Chain reaction

Global supply chain issues could continue to support US container and railcar ABS. However, as Mark Pelham reports, both markets are facing challenges on other fronts.

As with most other US esoteric ABS sectors, the container and railcar markets suffered when Covid-19 first hit. However, the more broadly driven – though pandemic exacerbated – global supply chain dislocation has benefitted container and railcar demand and pricing.

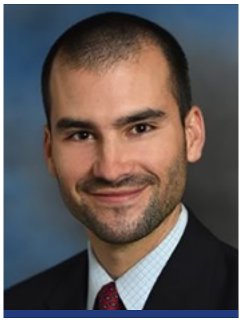
That dislocation looks set to continue, according to a June 2022 report from Citi's Global Perspectives & Solutions (Citi GPS) research team. "We expected improvement in shipping and logistics during the first part of 2022, as seasonal pressures associated with elevated fourth-quarter demand were reversed, steps were taken to unclog the ports and oil prices began to moderate," the report notes.

However, the report adds that 1Q22 brought significant downside surprises. Those included the emergence of the Omicron variant and consequent upsurge of coronavirus cases – notably in China – and, of course, the conflict between Russia and Ukraine.

As the Citi GPS analysts note: "Bottom line, we find that supply chain pressures have proved to be more persistent, and apparently deep rooted, than we had expected even a few months ago. And the Russia-Ukraine conflict seems to be further amplifying the stresses. Given these realities, any hopes of near-term improvement in supply chain conditions have been shattered. The challenges in the months ahead look to be as acute as at any time over the past two years."

Consequently, the macro environment looks set to support container and railcar ABS for some time to come. Nevertheless, the two sectors will be impacted in their own different ways – with container being more of a global product and therefor more closely reflective of the global economy, whereas railcar is more closely aligned with that of North America.

"Container and rail car are two distinct markets, though both have been impacted by supply chain issues," observes Michael Lepri, director at KBRA. "On the container side, we have a couple of container deals that we rate, but I'd say the supply chain slow-down has been great for container leasing overall. As with both the deals we have, all their containers are approximately 100% utilised. ▶



Michael Lepri, KBRA

Theresa O'Neill, Bank of America

While there is full utilisation, lease rates are also close to highs, therefore ABS deals are performing extremely well."

"In the container market, there are still a lot of logistical backlogs and while the industry has been trying to at least minimise port congestion, it's still there and the lessors still think it's an issue," says Theresa O'Neill, ABS strategist at Bank of America. "However, some measures – such as utilisation and freight rates – have slightly come off the peaks we saw in 2021. Though that was to be expected, as the manufacturers had ramped up production of containers, but again that is now slightly off the peak."

She continues: "Consequently, I would say some of the tight conditions we saw in 2021 might have softened a little bit in 2022. It's hard to be certain though because the peak shipping season for containers is the second and third quarter. So, the situation will be clearer once they are over, although we do have some data on container volumes at the US ports and that's still pretty strong."

The rail car sector is also supported by supply chain issues, combined with strong industrial production. However, O'Neill notes: "Questions about consumer and small business confidence are definitely creeping a little bit into the picture, but generally utilisations are pretty good on the rail car side, even though a lot of that is just that the manufacturers have cut back down on production and order books are down a bit. I would say the results are a little bit more mixed for rail car than they are for container, but still overall, I think they're fairly strong."

KBRA's Lepri reports: "Most of the servicers that we've talked to are now more focused on labour issues on the railroads, which are slowing down some of the velocities. There are also many different commodities involved on the rail side; it's difficult to generalise across the sector, as it is impacted positively and negatively by so many events here and there."

He continues: "For example, tank car lease rates have gone down a little bit, but are now coming back. They typically fluctuate on fuel prices and how much oil is being produced, domestically versus internationally. Similarly, we saw the frac sand issue in 2020 leading into Covid that impacted related types of cars – the small cube covered hoppers – which we still haven't seen come back."

Conversely, overall lease rates on rail cars have been increasing since the end of last year. "That's mainly due to steel prices, as servicers have been scrapping cars a little earlier and the manufacturing of new cars hasn't kept up – therefore, there's more cars being retired than are being manufactured," Lepri explains. "ABS rail deals are performing pretty well overall – they're all in the in the mid- to high-90s on utilisation rates."

However, despite such healthy performance, macro issues appear to be holding back new issuance. "Last year saw a lot of deals, especially in the rail sector. But not as many have come to market this year so far, which I believe is more rate-driven than anything else," says Lepri.

Last year saw nine new issue railcar ABS price for an aggregate principal balance of US$2.8bn, beating 2011's full-year record volume of US$2.4bn, according to Bank of America ABS research. In contrast, up to the time of writing (21 June 2022), this year has only seen US$895m of issuance across three deals *(see Figure 1)*.

Container ABS saw 11 deals in 2021 totalling US$5.6bn, compared to 2020's record volume of US$7.1bn. 2022 to date has seen US$830m of paper in two deals *(see Figure 2)*.

"Supply chain issues are, of course, important for the container and rail car ABS sectors. But with the broader market as volatile as it's been,

Figure 1: Container ABS

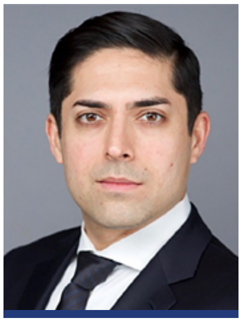
Pricing Date	Name	Class	Size (US$m)	Bmark	Coupon	Price	Yield	Spread	Lead structurer	Originator	Collateral
08/02/2022	Global Container Assets 2016 2022-1	A	200.00	Swaps	3.21%	99.99786	3.230%	140	Mizuho	Buss Global Management	Circa $358m portfolio of 174,157 containers
		B	30.00	Swaps	3.75%	99.99741	3.780%	195			
19/01/2022	CLI Funding VIII Series 2022-1	A-1	558.50	Swaps	2.72%	99.94978	2.745%	100	Wells Fargo	SeaCube Container Leasing	Circa $1.18bn portfolio of 235,381 containers
		B-1	41.50	Swaps	3.12%	99.97596	3.145%	140			

Source: Bank/rating agency research & dealer pricing information

Figure 2: Railcar ABS

Pricing Date	Name	Class	Size (US$m)	Bmark	Coupon	Price	Yield	Spread	Lead structurer	Originator	Collateral
19/05/2022	Tribute Rail 2022-1	A	298.51	I-Curve	4.76%	99.97986	4.81%	200	Wells Fargo	Trinity Industries Leasing	Portfolio of 6,466 railcars - Freight (44.1%) & Tank (55.9%)
		B	28.49	I-Curve	5.75%	99.98608	5.82%	300			
20/04/2022	Trinity Rail Leasing 2022-1	A	244.76	I-Curve	4.55%	99.99570	4.594%	170	CS	Trinity Industries Leasing	Portfolio of 3,652 railcars - Freight (42.21%) & Tank (57.83%)
01/02/2022	GBX Leasing 2022-1	A	302.56	Swaps	2.87%	99.95188	2.896%	115	Wells Fargo	GBX Leasing	3,363 full service, per diem and net lease freight railcars
		B	20.72	Swaps	3.45%	99.97481	3.479%	170			

Source: Bank/rating agency research & dealer pricing information



Yezdan Badrakhan, MUFG

we've really been focused on the cost of financing impact on these businesses," says Yezdan Badrakhan, head of US esoteric ABS at MUFG. "We've been focused on what supply chain dynamics mean for their capex spend and how that's impacting their behaviour. The reality is that these leasing companies are having trouble getting a hold of assets and scaling."

"IF A CONTAINER OR RAIL COMPANY WAS GOING TO COME TO THE CAPITAL MARKETS FOR FINANCING, AT THE MOMENT IT WOULD BE OUT OF NECESSITY RATHER THAN ELECTION"

He continues: "I think the other thing that fundamentally is making this period challenging is that the lease rates that are being commanded in the market today really are no longer reflective of the necessary lease rates to support the current cost of funding. They really don't contemplate the swift and severe move we've had in interest rates and global market volatility on spreads and that means firms have less cash available to service their debt, which then – as a second order effect – limits the amount of leverage the business can take."

As a result, ABS new issuance has been stymied and faced with the consequent lack of new assets, companies have become less likely to sell assets despite any trading gains they may see on those assets. "So, because no one wants to lose scale, it feels like we're in a holding pattern," Badrakhan says.

The secondary container and rail car ABS market has been impacted in the same way as the primary market. "Secondary activity has been muted," confirms Badrakhan.

"The buyers of rail and container ABS tend to be asset managers or insurance companies, who have buy-and-hold strategies," he adds. "The fundamentals of those businesses don't present any significant credit risk at this time and so the idea that asset managers would sell into a volatile market is counter to what you'd expect an insurance company to do."

There is, nevertheless, some patchy secondary trading from time to time. "Senior liens on ABS broadly speaking are faring better, notwithstanding rate and spread moves, and in the container and rail sectors names or issuers that are perceived to be more liquid are also faring better from a price perspective," Badrakhan says.

"I think our expectation would be that we will still see more container and railcar ABS deals throughout this year, but I think a lot of it's going to depend on overall market tone," says Bank of America's O'Neill. "We might have short periods of time where spreads tighten in, but broadly the thought is that spreads are definitely biased wider, given the overall volatility in the market; the risks that inflation will have; and the risk of the pressure from the Ukraine war. So, that could also mean that some of the rail and container lessors might be willing to finance in another market other than ABS."

Indeed, MUFG's Badrakhan suggests container and rail car companies are looking at alternative structures. "I think a lot of these names are exploring floating rate debt as an alternative, but as the yield curve changes shape, that theme may or may not persist," he says. "Equally, for people we knew had required capex expenses or near-term debt needs, we were suggesting they think about some kind of interest rate lock on a forward basis to help with some of the forward-looking rate noise, knowing that they would have the obligation to finance."

For now, obligation is the key word, according to Badrakhan. "It's my view that if a container or rail company was going to come to the capital markets for financing, at the moment it would be out of necessity rather than election. However, we are seeing a growing realisation from those who are able to wait for markets to normalise that there is a trade-off involved –while they're waiting, rates may just continue to trend upwards on assets that have existing fixed leases."

In any event, there remains room for some positivity in the container and rail car ABS market. As O'Neill concludes: "There's still a lot of uncertainty with respect to inflation and market volatility, and that certainly can have an impact, but the supply chain issues should still be supportive. Industries need to rebuild inventories and I think that's especially true of the container market."■