Upgrades and Downgrades

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The global shortage of intermodal shipping containers is making the companies that lease them rich.

By: Jack O'Connell

Will wonders never cease? Not in the shipping industry. In a year that will probably go down as the worst in shipping history, a small group of companies is making a fortune. These are the companies that buy and then lease to major shipping lines the humble "box," or intermodal shipping container. You know, those ugly rust- or gray-colored containers that sit atop 18-wheelers and block your view of the road and cause massive congestion and beaucoup emissions? And I bet you can't name a single one of these companies. I couldn't, until I started researching this article. They're not exactly household names, but they should be for any investor worth his or her salt.

And just why are these companies suddenly so valuable? Because they own a scarce commodity. Because back in 2009, in what was then the worst year for shipping in its history, the Chinese manufacturers who produce all the boxes in the world stopped making them. Nobody wanted them. Global trade had fallen for the first time in decades, and the market responded the way it always does. Then when trade rebounded last year, there was a scramble to get boxes. But nobody had them. The Chinese factories that made them had closed or shifted to other production, and most of the workers who made them had found other jobs. Global trade has continued to grow this year – at close to 10 percent – further exacerbating the problem. Meanwhile, the container-leasing companies, who control roughly 45 percent of the world supply, are sitting pretty as the price of new containers and the cost of used ones goes steadily up.

Facts & Figures

Containers are the lingua franca of world trade and one of the greatest inventions of the second half of the 20th century. Ninety percent of everything you buy or use – from cars and refrigerators and laptops and toys to clothes and fresh fruits and vegetables – are carried in them. People seeking asylum hide in them. Drugs are smuggled in them. After 10 or 15 years they're converted into shelters or offices or temporary storage facilities. And they're ubiquitous. You see them everywhere, no matter where you travel in the world, because they're all the same. They're interchangeable. And that's the key to their success.

Containers come in varying lengths of 20, 40, 45, 48 and 53 feet and vary in height from eight to eight-and-a-half to nine-and-a-half ("high cubes") feet. But they are all eight feet in width, and that's what makes them transportable or "intermodal," capable of being moved on ships or barges or rail cars or trucks and shifted from one mode to another interchangeably. So on a typical journey from China to the U.S., a container will be loaded in Hong Kong onto a container ship ("box ship"), offloaded by crane at LA/Long Beach onto a rail car for the long ride to Denver or Chicago or Houston, and then offloaded again onto an 18-wheeler for delivery to Target or Walmart or wherever its final destination is. They are measured in TEUs, which stands for "twenty-foot equivalent units." A standard 20-foot box weighs over two tons and costs about $3,000. It can carry 30 tons of merchandise. A 40-foot box weighs over four tons and costs about $6,000 and can carry 60 tons of merchandise, and so forth. A refrigerated container, known in the trade as a "reefer" and used to transport vegetables, fresh fruit and fish, has its own built-in refrigeration unit and can cost more than $20,000.

The modern shipping container was invented in 1955 by Malcolm McLean, a trucking company owner from North Carolina who developed – together with Keith Tantlinger, an engineer – the first standardized version, which was eight-feet high by eight-feet wide and forty-feet long. In addition to its standardized size, what made McLean's invention revolutionary was its stackability: You had to be able to stack them, one atop the other, on ships in order to make transporting them economically feasible. So an ingenious device called a "twistlock" was developed that fit into a large hole at the bottom of each corner of the container and secured it to the ship's bed or truck or rail chassis or to the container below it. It also enabled cranes to lift and move them safely. "Corner castings" (holes) on each side enabled the use of "turnbuckles" and other lashing devices to further secure the container as needed. Today's modern box ships can carry up to 14,000 TEUs or 7,000 40-foot containers, which are stacked in rows more than 10 containers high. Containers can be double-stacked on rail cars, and sometimes – particularly in the western U.S. – you'll see an 18-wheeler hauling two trailers in tandem.

There are roughly 17 million containers in the world, representing 30 million TEUs. A little more than half are owned by the shipping companies themselves with the remainder owned by the container-leasing companies.

Where the Money Is

OK, have you figured out who these companies are? If you said Crowley or Hanjin or Hapag-Lloyd or some other ocean shipping company, you'd be half right. They do own some of their containers, but they don't lease them. If you said Swift or J.B. Hunt or Werner or some other trucking company, you'd again be only half right. The same goes for FedEx and UPS and Ryder. No, the owner/lessors are companies like Textainer, Triton, Florens and GE SeaCo and – admit it – you've seen their names on containers while cruising down the highway. You've just never noticed.

TEX, short for Textainer, is the biggest. It's a Bermuda-based operator with about 18 percent of the market, a market cap of just over $1 billion, and annual sales of about $500 million. So it's small by public company standards – like all these companies – but amazingly profitable with estimated net income this year, according to Wells Fargo analyst Michael Webber, of more than $150 million. That's a 30 percent profit ratio. It also pays a nice dividend of nearly six percent. "We are doing incredibly well," gushed TEX's President & CEO, John Maccarone, during a recent conference call. 2011 will be "by far the best year in the history of the company," and Maccarone sees no letup in sight and a continuing shortage of containers going forward. Among the company's biggest customers are Walmart and the U.S. military, for which it is in the eighth year of an exclusive 10-year contract. It is also the second largest lessor of refrigerated containers, a market it has been in for only four years.

Number two is Triton, which is also Bermuda-based and has operations in 42 countries and was formerly owned by the Pritzker family of Chicago and Hyatt Hotel fame. In a sign of the times, Pritzker sold Triton in May to two private equity companies – Warburg Pincus and Vestar Capital Partners – for more than $1 billion, valuing the entire company (including debt) at about $3.5 billion. The deal signaled how private equity companies are jumping into the container leasing space, attracted by both the depressed valuations of these companies and their high profitability. In the latest such transaction, GE SeaCo, the fifth-largest container lessor, was sold in August to Chinese transportation and logistics company HNA Group and Hong Kong-based private equity firm Bravia Capital for $1.05 billion. For perspective, of the six largest container leasing companies, three are public and three are private. In addition to Triton and GE SeaCo, number three Florens is private. This Hong Kong-based operator is largely controlled by COSCO (China Overseas Shipping Company), one of the largest box lines in the world and its biggest customer.

Purchase, NY-based TAL International is the second largest public container leasing company and the fourth biggest lessor overall with roughly 11 percent of the market. It owns a million containers and stated in its most recent earnings report that "key operating metrics remained at historically high levels" (translation: "We're coining money"). It's also – to its credit – giving some of it back to shareholders, raising its dividend for the seventh consecutive quarter (that gives you some idea of just how good things are) to 52 cents a share. That's a seven percent yield at the stock's recent price. President & CEO Brian Sondey noted that many of the company's customers (the major container lines) – stung by low freight rates, an oversupply of tonnage and high bunker costs, and struggling to raise cash – are looking for ways to strengthen their balance sheets and "get their capital out of containers." This has opened the door to a flood of sale-leaseback transactions, in which container lines sell all or a portion of their containers to companies like TAL and then lease them back under long-term contracts. The leasing companies make money on both ends of the deal.

San Francisco-based CAI International, the number-six company in size and third largest public company, reported its results in late July and noted that per diem rates for its containers were up 31 percent over the year-ago period while utilization stood at 98 percent. President & CEO Victor Garcia noted that "Clarkson's Research in July estimated overall containerized trade growth to remain at approximately nine percent for 2011, supported by moderate growth of six percent in the main trading lanes to Europe and the U.S., and much more robust growth within Asia, Latin America and the Middle East." Reflecting the general sentiment in the industry, he added that "We believe utilization will stay strong next year due to ongoing trade growth and the investment we have made over the past two years in equipment with multi-year leases." CAI is a microcap company with sales of barely $100 million and does not (yet) pay a dividend.

Future Tech

The basic container has not changed in 50 years, and why should it? It's the perfect combination of form and function – elegantly simple in design, durable and long-lasting, and eminently practical. Yet security concerns and weight considerations are giving rise to the concept of a "smart container," which would have a lightweight, composite body (rather than corrugated steel) and a collapsible frame for ease of storage and transportation when empty. According to a recent Popular Science Web posting, the "Sensor-Packed Shipping Container" would have a tamper-proof tracking tag, padlock alarm, internal sensors and even an onboard computer capable of sending encrypted updates to appropriate parties in the event of a breach. Sounds a little far-fetched – not to mention prohibitively expensive – to this observer. But hey, I've been wrong before. In the meantime, put your money on the companies that lease them. – ***MarEx***

Jack O'Connell, the Senior Editor of this magazine and a former maritime executive, is a private investor who may own shares in some of the companies mentioned in his columns. The views expressed are his and his alone and are not in any way to be construed as investment advice.