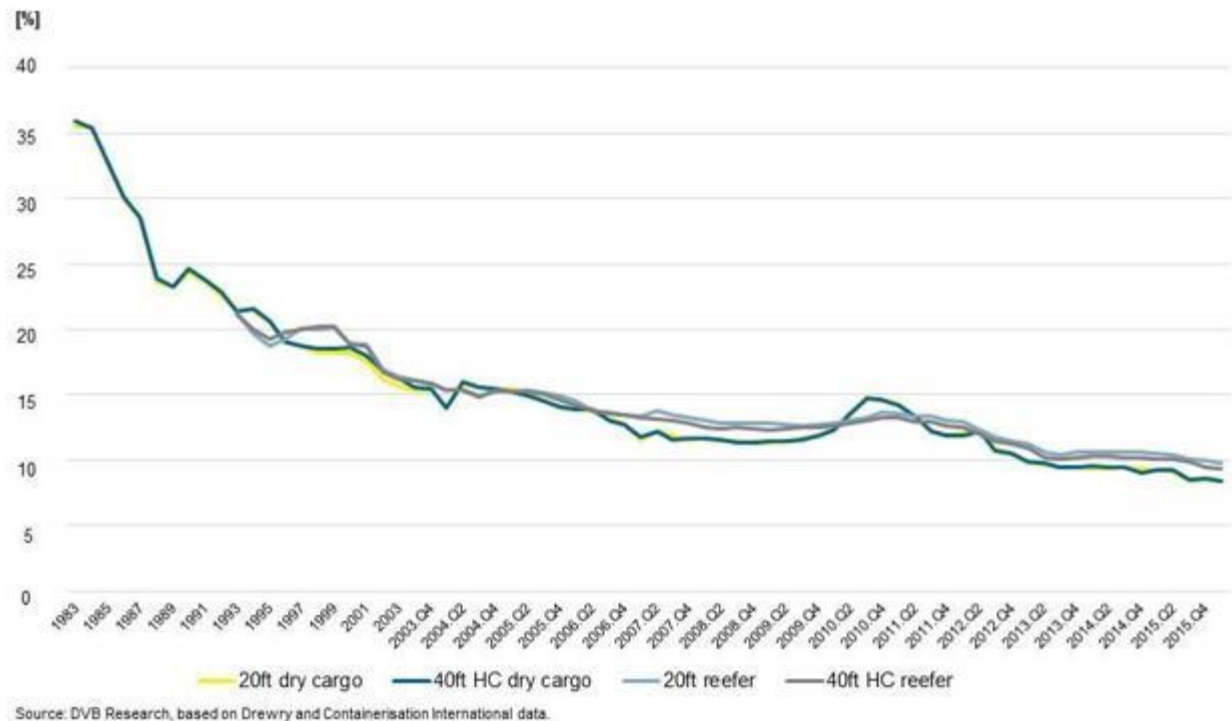
The implications of analyzing these two crises are:

- Watch for increasing steel prices and decreasing container production as a sign of improving conditions
- Which will the current downturn look more like? 1999-2003 or 2008-2011?

New container prices hit an all-time low of \$1200 in late 2015. They have since rebounded to \$1400 in August. Shipping companies are struggling as are container lessors. Container lessors have been absolutely dumping old containers. They've been taking massive impairments on these old containers (like 1/3 of BV) when they classify them as available for sale just before selling them, but CAI and TGH both believe it is the right economic decision given the alternative of very high storage and repositioning costs. The impairments, combined with reduced leasing rates related to the lower container prices, have caused Textainer to report net losses thus far in 2016.

I've talked a lot about new container prices. Well the other component of leasing company profitability is leasing rates. In 1983, 20ft dry bulk standard per diems peaked at \$1.70. Through 2000, rates declined fairly consistently to \$0.75. After a short period of recovery, reaching a peak level of \$0.94 in 2011, the rates have collapsed and are now (early 2016) at \$0.31. Leasing rates are supposed to track new container prices, but probably as a function of the decline in interest rates, they have declined more than new container prices, which has caused initial cash investment returns (per diem x 365 / new container price) to fall to an all-time low under 10%.

Intermodal containers – Initial cash investment returns



Source: [World Leasing Yearbook](#)

ICIRs are the best measure we have of industry-wide profitability for container lessors, and this is the worst it's ever been.

The industry is on the ropes. There's blood in the streets. Use whatever metaphor you want; this industry is experiencing tough times. And it shows in their stock prices:



Among the container leasing stocks, Textainer and Triton (previously TAL) have long paid big dividends, while CAI has never paid one. Like a REIT or MLP, TGH and TRTN regularly traded at dividend yields above 5%:



This attracted income-focused retail investors to the names and they became accustomed to high dividend yields and growing dividends. To this day, institutional ownership in TGH and TRTN remains very low at 19% and 26% respectively. TGH is nearly 50% owned by Trencor, but even adjusting for that, 38% institutional ownership is low. So when the financial performance collapsed and Textainer cut its dividend from \$0.47 per quarter to a nominal \$0.03, these unsophisticated investors understandably freaked out and sold. This explains the massive declines in the stocks and Mr. Market's continued pessimism.

The scene is certainly set very dark and there is a lot of uncertainty as the container leasing companies don't really control their own fates - a lot depends on external forces as mentioned above. I think there is a compelling case for things to turn around though.

Buy When There's Blood in The Streets

Signs of Container Comeback

1. *Industry Consolidation*
2. *Rising Interest Rates Likely Off All-Time Lows*
3. *Continued Globalization and Global GDP Growth*
4. *Tangible Evidence of Rising Steel Prices and Decreased Container Production*
5. *Increased Retirements*
6. *TGH 29 Consecutive Years of Profitability*
7. *Shipper Distress = More Leasing and Juicy Sales Leaseback Transactions at All Time Low Box Prices*

Consolidation

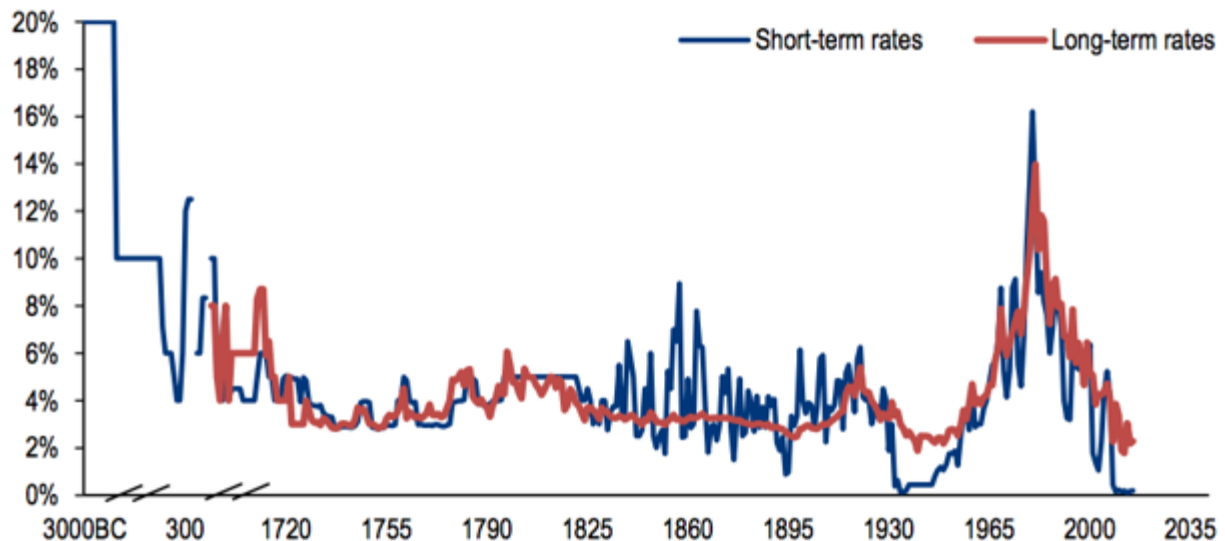
The container leasing industry is consolidating. Fewer players should increase bargaining power with manufacturers and shipping companies and lead to more rational or cooperative behavior in what has historically been a very volatile industry. TAL and Triton merged this year, a few years ago was SeaCo and Cronos, and in Tex's [Q2 call](#), management hinted at potential inorganic growth opportunities, though it is unclear what that may entail.

I don't know that barriers to entry in container leasing are terribly high in the sense that most anyone with a good chunk of capital could invest in containers and have one of the existing lessors manage them, but it would be difficult to start a new actual container leasing business from scratch due to economies of scale. Textainer manages a fleet of 3.2mm TEU that is 17% of the industry by TEU with merely 160 employees. In 2007 the fleet was 2mm TEU and they had 147 employees. G&A cost per TEU has come down over time. For a new container leasing business, I think much of those hundred plus positions would be necessary to manage a fleet of any meaningful size effectively, so G&A cost/TEU would be much higher for a new player. They also wouldn't have the 30+ year leasing relationships that Textainer does with all the big shipping lines.

Rising Interest Rates

As I mentioned, a big part of the decline in ICIRs has been the historic decline in interest rates over the last 30 years. Interest rates are now at an all-time low, and I mean "all time":

Chart 1: Still the lowest interest rates in 5000 years!



Sources: Bank of England, Global Financial Data, Homer and Sylla "A History of Interest Rates"

Note: the intervals on the x-axis change through time up to 1700. From 1700 onwards they are annual intervals. Full methodology available upon request

Source: [Business Insider](#)

I don't know when they will increase again or if they will, but I am very comfortable with the relative odds of those squiggly lines on the chart going up rather than down from here over the next few years.

Continued Globalization and Global GDP Growth

World container traffic was initially driven by containerization as container shipping replaced breakbulk shipping, then by globalization as the reduced costs of shipping increased world trade:

YEAR	World Container Traffic (Million TEU)	Growth	End-Year Fleet Size (Million TEU)	Growth	Traffic/Fleet Ratio
1990	28.7		6.375		4.50
1991	31.3	9.06%	6.905	8.31%	4.53
1992	34.1	8.95%	7.63	10.50%	4.47
1993	37.1	8.80%	8.11	6.29%	4.57
1994	41.9	12.94%	8.8	8.51%	4.76
1995	46	9.79%	9.73	10.57%	4.73
1996	49.1	6.74%	10.55	8.43%	4.65
1997	54	9.98%	11.485	8.86%	4.70
1998	56.3	4.26%	12.445	8.36%	4.52
1999	61.6	9.41%	13.47	8.24%	4.57
2000	68.3	10.88%	14.875	10.43%	4.59
2001	70.7	3.51%	15.53	4.40%	4.55
2002	78.9	11.60%	16.56	6.63%	4.76
2003	91.9	16.48%	18.085	9.21%	5.08
2004	105.3	14.58%	19.965	10.40%	5.27
2005	115.5	9.69%	21.415	7.26%	5.39
2006	127	9.96%	23.335	8.97%	5.44
2007	142.4	12.13%	26.235	12.43%	5.43
2008	148.9	4.56%	28.135	7.24%	5.29
2009	134.56	-9.63%	27.085	-3.73%	4.97
2010E	153	13.70%	27.635	2.03%	5.54
2011F	165.6	8.24%	29.485	6.69%	5.62
2012F	177.7	7.31%	32.185	9.16%	5.52

Source: World Container Traffic - Drewry Annual Reports; End Year Fleet Size - CI Market Analysis: Container Leasing Market 2010

Source: WorldShipping.org

Time Period	World Trade Growth
1500-1820	0.96%
1820-70	4.18%
1870-1913	3.40%
1913-50	0.90%
1950-73	7.88%
1950-1973	7.88%
1973-1985	3.65%
1985-1996	6.55%
1996-2000	6.98%
2000-2011	5.00%

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Source: OurWorldinData.org

Today, world trade continues to increase at a good rate exceeding global GDP growth. While we are at a fairly high base now with exports + imports ("trade") approximating 60% of global GDP, I think this number still has some room to run, making further above GDP gains likely. However, the important thing is that even if the world stops globalizing and this growth driver, like containerization, is lost, world demand for containers will still grow 3% per year or so based on global GDP growth alone, such that GDP growth could fix the supply/demand situation over a few years without assuming anything more than that.

Tangible Evidence of Rising Steel Prices and Decreased Container Production

I have no clue why Textainer stock has sold off 40% since April:



Yes, they've reported losses with the impairments, but in the last few months we have gained some crucial tangible evidence that things are starting to turn. Steel prices have increased since the beginning of the year and now aren't much lower than where they were at the beginning of 2015 before the big leg down. And we can clearly see that manufacturers are beginning to cut production in a big way. Here's a quote from TGH management from the [Q4 2008 call](#):

In 2009, we expect new production to be no more than 1.5 million TEU and possibly less while retirements could be at least 1.5 million TEU, maybe more. So this means that instead of the historical average of net fleet growth of 1.8 million TEU, it could be zero in 2009.

Compare that to their recent [Q2 2016 call](#) and the message sounds eerily similar:

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New dry freight container production is expected to be no more than 1.5 million TEU this year compared to 2.5 million TEU produced last year and 3.2 million TEU in 2014. Since approximately 1.5 million TEU are disposed annually and refrigerated container production is also expected to be below last year's record levels, the world's container fleet is unlikely to grow and may decline this year. Furthermore, new container inventory at the factories is only approximately 600,000 TEU, well below the 1.1 million TEU peak reached last year. Containers are not in an oversupply situation.

In the Q2 call, management also said they believe at current steel prices, box prices are below production costs. I looked at the financials of the biggest container manufacturer, CIMC, and I believe they earned a 17% gross margin from containers in 2015, but things may have changed since then given the rise in steel prices. I also think TGH management has a lot of credibility because they have been very pragmatic in recent calls about a delay existing between when new box prices rise and when residual values increase, in addition to predicting the box shortage in 2008 as reflected in the quote above. So when they say they believe box prices are currently below production costs, I believe that, and that has *massive implications* for manufacturer behavior over the next year or two. Manufacturers have probably learned their lesson and won't shut down completely as they did in late 2008, but cutting production to say 500k-1mm / yr levels is reasonable.

Some investors may argue that this will limit container lessors' ability to grow their books. There is probably some truth to that, but the economics that the fleet as a whole is experiencing is more important than how much TGH pays for containers in a given year. And while new containers may become limited as a buying option, there are now plenty of opportunities to buy used containers from shipping companies and lease them back to the shipper, which TGH and other lessors are taking advantage of. The other question that remains to be answered is why Textainer is simultaneously buying these used containers in sales/leasebacks and selling used containers. A lot has to do with positioning and "leasability". All else being equal, a container positioned in Singapore is worth much more than one in the US because Asia is where the trade surplus is- where there's a net outflow movement of containers. Also, a sales-leaseback comes with a guaranteed immediate lease attached, whereas a used container is sold at the end of its life because it can't be leased again.

Increased Retirements

While management mentioned the standard 1.5mm of industry retirements in 2016, I would not be surprised if retirements this year are above that. So far in 2016, Textainer has sold 1/3 more containers than they did in the first half of 2015, and we are seeing similar behavior at other big players. YTD, CAI has sold 39% more used containers than 1H 2015, and in Q2 that accelerated to +63%. There's this notion that lessors would resist selling old containers at a time of low residual values like this because it forces them to take impairments/losses on sale depending on accounting treatment and looks bad in the short term on the financials. However, that notion seems completely mistaken. I have not done a ton of research on Triton yet, but from the calls, both CAI and TGH management seem to be explicit in saying that they are making these sell vs. store decisions on used containers in an extremely disciplined way based on actual cash flows in a model, not really qualitatively and not based on appearances. As an analogy, they are not acting like you'd expect politicians would making decisions based on how it will look in the press and affect public opinion (poor near-term EPS, stock selloff), but rather based on what

they genuinely believe is best for their country (company). If this behavior continues, then increased retirements will further help the supply/demand situation. In a vacuum these actions create a shortage of containers.

TGH 29 Consecutive Years of Profitability

While we don't know what TGH did prior to 2002 and they have reported losses thus far in 2016 because of the impairments, we do know that in each of the 29 fiscal years leading up to 2016, they posted a profit. That is tremendously impressive given how cyclical the industry is. Perhaps they will post a loss in 2016, but it will take more than a year of moderate losses for the stock to work out poorly over a 3-5 year holding period and in my mind, the worse this downturn is, the more powerful and profitable the next upturn will be. I hope other investors will remember this historical context while extrapolating the last two quarters of performance through the dirt like [monkeys](#).

Shipper Distress = More Leasing and Juicy Sales Leaseback Transactions at All Time Low Box Prices

We've talked a lot about the container industry in general, but what really matters to companies like Tex and CAI is the roughly half of it that's owned by lessors. While the containers that shipping companies own are the same hunks of steel that lessors own, the dynamics for each can be different. If ownership share increases for lessors, then leasing rates can increase without anything else occurring in the industry. That market share shift is a net positive for lessors. And what happens in times like 2009 and now when shipping companies are hurting financially and seeing an oversupply situation with vessels and low freight rates, is that shipping companies execute sales leaseback transactions with lessors to free up capital to pay off debt, and lease more of their new boxes vs. buying them. Sales-leaseback transactions were much talked about on TGH's Q2 call, and they are very attractive right now at today's low prices. As CEO Phil Brewer said, "if you're a container leasing company and you're not buying at \$1200, when do you buy?" He noted that the last time container prices were this low, in 2002-2003, those containers that were bought via sales-leaseback ended up performing really well. Sales-leasebacks are great because Tex is getting a container at historically low prices AND getting it leased right away and probably at a long lease term for a container that's not new.

To be clear, shipping liners are selling these containers to container lessors and agreeing, as part of the sale, to immediately lease them back from the lessor. This may seem weird as I mentioned elsewhere that lessors are selling used containers. As I explained in the "*Tangible Evidence of Rising Steel Prices and Decreased Container Production*" section above, at any given point lessors are both buying some containers and selling others based on the age of container, where it's located, and its leasing prospects. The containers related to these sales-leaseback transactions still have some useful life and come with an immediate lease attached. The old ones that lessors are selling are at the end of their useful lives and don't have much hope of being leased in a sufficiently short period of time due to where they are located.

Yes, things are tough in the container leasing industry right now, but that's the time to buy these cyclical.

Be fearful when others are greedy and greedy when others are fearful - Buffett

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The darkest hour is just before the dawn - [1600s self-help manuals](#) and... [Batman](#)



[Source](#)

Need I hammer your brain with more cliché but absolutely true quotes? Things look bad now, but there are many signs of better times to come. The industry turnaround is materializing. It's not in the financials yet, but it's everywhere else. That is the textbook time to buy a cyclical.

Valuation

I'm going to show you how TGH is extremely cheap in four different ways:

- Book value
- Comps
- Accrual number-based back-of-the-envelope model
- P/maintenance FCF

But first, can we trust the GAAP accrual basis numbers? Does net income approximate the actual economic profits of TGH and does book value approximate the economic value of the company's assets, net of liabilities? I've had a lot of cognitive dissonance on this, much of which I communicated in my [article on CAI](#). There I wrote the following:

Is This a Financial?

To a large extent, whether you like CAI depends on what lens you look at it through.

Are you looking at it as a financial company, focusing on accrual basis numbers like net income, PE, P/TB, and ROE? If so, it looks pretty solid at 41% of tangible book and 9x earnings despite a history of double digit ROE...

Or are you looking at it as an industrial focusing on enterprise multiples and cash basis numbers like FCF? Through this lens, it's FAR less attractive because of the big debt load (88% of current EV or \$1.33B is debt) and big growth capex investments creating negative FCF.

This also has big implications for liquidity. If viewed as a financial with debt as part of the business model and constantly getting rolled without refinancing trouble, this isn't as much of a concern. After all, CAI is only levered 4.3x, whereas a conservative bank is at 10x. As a non-financial, you begin to seriously

question if its maturities over the next few years will be able to be refinanced, particularly if credit markets tighten from pretty loose levels today.

I've had a lot of cognitive dissonance on this, and being "wrong" here is probably the biggest risk to my thesis, but I think CAI is more of a financial than a non-financial. It may have some trouble with refinancing, and the debt is definitely a huge concern, but this is a company in the business of financial transactions. It is not primarily selling products or services. Leases are different.

So the remainder of the article uses the operating assumption that CAI is a financial company, but you may well feel differently, and if so, I'd love to hear about it in the comments.

Today I feel more confident in the answer. Container leasing businesses are much more like financials than an industrial business and the accrual numbers should be given a lot of weight. I did a survey of some of the best research on SA, in sellside reports, and elsewhere on leasing businesses, particularly businesses with long-term leases. Something like Aercap ([AER](#)) is much closer to the nature of container leasing than is United Rentals ([URI](#)). It seems that even the [best research](#) relies on net income and book values, so that made me more comfortable doing the same.

Depreciation plays a big role in whether book value is accurate. If Textainer over-depreciates their container assets, then they recognize gains on sale when they sell them. If they under-depreciate them, then they recognize an impairment that marks the container value down to FV when it is classified as available-for-sale, just before it is sold. Gains on sale and container impairments thus serve to effectively correct previous mistakes in depreciation. This is why they are real costs and income for a business like this, however, they are not incurred in just one year, in a perfect world they would have been amortized over the life of the container through the proper depreciation level, rather than a \$30mm lumpy gain one year and \$30mm of impairments the next.

It is also worth mentioning that Textainer has changed their depreciation policies many times. In 2006, 2008, and 2015 the company adjusted residual values it assumes for depreciation purposes. They may have also made changes in other years that I didn't catch. I don't think this is manipulation either. It's just very difficult to forecast what the company will be selling a used container for 12 years in advance. That's because of the time, but also because residual values fluctuate widely. According to [World Leasing Yearbook](#):

The useful life of a container is around 12-15 years in the deep-sea markets, after which the units are sold for static storage, one way trips to less developed areas or regional land transport purposes. Price levels of 12-15-year-old 20ft boxes follow the pattern of the new equipment and fluctuate between \$700 and 1,700 in "wind and water-tight" condition.

\$700-1700 is an extremely wide range, and actually the range is even wider given that Textainer's realized residual prices have been about \$593/container so far in 2016.

This makes it incredibly difficult for the company to forecast economic depreciation, so of course mistakes will be made in hindsight, and that is why investors must include the gains and impairments in assessing performance. However, the gains/impairments are lumpier than

reality is, so I think long-term averages of the unadjusted profit numbers and ROE provide better context.

On the whole, has Textainer been conservative with their depreciation policies? I looked at gains on sale and FV container impairments since 2005 to see.

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015 YTD	2016	Sum 2005-16
Gains on Sale	10.5	9.6	13.5	17.8	12.1	27.6	31.6	34.8	27.3	13.5	3.5	2.5	204.2
Container Impairment for FV (not credit)	0.5	0.2	0.6	0.5	2.0	1.6	1.2	0.8	4.2	11.5	32.7	36.8	92.5
Gains - Impairments	10.0	9.4	13.0	17.3	10.1	26.0	30.4	34.0	23.1	2.0	(29.2)	(34.3)	111.8

While the company is reporting historically high impairments in 2016 with 37mm in the first six months exceeding all of 2015's already high number, over the 11.5-year period, gains on sale were more than twice impairments and we have a substantial net gain of over \$100mm cumulatively, indicating the initial depreciation assumptions were, on average, conservative.

Some readers may take a "replacement cost" approach and argue that it doesn't matter what containers were bought at, sold for, and what rate they were depreciated at in the past, only what they can be sold for now. And now, the containers probably couldn't be sold for book value given the impairments. There are several problems with this argument:

- it assumes that current used/new container prices are "right." Container prices fluctuate in a very wide range based on a host of factors and there are many limitations to an efficient market. In the stock market, some limitations to an efficient market are forced sellers driven by fund redemptions and career risk, limits on arbitrage or "buying" like margin limitations and cost to borrow for short sellers, and demand in the market: "too many dollars chasing not enough opportunity" and vice versa. The same dynamics exist in the container market. Sometimes container lessors are forced sellers when they repossess or get a container off lease that is not ideally positioned. They then can either re-lease it, sell it where it is, store it in a depot where it is, or reposition it to another port where their options are better. Re-leasing is ideal but sometimes shippers don't need more containers, particularly at ports in the US, a nation with a trade deficit where leasing the container there would mean the shipping company would bear the repositioning cost and be hauling an empty container to China or Singapore. Then the options are store, reposition, or sell. Storing or repositioning are massively expensive relative to the value of a used container. Think about it. A used container may only be worth \$600-700, but it sure would cost a lot sitting and taking up space in a depot on prime port-side real estate. It also takes up a lot of otherwise revenue-generating space on a containership riding empty. This is why container lessors opt to sell used containers and take a loss rather than pay these costs. These storage and repositioning costs are big "frictions" in the container market, which we understand as limiting factors preventing total market efficiency.
- It assumes an unrealistic proposition. Textainer is the 2nd largest container lessor with 17% of the market by TEU. The company could not and would not liquidate its fleet at the market tomorrow. The vast majority of these containers are on lease and Textainer is making good money from them. They are best thought of as revenue-generating assets

in the present. They are not idle. An on-lease container is not the same thing as a barrel of oil sitting idle deep beneath the earth's surface.

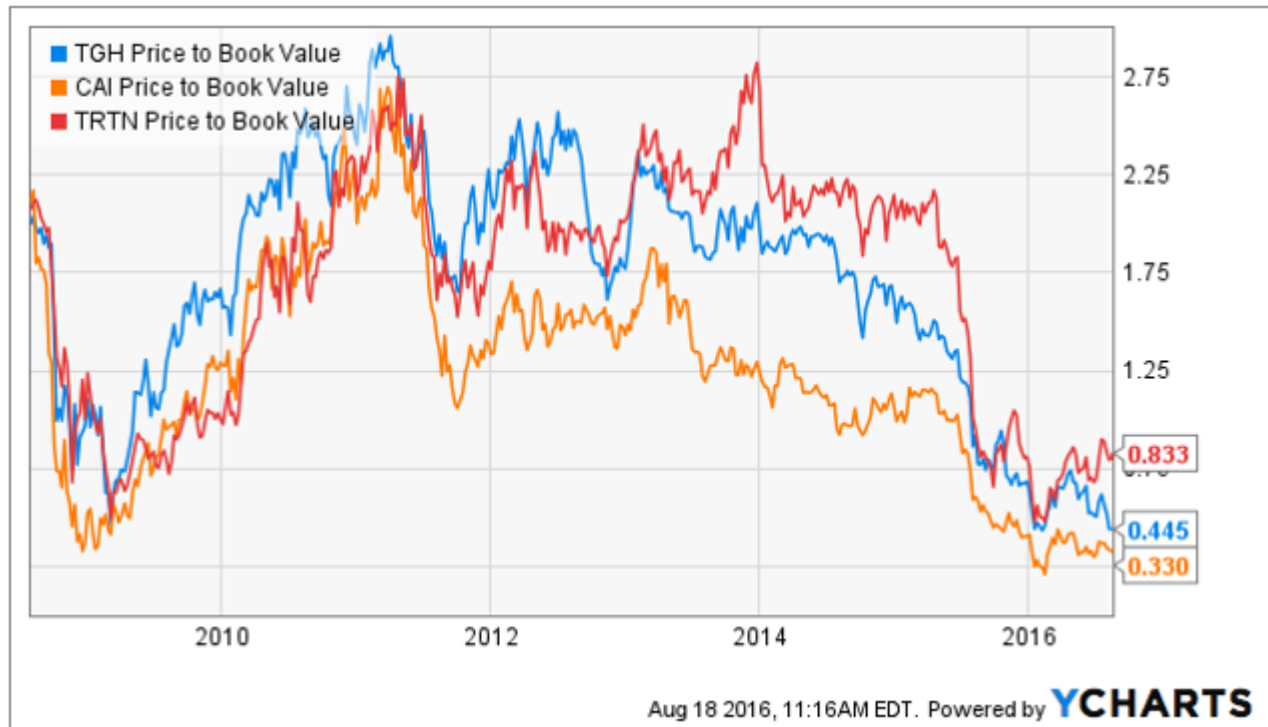
- It assumes the used containers that have been sold at impaired prices are reflective of the entire fleet. That's not the case. These used containers are the worst of the bunch. They are old, off-lease, and in very poor locations, which makes storage, repositioning, or getting a new lessee very challenging. But that's not what Textainer's entire fleet looks like. The fleet on average is much newer and at any given time, probably half the containers are in attractive locations like China/Singapore, and half are in disadvantageous locations like Long Beach, CA.

Some readers may still disagree, but I believe book value of a container is a much more stable indicator of its long-term value to Textainer than what certain containers are being sold for today, just as I believe book value is a much better indicator of what Textainer stock is worth long-term than what it is being bought and sold at in the market today at a trough among pessimistic market participants, as I will discuss below.

Book Value

My hypothesis is that individual containers and in turn container leasing companies which are just big container portfolios offset by debt and other liabilities, will occasionally sell in the market above book value (gains on sale, TGH trading above book) and occasionally sell below (impairments, TGH trading at a discount to book), but generally at any given point intrinsic value approximates book value and hugs it pretty well in a 0.75-1.25x or so range.

Right now, we can see Textainer stock and the other container leasing stocks are trading at big discounts to book and obviously reporting impairments, but we can also see that they've all traded well above book (each of the three have reach 2.5x book this cycle) in the past and reported gains on sale.



I think it's very reasonable that perhaps short-sighted Mr. Market overweighs near-term evidence and the stocks are well overvalued at 2.5x book and well undervalued today. The case for book value as fair value is well supported.

Textainer Financials 2002-Present, Source 20-Fs and 2007 F-1															
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	TTM
Revenue USD Mil	126.5	150.2	180.3	234.4	216	256	277	237	304	423	487	529	563	542	521
Net Income USD Mil	11	35	54	63	56	68	85	91	120	190	207	183	189	107	26
	9%	24%	30%	27%	26%	26%	31%	38%	40%	45%	42%	35%	34%	20%	5%
Total Assets	570	615	847	871	944	1,128	1,304	1,360	1,747	2,310	3,476	3,909	4,359	4,386	4,365
Total Equity	115	141	175	212	241	404	450	500	584	684	1,008	1,098	1,193	1,203	1,174
ROA	2.0%	5.8%	6.3%	7.2%	6.0%	6.0%	6.5%	6.7%	6.9%	8.2%	6.0%	4.7%	4.3%	2.4%	0.6%
Leverage	5.0	4.4	4.8	4.1	3.9	2.8	2.9	2.7	3.0	3.4	3.4	3.6	3.7	3.6	3.7
ROE	9.9%	25.1%	30.7%	29.8%	23.3%	16.8%	18.9%	18.1%	20.6%	27.7%	20.5%	16.7%	15.9%	8.9%	2.2%

Textainer Financials, Totals/Averages						
	All	2002-2008	2009-TTM	2002-2006	2007-2011	2012-TTM
Revenue USD Mil	5,046	1,440	3,606	907	1,497	2,642
Net Income USD Mil	1,485	372	1,113	220	553	712
Net Margin	29.4%	25.9%	30.9%	24.2%	37.0%	27.0%
ROA	5.3%	5.7%	5.0%	5.5%	6.9%	3.6%
Leverage	3.7	4.0	3.4	4.4	3.0	3.6
ROE	19.0%	22.1%	16.3%	23.8%	20.4%	12.8%

In all periods that we have financials for, even since 2012 which only includes the recent downturn, Textainer has achieved returns on equity well above 10%. Since 2002, Textainer has compounded book value per share at 15.3% per year from \$3.03 to \$20.6. That does not include the \$14.18/share of cumulative dividends they have paid out over the 14.5-year period either. At those rates and average ROEs, getting Textainer stock at book value seems like a bargain.

That is why I believe shares look very attractive today at 45% of book. Having established that shares are probably a bargain based on the long-term track record at book and reporting dynamics, we could simplistically assume the stock more than doubled tomorrow and traded at book and it'd still be fairly cheap.

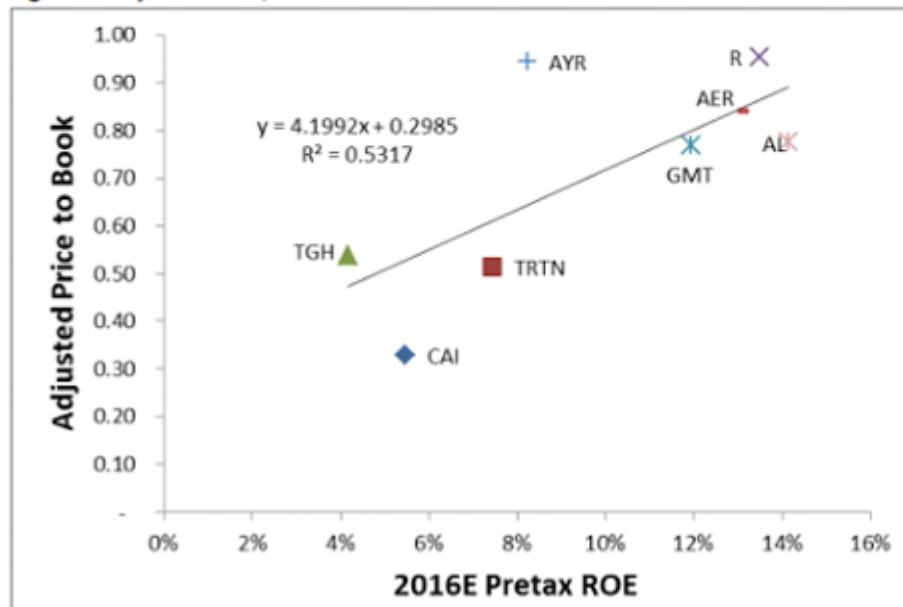
Comps

To many, CAI probably looks like the cheapest of the container lessors. Indeed, it trades at the lowest PE and PB and is very cheap. That's why I've [written](#) about it and own shares in it. A friend recently asked me why I am so interested in TGH then. The reason is that book value isn't everything. A stock can trade at a higher book value than another and still be cheaper. The empirical evidence suggests otherwise, but of course there are many, many exceptions. What matters is the rate at which the company has demonstrated it can compound book value at. And I don't think that recent performance is necessarily indicative of a company's long-term, demonstrated ability to compound book. So when I was looking at a recent sellside report from SunTrust which relied on current earnings, I decided to take their comp universe and instead build a comp table using 10-year average return on equity.

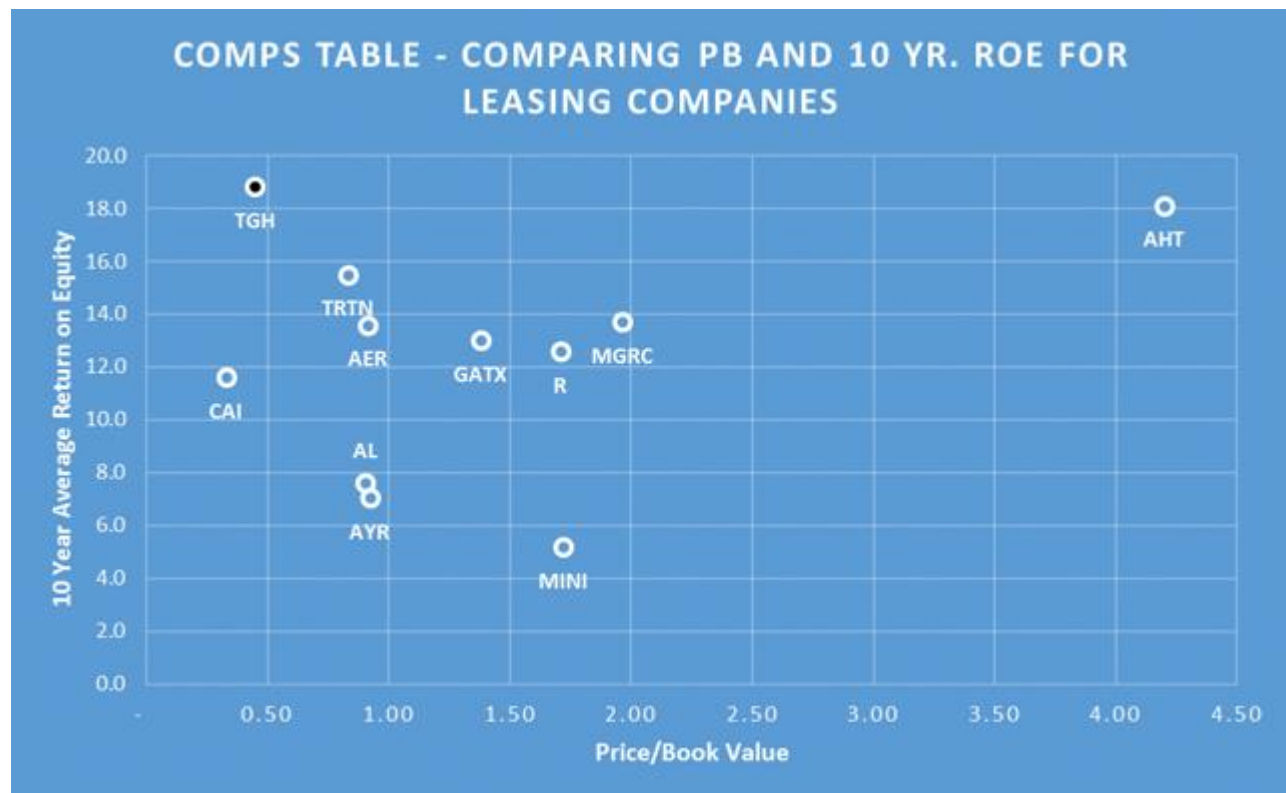
Institution Name	Ticker	Type	Rating	Price 06/06/16	Capitalization (\$MM)	EV to 2016E EBITDA	Price to 2016E EPS	Price to 2016E pretax EPS	Price to Book Value	Price to Book	2016E ROE	2016E Adjusted Pre-tax ROE
Container Lessors												
CAI International, Inc.	CAI	Container	Buy	8.61	167.28	9.17	6.70	6.01	0.36	0.33	5%	5%
Triton International Ltd. Class A	TRTN	Container	Buy	16.82	749.10	8.85	12.61	6.91	0.88	0.51	7%	7%
Textainer Group Holdings Limited	TGH	Container	Buy	11.38	643.78	8.73	14.94	12.88	0.54	0.54	4%	4%
Other Leasing Companies												
Ryder System, Inc.	R	Truck	NR	66.00	3,529.55	5.13	10.99	7.06	1.72	0.95	16%	13%
GATX Corporation	GMT	Rail car	NR	45.11	1,822.44	7.91	8.07	6.45	1.39	0.77	17%	12%
AirCap Holdings NV	AER	Aircraft	NR	37.76	7,384.72	8.60	6.37	6.45	0.88	0.84	14%	13%
Air Lease Corporation Class A	AL	Aircraft	NR	28.33	2,913.51	8.60	8.43	5.48	0.91	0.78	11%	14%
Aircastle Limited	AYR	Aircraft	NR	21.26	1,671.76	8.25	11.69	11.46	0.94	0.94	8%	8%
United Rentals, Inc.	URI	Equipment	NR	79.47	6,847.22	5.27	9.71	6.64	4.59	2.11	47%	32%
Fluor Financial Corporation	FFN-CA	Equipment	NR	14.15	5,466.94	24.24	9.25	7.45	1.13	1.11	12%	15%
McGrath RentCorp	MGRC	Equipment	NR	31.24	746.89	6.74	19.01	11.50	1.95	1.11	10%	10%
Ashford Group plc	AHT-LON	Equipment	NR	12.01	6,023.21	5.86	12.67	8.25	4.07	2.57	32%	31%
Hubila Mini, Inc.	MINI	Storage	Neutral	30.89	1,172.72	11.57	22.84	15.04	1.85	1.42	8%	9%

Source: FactSet, STRH estimates

Figure 4: Adjusted Price/Book vs. 2016E Pretax ROE



Source: SunTrust



In my chart, price to book is the x axis and 10-year average ROE is the y axis. X is what you pay, Y is what you get. That means up and to the left is good and... oh hey, look where the black dot that represents TGH is.

Now you could argue that maybe Mr. Market agrees with the SunTrust method using current earnings more given the linear correlation that chart shows compared to mine's randomness, but I'd say Mr. Market is wrong and predictably so with this kind of thing. He is extrapolating current results for a cyclical industry when he should be looking at averages and anticipating mean reversion.

Back-of-the-envelope

The accrual numbers are compelling, and this section will show the same conclusion, but I like to get a more precise idea of what my upside and downside is and what my return expectations should be, rather than just being able to say something is "cheap."

The bull case is easy here. Textainer has consistently done 15% ROEs and while a return to that might seem far-fetched right now if you look at trailing earnings, you need to appreciate how many temporary "lump" items are embedded in those numbers and how they can and do swing in the opposite direction quickly. We've seen \$37mm of fair value container impairments in 2016 YTD and there were \$32.7mm in all of 2015. So call \$53mm of impairments embedded in the TTM number, \$50mm net of the few million of gains on sale they've reported. In 2015, there was \$10.5mm of extra depreciation expense compared to 2015 because the company lowered residual values on 40' high cube containers from \$1650 to \$1450. There's been at least 3 major

depreciation policy changes in the recent past and another change increasing residual values could just as easily increase income \$10.5mm. Then there are also elevated storage and repositioning costs as well as bad debt expense, none of which will I quantify, but trust me when I say normalization there could add another \$10mm. Lease rates improving also help, after all that is supposed to be the main business driver. My point is that profitability at this business can swing very quickly and 3 years is a long time. So that is the bull case - 15% ROE and exiting at 1.5x book, well below where the stock traded at the last peak. With that the stock could increase over 400%. With a 50% chance of a return like that, you can assume the stock goes to zero otherwise and still find it well worth betting on with reasonably small amounts of capital:

TGH 3 Year Valuation	Bear	Bull
Current BV	1174	
ROE		15%
T+3 BV		1,786
T+3 Net Income		268
PB		1.50
PE		10.00
Market Cap		2,678
T+3 PPS		46.82
Total Gain/Loss	-100%	409%
Expected Return	154%	

However, I don't think Textainer going to zero is a reasonably likely bear case. Yes, container leasing is rough right now and they have maturities in 3-4 years they'll need to refinance, but this is a company that lenders are clearly treating as a financial and lending money to at LIBOR plus 1%, allowing impairments to be excluded from interest coverage calculations, and making other concessions. Instead, I think the bear case is 3 breakeven years for a company that has been profitable in the last 29, and some contraction in the P/B multiple. With that, the stock isn't just a triple in the bull case, it's an *expected triple*.

TGH 3 Year Valuation	Bear	Bull
Current BV	1174	
ROE	0%	15%
T+3 BV	1,174	1,786
T+3 Net Income	-	268
PB	0.40	1.50
PE	-	10.00
Market Cap	470	2,678
T+3 PPS	8.21	46.82
Total Gain/Loss	-11%	409%
Expected Return	199%	

For what it's worth, I keep track of my return expectations for all the stocks on my watchlist and Textainer is currently ranked 2nd among several hundred names.

P/Maintenance FCF

While I think the accrual basis numbers are more reliable for Textainer, we can actually still see that the stock is cheap relative to cash flows. They've been growing the fleet over the last decade so capex has well exceeded depreciation, but they really could cut capex at or slightly above depreciation levels and maintain fleet size, particularly with container prices where they are today, and even if you just look at the numbers with capex as-is, the stock is still generating free cash and trading at a low multiple of it.

Textainer Cash Flows TTM Ending Q2 '16

Net Income	28.5		
Depreciation	212.4		
Other	101.2		
Operating Cash Flow	342.1		
Capex	-390.9		
Disposals	130.6		
Sales Type Lease Receipts	97.7		
Investing Cash Flow	-162.6	Market Cap	P/FCF
Unadjusted Free Cash Flow (OCF - Capex + Disposals)	81.8		6.4
Maintenance FCF (OCF - Depreciation)	129.7	526	4.1

Risks

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No investment is without risk, and certainly no investment that could offer fivefold returns is. Sources of risk for Textainer include:

- Refinancing Debt Maturities
- Protectionism
- Major Global Economic Downturn

Debt

Textainer currently has just over \$3B of debt. 2017 is a light year for maturities, but the company will need to refinance some of the 2018 and 2019 maturities:

	Twelve months ending June 30,					Total Borrowing	Available borrowing, as limited by the Borrowing Base	Current and Available Borrowing
	2017	2018	2019	2020	2021 and thereafter			
TMCL II Secured Debt Facility	\$ —	\$ 66,818	\$ 89,090	\$ 89,090	\$ 645,902	\$ 890,900	\$ 11,655	\$ 902,555
TMCL IV Secured Debt Facility	—	160,000	-	—	—	160,000	9,071	169,071
TL Revolving Credit Facility	—	—	—	—	598,000	598,000	102,000	700,000
TL Revolving Credit Facility II	—	—	—	—	186,000	186,000	4,000	190,000
TW Revolving Credit Facility (1)	32,853	25,851	22,656	18,238	48,100	147,698	8,325	156,023
TAP Funding Revolving Credit Facility	—	—	145,500	-	—	145,500	4,500	150,000
TL Term Loan	31,600	31,600	353,100	-	—	416,300	—	416,300
2013-1 Bonds (2)	30,090	30,090	30,090	30,090	97,793	218,153	—	218,153
2014-1 Bonds (3)	30,140	30,140	30,140	30,140	130,607	251,167	—	251,167
Total (4)	<u>\$ 124,683</u>	<u>\$ 344,499</u>	<u>\$ 670,576</u>	<u>\$ 167,558</u>	<u>\$ 1,706,402</u>	<u>\$ 3,013,718</u>	<u>\$ 139,551</u>	<u>\$ 3,153,269</u>

Source: [Q2 16 6-K](#)

The company has had plenty of access to credit in the past and consistently been refinancing:

USD in Thousand except per share data	2011-12	2012-12	2013-12	2014-12	2015-12	TTM
▼ Cash Flows From Operat...						
Net income	204,018	205,063	189,374	195,054	112,463	28,531
Depreciation & amortiz...	89,287	109,864	153,200	180,606	196,114	212,360
Amortization of debt d...	(10,546)	(6,187)	10,586	17,144	7,887	7,433
Investment/asset impai...	—	—	—	—	35,345	64,266
Investments losses (ga...	3,849	—	—	—	—	—
Stock based compensati...	6,177	7,968	5,694	7,499	7,743	7,365
Accounts receivable	(25,924)	(4,226)	(5,949)	575	(1,532)	—
Prepaid expenses	(7,046)	218	(4,692)	(12,240)	(3,873)	—
Accounts payable	(3,680)	1,631	3,635	(2,434)	4,825	—
Accrued liabilities	6,503	(4,850)	(4,491)	2,097	(5,108)	—
Income taxes payable	1,908	4,851	(11,530)	(8,354)	982	—
Other working capital	(2,804)	475	8,714	(1,685)	11,513	4,536
Other non-cash items	(48,397)	(48,280)	(27,912)	(15,455)	3,521	17,650
Net cash provided by o...	213,345	266,527	316,629	362,807	369,880	342,141
▼ Cash Flows From Invest...						
Investments in propert...	(823,694)	(1,087,489)	(765,418)	(818,451)	(533,306)	(390,855)
Property, plant, and e...	75,311	91,324	123,738	141,181	129,452	130,642
Acquisitions, net	(11,783)	(20,532)	—	—	—	—
Other investing activi...	35,042	42,410	57,200	78,173	100,305	97,733
Net cash used for inve...	(725,124)	(974,287)	(584,480)	(599,097)	(303,549)	(162,480)
▼ Cash Flows From Financ...						
Debt issued	1,229,100	1,742,720	996,097	1,665,049	566,177	440,000
Debt repayment	(609,356)	(1,099,192)	(590,595)	(1,336,642)	(538,877)	(530,978)
Common stock issued	6,065	189,508	3,617	2,497	301	—
Common stock repurchas...	—	—	—	—	(9,149)	—
Dividend paid	(62,549)	(83,473)	(104,199)	(106,648)	(94,079)	(67,573)
Other financing activi...	(33,770)	(16,634)	(16,928)	(1,010)	18,063	(8,927)

Source: [Morningstar](#)

It certainly seems that creditors view the company as a financial with leverage an integral part of the business model based on the interest rates on their loans (typically LIBOR plus 1.5-2%, LTM interest expense just 2.58% of current debt balance) and accommodative actions we've seen:

- Recently amended one facility that had covenant on consolidated financials for interest coverage $\geq 1.5x$ to exclude container impairments from EBIT in the calculation.
- Large recent refinancing at reduced interest rate
- Lowered residual value covenant on one loan from 100% to 90%

Management also sounds confident based on this excerpt from the [2015 Letter to Shareholders](#):

We continue to maintain a strong and flexible balance sheet. Our debt-to-equity ratio at 2.4:1 remains the lowest among all our publicly listed peers. Our financial results and relatively low leverage have allowed us to access the capital markets when and as needed and at very competitive terms. Our financial strength and strong liquidity enable us to remain one of the industry's most reliable suppliers, and we have the ability to take advantage of any investment opportunities which arise. During 2015, we executed \$1.2 billion in debt financings, including both raising new funds and amending and refinancing existing facilities. These financings allowed us to lower our funding costs further and greatly increased our financial flexibility which is critical given the current challenging operating environment. The

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refinancing steps we have implemented over the past two years have resulted in a reduction in our average annual interest cost by 121 basis points. Our current average annual hedged interest rate is below 3%.

Also, the company took the right action recently cutting the dividend to a nominal \$0.03 quarterly, which will save \$90mm or so annually from peak levels. Nevertheless, I am averse to debt-heavy companies and Textainer has issued equity in the past. When Textainer issued equity in 2012, the stock was trading over 2x book and peaking, so it was probably accretive to intrinsic value/share and demonstrates management's awareness of the impact of time and price with share issuances. Being forced to issue equity again at a time like this would be heartbreakingly dilutive given how cheaply shares are trading.

Protectionism

This is a risk no one seems to be taking seriously. Sure Donald Trump is [down in the polls](#), but a 24% chance him winning is still a ¼ chance. That's very non-zero. And it's not necessarily about whether he will be elected, but that his success is a signal of a changing tide in the US. And actually globally. Protectionist, extremist candidates have gained support in other nations and don't forget the elephant in the room - Brexit and other countries like the Netherlands that are considering exiting as well. Is protectionism so crazy? For most of modern history, trade was fairly minimal. When you widen the perspective, the explosion of global trade over the past half century starts to look like a momentary... bubble?

Globalization over 5 centuries (1500-2011)

Shown is the sum of world exports and imports as a share of world GDP (%)
The individual series are labeled with the source of the data



Data sources: Kiasing and Milonis (2014), Estevadeordal, Frantz and Taylor (2003) and the Penn World Tables Version 8.1
The interactive data visualization is available at OurWorldinData.org. There you find the raw data and more visualizations on this topic.

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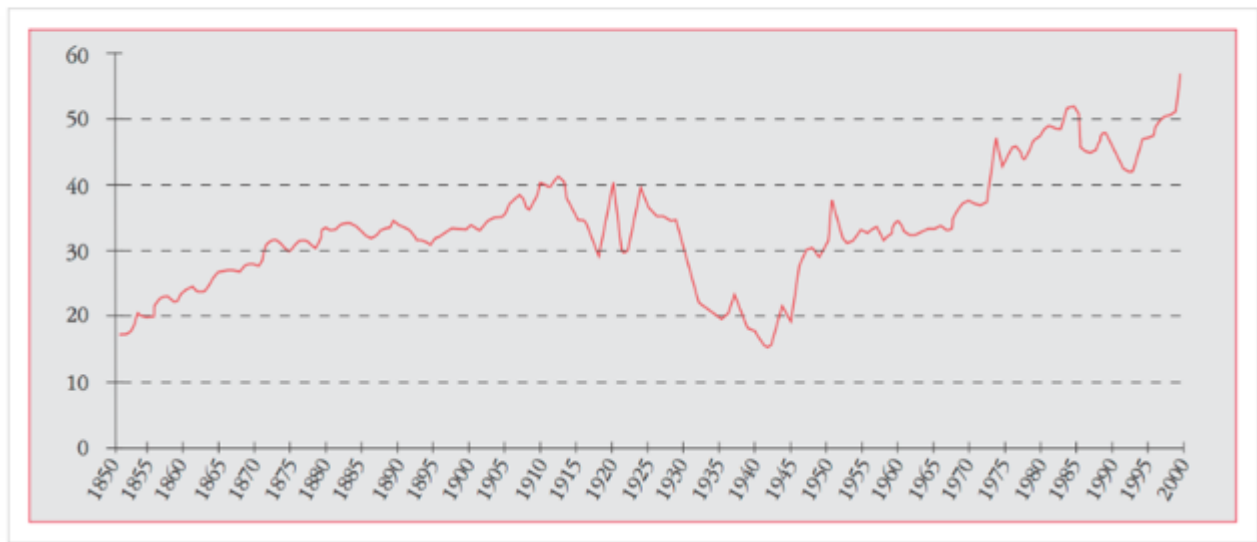
Source: [Our World in Data](http://OurWorldinData.org)

Trade now represents 60% of the global economy. If globalization is for real and for good, I could see than easily increasing to 80% or so, but if not then there's a lot of room between here and 5-10% again. The difference between 5% in 1600 and 60% in 2016 is that now we have the capability to do 60%. We didn't then. But we're capable of doing plenty of things that may or may not be optimal.

Terrorist attacks could also spark a decline in global trade. 9/11 caused a substantial decrease in trade in the immediate aftermath.

Wars can do the same. Look what World War 2 did to trade in Western Europe. That's more than a 60% decline:

🔗 Exports plus imports as a share of GDP in Western Europe, 1850-2000 – Carreras and Tafunell (2008)⁵



Source: [Our World in Data](#)

These kinds of charts make you wonder what those lenders are thinking lending to Tex at 2.5%...

Major Global Economic Downturn

A major global economic downturn would cause the worst of both worlds above. Credit markets would become much tighter, in and of itself making it more difficult for Tex to re-fi, and that would be compounded by the world trade decline it would cause (we saw a decline in 2009, remember) hurting financial results. It would also create collection issues for Tex with its shipping line customers which, as I mentioned are struggling right now. Textainer maintains insurance that has come in handy in the past. For example, they have a customer default in August 2015 and insurance covered over \$11mm of what would have been a \$16mm loss when all was said and done - repossession, storage, repositioning, uncollectables, etc.

Nevertheless, this is a risk that is on people's minds. There were two restructurings involving Korean shipping lines recently, one of which Tex has gotten paid on, the other they expect a reduced amount from. There is customer concentration with two 10% customers. The largest customer is CMA CGM. CMA CGM is one of the largest shipping companies in the world and in Q1 posted a loss of \$95mm, down from net income of \$413mm in Q1 2015.

Conclusion

The container leasing industry is certainly in trouble right now, but this is clearly a cyclical industry. The time to buy cyclical stocks is well into a downturn when all hope seems to be lost, but there are faint signs of recovery that the market seems blind to. There's that very brief

period of time between when traction starts to develop and when it starts to get appreciated. I think opportunities exist at this period in almost all cyclical industries and cycles, but this decline in the container leasing industry and the prices of container leasing stocks today strike me as particularly severe and cheap respectively. I think the severe decline and market pessimism is largely explained by who owns these stocks: unsophisticated, income-focused retail investors. They came to expect stable to improving financials and big dividend yields, similar to a REIT or MLP. Now they have neither of those and that explains the massive selloff and Mr. Market's continued pessimism. I already own CAI but now believe Textainer, the most efficient, profitable, and until the merger between TAL and Triton, largest player, now looks the most attractive of the bunch. The idea is not without risk including refinancing risk in 2018-19, protectionism and declining global trade, and of course another global economic downturn, but Textainer could very realistically offer triple digit returns over a few years which make the risk well worth taking at this price.

Disclosures

The author currently holds a long position in TGH and CAI. The author may choose to transact in securities of one or more companies mentioned in this article within the next 72 hours.

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