GATX | GATX Corporation

2017 Fourth Quarter Conference Call — January 18, 2018

Operator:

Good day, and welcome to the GATX Fourth Quarter Conference Call. Today's Conference is being recorded. At this time, I'd like to turn the Conference over the Jennifer McManus. Please go ahead.

Jennifer McManus:

Good morning, everyone, and thank you for joining GATX's Fourth Quarter and 2017 Year-End Earnings Conference Call. I'm joined today by Brian Kenney, President and CEO; and Bob Lyons, Executive Vice President and CFO.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements. Actual results or trends could differ materially from statements or forecasts. For more information, please refer to the risk factors discussed in GATX's Form 10-K for 2016. GATX assumes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

I will provide a brief overview of our 2017 fourth-quarter and full-year results, and then Brian will provide some commentary on what to expect going into 2018. After that, we'll open it up for questions.

Today, GATX reported 2017 fourth-quarter net income of $342.1 million or $8.83 per diluted share. These results include an estimated one-time, non-cash, net-tax benefit of $315.9 million or $8.15 per diluted share, resulting from the enactment of the Tax Cuts and Jobs Act signed into law on December 22, 2017. This compares to 2016 fourth-quarter net income of $30.9 million or $0.77 per diluted share, which includes a net negative impact from Tax Adjustments and Other Items of $0.37 per diluted share.

For the full-year 2017, GATX reported net income of $502 million or $12.75 per diluted share. This compares to net income of $257.1 million or $6.29 per diluted share for 2016. The 2017 full-year results include a net benefit from Tax Adjustments and Other Items of $8.05 per diluted share. The 2016 full-year results also included the positive impact from a number of Tax Adjustments and Other Items, all of which are detailed in our press release.

In 2017, investment volume was $603.4 million, which is another solid year on that front. In addition, in 2017, GATX repurchased over 1.6 million shares for approximately $100 million. This brings our total repurchase activity over the past two years to approximately $220 million. With that quick overview, I'll now turn the Call over to Brian.

Brian Kenney:

Okay. Thanks, Jennifer. As she said, I'll take the next few minutes to give you some color on our business outlook and guidance.

In 2018, the North American railcar market is entering its fourth year of oversupply. But again, we entered the year in outstanding conditions. At the end of last year, our North American fleet utilization remained above 98%. We have placed the majority of our 2018 committed new car deliveries; our fleet composition and our average lease term remaining, positions us very well to withstand the continued weak market.

Now as I said in the press release, we outperformed our original financial expectations pretty much across all our business segments in 2017. So let me put 2017 earnings in perspective.

As we reported this morning, as Jennifer said, ignoring large positive impact to the new tax law, we earned $4.70 per share in '17, that's with the upper-end of our guidance. And although we're operating in the third year of the downturn in the railcar leasing market, these earnings in '17 of $4.70 were still well above our peak earnings of $3.49 per share that we earned at the top of the last railcar cycle. So that shows me the great job our commercial team did during the strong market -- making good investments, locking in high rates for long lease terms. And with less than 14,000 railcars scheduled for renewal in North America in 2018, along with some continued cost control, we're projecting another strong year of financial performance, especially given where we are in the business cycle.

So let me go over the 2018 outlook by each business segment, and I'll start with Rail North America.

So in Rail North America, we expect lease revenue to decline again in '18. But the good news, as compared to our outlook a year ago, is that absolute lease rates for most car types increased during 2017. However, today's market lease rates, as well as the rates we're anticipating to see moving through 2018, will still not be high enough to offset the fact that the average expiring rate for cars coming up for renewal is also increasing this year. So it's definitely a better lease rate environment than it was coming into 2017, but we still expect lease renewal rate pressure in 2018.

As I said, we were able to hold utilization over 98% throughout the year last year, and that was better performance in the few point drop in utilization we originally anticipated. We're more optimistic this year. We still anticipate some downward pressure on utilization, so we project a slight drop in 2018.

So the impact of the negative revenue assumption is muted somewhat by the fact I mentioned that less than 14,000 cars are scheduled for renewal in 2018. That's lower than the exposure coming into last year, much lower than the average number of cars that were renewing in the strong markets of 2012 to '15. So once again, the good work done by our commercial team in extending those lease terms in the strong market is really paying off now.

On the investment side, I expect a strong level of railcar investment in 2018, $500 million or more. Again, the majority of these cars are already placed with customers. So new car additions will obviously positively contribute to revenue this year. And the net effect on revenue in North American Rail, if you combine the placement of new cars delivering -- declining renewal rates on existing fleet and slightly lower fleet utilization, it results in 2018 revenue that we expect to be decreasing a little under 4% from last year.

Another driver of segment profit at North American Rail is obviously net maintenance expense. We continue to have success with our strategy of moving our maintenance into our own network and away from certain third-party providers, particularly tank car and especially freight car maintenance.

But looking at the maintenance cost driver, I'd start with tank qualifications, which is one of the main maintenance cost drivers. The number of cars that we technically have due in 2018 is about 1,000 cars higher than what was due in 2017. However, as we discussed in the past, for efficiency purposes in our network, we try to maintain an even flow of the compliance work year to year to the extent possible. So we try to pull cars forward that are due in later years. We try to complete qualification work on cars that are not due but are in the network for other reasons. Thus, we actually anticipate completing just a few hundred more tank qualifications in '18 than '17.

We also expect higher boxcar assignment costs as we put some of the idle portion of that fleet back to work, which is good news.

The overall effect is that net maintenance expense in '18 is expected to increase approximately 3% to 4% from the 2017 level.

The last factor I'll discuss for North American Rail is remarketing income. So, we continue to optimize our fleet, as we do every year, through the secondary market sale of railcars. But we continue to be surprised by how robust that market is, given where we are in the cycle. We have not seen it let up. So our realistic projection is that remarketing income will be up again in 2018. It's really the economic thing for us to do.

So, summarizing North American Rail, the net effect of lower revenue, increased ownership costs from new car investment, slightly higher maintenance expense and higher remarketing income will result in North American Rail segment profit -- we expect it to be down in '18 between 10% to 15% from last year.

Let's talk about International Rail, and first, GATX Rail Europe. They continue to focus on maintaining utilization in a difficult market. Remember that 80% of their fleet is serving the petroleum and LPG markets. And over the last several years, their customers' refining margins have suffered and it's been a tough market, although it seems to be getting better now.

GATX Rail Europe will continue its fleet modernization plan that you've seen the last few years. They're investing in modern, higher-capacity, more-efficient railcars. And they're either scrapping the older cars and smaller cars or redeploying them in other service. We currently plan that GATX Rail Europe will add over 1,000 new cars to the fleet in 2018. And even with the high level of scrapping, if that continues, they'll still see net fleet growth. That fleet growth will be offset somewhat by slightly lower lease rates that we anticipate will be required to maintain their high level of utilization on their existing fleet. And that should result in slightly-higher revenue in 2018, in euros.

That small revenue increase, however, will be offset by higher ownership cost from new car investment. Also on the cost side, we expect net maintenance expense to increase between 7% and 10%, in euros, in 2018. That's due to higher wheelset and tank revisions than we experienced in 2017. So the net effect of those factors is, we expect GATX Rail Europe segment profit to be fairly flat in 2018 in local currency, but up on a U.S. dollar basis due to the much weaker dollar.

Now, adding to this increase in segment profit in Rail International, in 2018, there's increased profitability at GATX Rail India where we're currently experiencing increased lease growth and, more importantly, fleet diversification. Now, I'm really excited about the prospects on our Indian rail business. It's not a huge contributor to GATX's overall profitability, but they do generate a few million dollars of segment profit and they will again this year. But they're well-positioned as the #1 rail lessor in a fast-growing economy and rail market. And their outlook fits perfectly within our strategy of taking what we do well in North America and applying it in more attractive growth markets.

So, summarizing our expectations for International Rail, European and Indian fleet growth and revenue growth will be offset somewhat by higher ownership and maintenance expense in Europe, and the stronger euro should help overall segment profit in Rail International increase over 5% in 2018.

As we indicated in the press release, American Steamship outperformed our expectations in '17. We originally expected they would carry similar tonnage to the prior year, but carry it more efficiently using fewer vessels as well as realizing some other cost efficiencies due to return of leased-in vessels, some efficiencies in labor contracts, etc. They were able to realize the efficiencies as we planned, but they actually ended up the year delivering over 2 million more tons than we anticipated, and that was due to spot iron ore and limestone tonnage that developed later in the year.

So looking at 2018, we anticipate Steamship will carry less tonnage than last year. However, we do expect they will produce slightly-higher segment profit due to freight rate increases and continued gain of fleet efficiencies. So, expect that they will increase their strong performance in 2018.

And now in Portfolio Management, we expect to see lower segment profit this year. We anticipate that Rolls-Royce and affiliates will continue their excellent investment and financial performance again this year, but it will be offset by lower residual income in our managed portfolio. You might remember, for instance, a large gain from the nuclear facility residual last year in our legacy managed portfolio. So that's not going to repeat itself. They will also have some lower earnings from marine assets that were sold in '17, and the net effect is that we expect Portfolio Management segment profit, despite Rolls-Royce's performance, to be down approximately 15% in 2018.

On the Corporate side, we expect a modest reduction in SG&A in 2018 in the range of 2% or so. SG&A did come in higher than we originally projected in 2017, but that was due to some unusual items that we don't anticipate reoccurring this year. So, prior to the recent tax law change, we would've expected 2018's effective rate to be lower than '17s due to the fact that our U.S. operations were sort of generally taxed at a higher rate than our foreign operations. We're expected to generate a lower percentage of pretax income in 2018. Now that's still true, but with the new tax law passed, we now expect the 2018 tax rate to approximate 25%.

So, consolidating all this individual segment guidance results in the 2018 total net income that's somewhat lower than '17; but when combined with the anticipated share repurchase results and annual guidance in the range of $4.55 to $4.75 for '18 that Jennifer referenced.

So, a little more color on that guidance because we got a lot of questions about what kind of economic assumptions we're using for our EPS build up; what are our assumptions for railcar loadings; railroad performance -- variety of variables. As far as the economic backdrop, it's not really a direct input into how we build our model for financial performance. As I've said in the past, we build our 2018 expectations based on a lease contract-by-lease contract review of what cars are coming up for renewal this year; what we think the commercial and operational outcome will be for those cars, as well as for new cars that are delivering. So obviously, those expectations are based on what we're hearing from our customers and their expectations for their business as well as what the railcar supply situation is in the market. What I will say is that our 2018 guidance does not reflect a significant increase in economic growth over what North America has been experiencing over the last few years.

Also in the press release, I did mention a positive year-over-year move in a number of market metrics relevant to our business in North America, such as railcar loadings and absolute lease rates -- all positive indicators for railcar demand. So it does appear the railcar leasing market is moving off the bottom. But again, absent that currently unforeseen demand catalyst, we think the trend is one of continued slow recovery this year.

So with that as our assumption, we have not assumed any significant increase in absolute lease rates across the fleet in 2018 from where they are today. So if the demand catalyst does appear, as I said it's unforeseen -- so the economy, say it grows much stronger than we anticipate, there is some minor upside for earnings guidance. And why do I say minor? Obviously, one of the unique characteristics of our business is the term structure of our lease revenue. It may take some time for market trends to show up in a material way in our financial statements. Much of our revenue performance is fairly well-known coming into the year.

So, for instance, coming into '18, for example, we've placed the majority of our 2018 new car deliveries at 2017 market rates. And as I said, I think we have a pretty solid view on what may happen with our 2018 lease renewals on the existing fleet.

So, if we have underestimated the pace of recovery in the leasing market -- there is some minor upside in '18, but it's going to be much more impactful for our outlook in 2019 and beyond. So either way, our focus is continue to outperform our competitors, as well as take advantage of any growth opportunities that we see.

The last thing I'll mention before we open it up to questions is that 2018 will mark our 100th consecutive year of paying a dividend. That's a track record that we're proud of. I don't think very many companies can match that. The GATX Board meets next week. We'll announce their dividend decision at that time.

I will say, they understand the importance of the dividend and I think our almost century-long streak through last year is a great example of our long-term record of success and our commitment to our shareholders.

So that's all I have, and let's open it up to questions.

QUESTION AND ANSWER

Operator:

(Operator Instructions) We'll take our first question from Allison Poliniak with Wells Fargo.

Allison Poliniak-Cusic:

Hi, guys. Good morning. You mentioned, obviously, the secondary markets still being very active. Could you talk to maybe the absolute values? Are they becoming more realistic? And then also with tax reform, is there, I guess, increased interest from new entrants into this market today?

Robert Lyons:

Well, I would say on the tax reform piece, the parties that have been bidding on our assets in the past -- we haven't seen any material change. In terms of the composition of that group -- don't anticipate it. I would add that it continued to be very robust. A good number of bidders, a lot of interest across-the-board, different asset types at good valuations for GATX. And as Brian mentioned, the economics makes sense for us to continue to optimize the fleet and we'll see good opportunity to do that in 2018.

Allison Poliniak-Cusic:

That's great. And then obviously, the storage number is still very high. There's obviously, talk of accelerated retirements, improved traffic outside of coal -- what do you think that number is? We -- that we should get, realistically, before we see a bit of an inflection in lease rates. Do you have any sense of that?

Brian Kenney:

You're not going to like the answer. But it really depends. It's a car type-by-car type analysis. So as you said, there's still a lot of idle cars in the industry. But as you saw last year, like at small-cube covered hoppers -- that market took off pretty [inaudible] very quickly within a quarter or two when lease rates took off. But if you want to speak generally about, I think, the 19% of the industry fleet that hasn't moved in 60 days and it's called idle -- I think the best it's ever been is the 12% to 13%. So that suggests to us that a lot of those cars, not all of them, but a lot of those cars need to either leave the market or start moving in order for lease rates to really get some traction here. It's not -- it hasn't been helped tremendously by scrap rates. I mean, that did increase through 2017. I think they started the year around 200 and ended the year at 265; in January, it's up to 295. It's moving in the right direction. But it's really not enough to stop the net growth in the industry fleet, which I think has continued for the last six years. So if scrap rates continue at the current level or increase, that would certainly help, and maybe we'll see that move the other way. But it hasn't been a big help over the last couple of years.

Operator:

And we'll take our next question from Prashant Rao from Citi.

Prashant Rao:

Good morning. Thanks for taking the question. Brian, last quarter, I think we talked a little bit about how the -- on the manufacturing side, delivery expectations were starting to pull up for 2018. And compared to where demand was inflecting, it seemed to you that this could be a kind of a warning signal for oversupply. It sounds like demand is slowly moving. But like you said, you don't have that catalyst yet. I just wanted to kind of get an update on how you think about the ordering levels and the delivery levels you're seeing on the order book versus demand, now that we're one quarter later. If your view has changed, or if there's a little bit more detail on that front.

Brian Kenney:

The latest forecast I saw was, I think, 45,000 for deliveries in '18. Would I like it to be lower? Absolutely. I think some of the orders that have been announced were also -- there's some international flavor to that as well. I don't really know. It doesn't seem that the market can support this level of new cars, absent that demand catalyst. So I would reiterate what we said last quarter -- we would like that number to go down like it has in the past cycles to really get traction. Utilization's been fine, but to get really good traction on lease rates.

Prashant Rao:

Okay, thanks. And then just a follow-up on the remarketing income question. When you look at the package for this year, maybe compared to last year or prior years, is there anything -- what are the mix of types of cars or what you're expecting to be able to remarket? Is there anything notable? Or any color on shifts there -- this year versus last year, prior years in car types? And maybe what that might portend for particular end markets? Anything to read there?

Robert Lyons:

Sure. I'll take that one. And first of all, there are a number of sales initiatives throughout the course of the year. It's not just one initiative. So we're constantly in the market and testing what buyers' appetites are for different assets at different valuations. I can say for 2018, where we sit today and looking at what we have gone to market with -- and may, as the year progresses, there's no notable difference in the asset mix from last year to this year. So it's still a pretty broad, kind of across the fleet.

Brian Kenney:

What I'll add to that is the strength you've seen despite the market being weak overall, I think, has been exacerbated by financial players coming into the market. GATX is very focused when we remarket railcars on our equipment, and our customer and our lease expiration schedule -- that's what we're trying to optimize. It seems increasingly that the people that buy railcars are focused mostly on the cash flow. So we're much more focused on the equipment and the residuals than the average buyer these days, and that's been good for the market. And that's why you're seeing that remarketing number so high at GATX.

Prashant Rao:

Okay. Thanks very much, guys. I'll turn it over.

Operator:

And we'll take our next question from Matt Elkott with Cowen.

Matt Elkott:

Good morning. Thanks for taking my question. Brian, you mentioned how the earnings floor maybe is trending higher for you guys as you go throughout -- through more cycles. And I wanted to ask a question about -- you said that there's less than 14,000 railcars scheduled for renewal in 2018. If you think about that as a percentage of your active fleet and if you think back historically throughout the cycles at that percentage of the active fleet coming for renewal every year, is that a meaningful number? Is that a number that you guys look at? Is that a number that you want to make smaller so that the cyclicality is smoothed out?

Brian Kenney:

Yeah, absolutely. That's why you see us extend term dramatically during the upturn, and that's what we were able to do in 2012 to 2015. We had 20,000, 22,000 cars renewing each one of those years. We pushed the pedal on both rate, but also even more so on term, and that's why you see that number relatively low during the downturn. That's the whole idea of recognizing we're in a very cyclical business. And, as you just said, trying to smooth out that pattern to the extent you can. Now, the longer this lasts, obviously, it gets us, too. But at least so far, we've had lower renewals because of the extended term that we put on during the upturn. So you're right, that's the objective. It depends on when things turn around about if you're completely successful.

Robert Lyons:

The other thing I'd add, too, is I think most -- we provided data points with regards to the average renewal term, and you can see how long it was during 2012 through really up to 2015. Also, keep in mind that as new cars were coming into the fleet at that point in time, we were also very much focused on term. So the majority of those new cars that came into the fleet during that period were put on very long-term lease.

Matt Elkott:

That's fair enough. And given the sharp drop in those average lease terms -- you mentioned, Bob, in beginning 2016 really, so you have that 2012 through 2015 where you had long average lease terms ranging from 5 to 6 years, I think, and then it dropped down to about 3 years in 2016. What is the most -- what's the most realistic chance of swinging back to revenue and profit growth in the North American lease segment? Is it 2020? Is that the first realistic chance? Or is it -- could it happen before, if we continue going with the macro as we are now?

Brian Kenney:

It's a really tough question to answer about when that happens. I will say the average expiring rate -- we said in the past that it's climbing. It climbed in '16, it climbed in '17; it climbs again in '18. But that hill is getting smaller to climb. As we renew leases in the weak market and keep a very short term, that average expiring rate is coming down -- so that hill is not as big as it was before. But as far as when the market gets back to equilibrium, that's the question. You saw it for small cubes in '17. When does it happen for the entire fleet? As I said in the past, it's really hard to answer. I can describe the math, but I can't do the calculation. The hardest part of the calculation is not demand, it's not scrapping; it's really the backlog. There's no reliable detail in the nature of the backlog. We don't know if a sizable chunk of that backlog is not needed by the actual end-user in the near term. I don't really have an idea of how real it is, how much has been deferred -- although still technically part of the number. We don't know how much of it may be canceled -- how much of it is for manufacturer's captive fleets. So we don't have great visibility into the backlog. And without that, it's hard to tell you how fast this market will turn.

Matt Elkott:

Fair enough. And just one last quick one. Did you guys -- sorry, if I missed it, but did you mention the sequential improvement in lease rates in the fourth quarter?

Brian Kenney:

In general, I'd say there are certain flammables cars and certain high-pressure cars that had a nice increase in lease rates, although off a very low base. So on the tank car side, like I said, high-pressure, some flammables increased 10% or more. The rest of the fleet was pretty flat in the fourth quarter on a lease rate basis. Up substantially for the year. In fact, I think, tank, on average, which is always dangerous to say, because it really -- you have to look at stuff on a car-type basis. But if you look at average increase for tank throughout the year, it was probably about 10% or more. Average increase for freight, generally, 25%, I'd say. But in the quarter, pretty flat except for flammables and high-pressure.

Matt Elkott:

So the 3% broad-based increase you saw in the third quarter, what would that number be in the fourth quarter? Is it flat or is it slightly 1%, or …

Brian Kenney:

I'd say it's slightly positive.

Matt Elkott:

Okay, great. Thank you very much.

Operator:

And we'll take our next question from Justin Long with Stephens.

Justin Long:

Thanks and good morning. So just to start, I wanted to ask about how tax reform could change your strategy on capital allocation. And I'm curious if this could drive a more aggressive approach to buybacks and/or acquisitions going forward -- just given the impact it could have to your leverage?

Robert Lyons:

Well, the biggest component of that really is to keep in mind where we have been historically from a tax position. The Tax Reform Act has not really materially changed our overall outlook with regards to our tax position. Given the fact that there's already accelerated tax depreciation available on railcars and we've recognized that over the years -- we tend to generate net operating losses. Not a significant cash taxpayer -- none of that will change on a go-forward basis. So we're keeping a close eye on how this may impact some other investors in the market. But from GATX's perspective, not a significant -- not a sea change in the way we think about the asset class we're in and our level of investment.

Justin Long:

Okay, that's helpful. And secondly, I wanted to follow-up on some of the commentary you made on the last Call. And Brian, I think you talked about lease rates still being 30%, 40% below what you would consider are attractive levels for investment. Can you just update where we stand in terms of that number and how that number compares between tanks and non-tank today?

Brian Kenney:

Yeah. I'd say rates got a little bit better in the fourth quarter, so it's pretty much in the same place.

Justin Long:

And going back historically, what's the most you've ever seen lease rates improve over the course of the year -- just on an absolute basis?

Robert Lyons:

Yeah. I can't answer that question off the top of my head. I would say that the last two recoveries, particularly the one in 2011; and 2012, when rates began to improve and found their footing -- they increased pretty dramatically. Now that -- there was a big catalyst for that, which would be the energy boom here in North America. But once they turned and started to move in the right direction, they moved pretty sharply and quickly.

Brian Kenney:

Yeah, I would agree with that. Things move very fast once that market gets back in equilibrium.

Justin Long:

Okay. And then lastly, I wanted to ask about crude oil prices; we've seen a recent rally on that front. Could you talk about the potential impact that could have to your business? I'm just curious how much this matters, and if you think this improvement could have a meaningful impact as it relates to absorbing the oversupply of tank cars in the market?

Brian Kenney:

Sure. It's a good question. In fact, I would say our utilization outperformance in '17 -- to a large part, we did better in coal, for instance, but the lease rates are so low -- the new releases versus expiring leases -- it didn't matter to the bottom line.

But the other source of strength and utilization wasn't cars in flammables service in 2017. And as you said, I believe the price of crude was $42 in June and $60-something today, so that obviously had an impact. You're seeing more crude-by-rail demand, especially in Mexico and Canada, for different reasons. But we are seeing -- and as I said, that was -- one source of lease rate strength in the fourth quarter was on 30s and the high-pressure cars, and that's once again driven by some of these flammables liquid movements where there is more demand now. So yes, it matters, and, hopefully it will soak up the excess capacity in the tank car market and not prompt further new-car builds in tank. So that would be very helpful.

But as far as what it means to our business long-term -- so if you look at Mexico, for instance, they've been increasingly importing refined product to meet their growing demand because Mexican production is dropping -- they don't have the pipeline capacity to do it, but they're working on it. So there's a lot of demand we're starting to see. People are trying to build up their inventory to reasonable levels, and so legacy 30s are in demand, for instance, in Mexico.

In Canada, it's a little bit different. It's more a function of new Oil Sands Projects coming online. Once again, that production is exceeding pipeline capacity; they're working on that as well. That's probably just a couple of year phenomena. So it really doesn't change our long-term view of that market, which is -- eventually, it will be served more efficiently by pipeline. But as far as soaking up excess cars in the market, it can be very helpful in the near term. So yeah, I would say that's an upside to the tank car market, in general, if those trends take off. But it's different this time. So the Oil Sands Projects have come online, but the Canadian rails aren't that excited about increasing their service because they, too, think it will be short term in nature. So that's why you see the price differential you do between, I think, Western Canadian Select and WTI in the Gulf. So there is increasing demand. We don't think it's a long-term phenomenon, but it could soak up cars in the short term, if people don't build to meet the demand.

Justin Long:

That all makes sense. I appreciate the time today.

Operator:

(Operator Instructions) We'll take our next question from Matt Brooklier with Buckingham Research. Please go ahead.

Matt Brooklier:

Appreciated the tank car color there. That was helpful. Any other car types that maybe saw a little better demand in fourth quarter? Or as you look out to '18, are there any other railcar types that maybe you're a little bit more bullish on that you think and potentially see, I guess, a pickup outside of, I guess, the tank car commentary that you gave?

Brian Kenney:

Yeah, well, small-cube covered hoppers, you know about that -- that was really a '17 phenomenon that continues. As far as what affects -- I mean, intermodal is strong, we have a very low exposure there. Probably a stronger car type, and actually, you saw it get stronger through 2017, and we do have a decent amount of exposure, is the boxcar fleet. So we expect the utilization to slip there -- it did. I think it was down close to 90% at the end of the second quarter. It's back up to 92.6% now.

As I said, we expected the utilization drop. Really, boxcars had been under pressure since 2016 due to railroad velocity increasing prior to that. We had some planned releases from certain customers. Obviously, CSX returned theirs to us. And there was kind of mediocre car loadings, forest products, and things like that, but it's gotten better in 2017. Now, part of that has been the CSX service issues; part of that has been certain railroads emphasizing 60-foot boxcars, and ours is more of a 50-foot fleet, which our customers like. These have seen a velocity decrease of about 4%, I think, among the Class 1s, excluding CSX, in 2017; that helps the boxcar market. So I mentioned, I think in my opening, that part of our maintenance increase we expect in 2018 is some boxcar cost as we put them back to work. So that market is stronger and, obviously, that helps us as well. Outside of that, it's just been a steady slow march you saw in '17.

Matt Brooklier:

Okay. Do you have the number for what your flammables services tank car fleet looks like, I guess, at the end of this year? I can always get it offline if need be.

Robert Lyons:

I'm sorry, Matt, are you talking about the total flammables fleet?

Matt Brooklier:

Yes. What does your total flammables service fleet look like right now?

Brian Kenney:

Yeah, it's about 13,500 cars.

Matt Brooklier:

Okay. And do you …

Brian Kenney:

And -- but only, I believe, 1,600 of those are in crude. And ethanol?

Jennifer McManus:

2,300

Brian Kenney:

2,300 in ethanol. So very low exposure to those commodities and most of ours are in other products -- fuel oils, things like that. So that fleet actually has grown somewhat -- not by 500 cars in the last year and a half, but it's been pretty constant over -- for our crude and ethanol -- crude exposure especially has gone down pretty seriously over the last couple of years.

Matt Brooklier:

Okay. And then amongst the 13,000 cars, roughly how many of those cars do you own, coiled and insulated cars -- i.e., cars that could be utilized in the Canadian market?

Brian Kenney:

Yes, we do. I don't have that number right in front of me.

Matt Brooklier:

And then you gave color on what's potentially contributing to improvement on the tank car side, i.e., demand. What about on the supply side? I know we're working through the first tranche of regulation change. Do you think some of the older cars being called from the North American flammables service tank car fleet -- do you think that's also contributing to maybe slightly tighter market and rates directionally moving up here?

Brian Kenney:

You mean on the tank car side? I'm sorry.

Matt Brooklier:

Yes. So I just, where -- I believe in '18, where DOT-111 cars on the flammables services side no longer valid, can't use those cars anymore. I'm just curious if regulation is starting to pull cars out of the market and maybe like the supply side of things -- the markets getting a little tighter because there's less available cars now in '18?

Brian Kenney:

No. I don't -- we haven't seen widespread scrapping. I'm trying to remember the retrofit number. I believe about 7,500 retrofits have been done in the industry. We've had zero retrofit requests from customers on our legacy 30s, but know others have done them; that's a very expensive retrofit. But others have younger legacy fleets, so it might make more sense for them. I think Union Tank Car's probably 60% of that market of retrofitting legacy 30s. I haven't seen widespread scrapping yet. We haven't had requests from our customers for legacy 30 retrofits. So hopefully, as the scrap rate increases and holds, we'll start to see that fleet transition out as these regulations come in. But I don't know that it's moved the market tremendously to this point.

Matt Brooklier:

Okay, that’s helpful. I appreciate the time.

Operator:

And we'll take our next question from Justin Bergner with Gabelli & Company.

Justin Bergner:

Thank you for taking my questions. Hi, everyone.

Bob Lyons:

Morning.

Justin Bergner:

First question just relates to sequential lease rates. In your 2018 guide, are you assuming lease rates are sequentially flat from 2017 fourth quarter?

Brian Kenney:

I would say there are no broad widespread increases assumed in our fleet. There are certain car types we assume are going to be better in '18, but I wouldn't say it's broadly across the fleet. So we're not assuming a lot of lease rate increase from today's rates in 2018.

Justin Bergner:

Okay. Secondly, with respect to the financial buyers who are out there buying railcars, which I guess, the phenomenon seems to be continuing relatively unabated. Are you hearing or seeing any signs that the increase in interest rates is starting to slow some of that interest down? Or are there other factors that are starting to slow some of that interest down?

Robert Lyons:

We haven't seen the impact, any impact, from the uptick in interest rates in terms of the number of buyers or the valuations they're putting on the assets. Now, if that trend continues and interest rates continue to move up, my expectation and my thought would be that there may be some other alternatives that some of these investors begin to look at away from rail, but we certainly have not seen that yet.

Brian Kenney:

Yeah. The other thing is, higher interest rates historically, especially in commodities and asset prices, as it reflects higher inflation, have been extraordinarily helpful to our business and the value of our fleets. So, inflation has generally been our friend. So, higher interest rates -- that could be good.

Robert Lyons:

And even from a funding standpoint, not a big impact on GATX. So net-net, I would take that scenario where rates gradually continue to move up.

Justin Bergner:

Okay. Then one more question. On the Portfolio Management business and the Rolls-Royce joint venture -- I guess, the segment operating profit or the affiliate income came in relatively flat for 2017 versus 2016 sort of in the high $40s, high $40 million-range. And then that was sort of a step down from sort of the $60 million-range that occurred in the prior years. Should we think about the sort of high-$40s range as the go-forward range? And with the prior years' $60 million-plus type profit figures more a function of just higher remarketing income in the Rolls-Royce joint venture?

Robert Lyons:

Actually, Rolls-Royce came in the high $50s, Justin. If you look at the Portfolio Management line, it's about $58 million of affiliate income and almost all of that is Rolls-Royce. So our share of that was about $57 million, an excellent year for Rolls-Royce. Yeah, that number will move around a little bit from the mid-$50s to the mid-$60s, depending on what happens with remarketing and asset sales. Longer-term, we expect that business to continue to generate very attractive returns and rising income over time. I'd also add, within Rolls-Royce, while we had north of $600 million of investment volume at GATX this year, our Rolls-Royce affiliate did close to $400 million in investment volume, which was a record level. So we saw outstanding investment opportunities there, and that's all self-funding. Obviously, off the credit facilities and cash flow to the business, so it continues to grow quite nicely.

Justin Bergner:

Okay. I apologize for -- I must have been looking at the wrong line on the P&L there with my comments. So that's helpful. And then finally, on the Tax Reform Act -- I guess, I'm somewhat surprised that from a booked tax rate point of view, you're not seeing more of an earnings benefit than the $0.20 per share, which would I guess, only suggest that your tax rate on a book basis is coming down a few hundred basis points. Is there any sort of reason why the book rate wouldn't come down by more? Or is

'18 sort of a smaller benefit versus out years? Any clarification there would be helpful.

Robert Lyons:

Yeah. It's definitely a smaller benefit in 2018 than the out years, given the fact that where we are in the cycle for rail U.S. -- and keep in mind, that's domestic U.S. only, where we'll see that benefit. We have, obviously, very large operations in Canada, Mexico, Europe; and Rolls-Royce is almost entirely already taxed at foreign rates. So this happens to be enacted at a point in time when the rail U.S. income contribution is at a low point in the cycle. So as it improves and, hopefully, this gradual recovery continues, the impact will be greater as we go up.

Justin Bergner:

Great. Thanks for taking my question.

Operator:

And we'll take our next question from Barry Haimes with Sage Asset Management.

Barry Haimes:

Thanks very much. I had just a follow-up question on the 19% excess cars that you mentioned earlier. And I wonder -- if you just took some of the range by car types, if you can give us some feel for which car types are meaningfully above or below that sort of 19% average?

Brian Kenney:

We don't have that data, do we? Yeah, that 19% are -- it's AAR cars that haven't moved in the last 60 days.

Robert Lyons:

Yeah, that's an industry data point, not a GATX-specific data point. So our ability to parse that data is limited.

Barry Haimes:

Okay. So even directionally, in terms of above or below that, you don't have any feel for that?

Robert Lyons:

[Pause] By car category? Tank or freight?

Barry Haimes:

Right.

Robert Lyons:

This market has been equally challenging on all car types.

Barry Haimes:

Got it. Okay, thank you. I appreciate it.

Operator:

And we'll take our next question from Willard Milby with Seaport Global Securities.

Willard Milby:

Hey. Good morning, everybody. I kind of wanted to focus on Rail International. Looking at the last couple of quarters, you've had good upper single-digit gross and lease -- growth in lease revenue per car type. I was kind of curious if you thought that was sustainable as we move into '18, or maybe with some easier comps coming in the first two quarters -- you could see some double-digit growth, net lease revenue per car figure?

Brian Kenney:

I don't know about that. But I will say, the market is generally a lot more positive in Europe than it has been over the last few years. So as I said earlier, the mineral oil, or petroleum market as we know it in the U.S., is the biggest portion of their fleet -- is 60%. I mean, that's been under pressure with the price of crude dropping and refiners' margins dropping, which is their customers.

But in the last half in the fourth quarter of '17, we started to see more customer inquiries, more new projects. And customers actually requesting additional cars, which we haven't seen in a while. Now, a lot of them are requesting very short lease terms, so they're not quite sure about the sustainability of a market recovery there. So we'll see if this recent upturn has legs in '18. But GRE did very well in that market in '17. As I said, they placed all, virtually all their new deliveries -- cars that were returned or released or either scrapped or remarketed successfully, many in Eastern Europe -- they had a very high renewal success rate. And when I say lease rates on renewal are down in Europe, as I've said in the past; for instance, the mineral oil fleet, it's less than 1% down on renewal.

So it's a much less volatile business than it is in North America. And the outlook, both in mineral oil, LPG and especially chemicals, which is about 13% of the fleet in Europe, is much more positive than it was a year ago. For instance, on the chemical side -- it's hard to generalize on that market, there's a wide variety of car types and commodities in our chemical fleet. Generally, it's been more volatile and had lower utilization. But recently, there's been some really good data. The European Chemistry Industry Council -- they had very solid data on chemical output, chemical prices, consumption and exports. And we started to see that strength show up in our fleet in the last quarter. Utilization was up, renewal rate pricing was up.

So across the markets at Rail Europe, things will look a lot better coming into '18 than it has in recent years. So hopefully, that recovery, which we've just seen in the first quarter, will have some legs.

Willard Milby:

Okay. And it sounds like with the strong demand -- do you think there's a risk to any kind of oversupply coming online anytime soon like we've seen in North America?

Brian Kenney:

I think that's one -- when I said it's a less volatile market in Europe, I think your question is right on point. The manufacturing, the supply situation. I mean, there are excess cars and there have been -- it's been a very competitive market over the last couple of years, especially in mineral oil. But it hasn't been the insane oversupply that you've seen in the U.S. And I think that's one of the sources of the lower volatility. It's been a more rational market, so hopefully, that continues.

Willard Milby:

All right, thanks. And just one housekeeping follow up. Did you say what your share repurchases were during the quarter? And what you forecasted from a dollar point of view in 2018?

Robert Lyons:

Yeah. We had $25 million of repurchase in the fourth quarter. For the full year, it was $100. And what we've assumed in 2018 is that we continue in that range for the year ahead.

Willard Milby:

Alright. Perfect. Thanks very much.

Operator:

And we'll take our next question from Steve O'Hara with Sidoti & Company. Please go ahead.

Steve O’Hara:

Just on the guidance that you provided for Rail North America. And can you just talk -- I don't think you mentioned, maybe I missed it, but the total gain on -- net gain on asset disposition you're expecting for 2018. I would assume you're talking flat-to-up, maybe. But can you talk about that a little bit?

Robert Lyons:

Sure. The disposition gains on the owned assets at Rail North America -- we, just for reference, was $46 million in ‘16, $44 million last year. We expect it to be in the range of $50 million, maybe slightly above that, this year.

Steve O'Hara:

Okay. And then the total amount -- I mean it was -- in 2016, I think it was about 84; last year, 54. I mean, looking back, it looks like maybe the normal level's higher. I mean, how do you expect that to be in 2018 overall?

Robert Lyons:

Well, the biggest driver is going to be the number I just gave you. We don't anticipate for -- obviously, for GATX overall, Brian referenced we had about a $10 million residual sharing fee at Portfolio Management on a nuke facility. That will not reoccur in 2018. So really, the main driver, or the primary driver of the remarketing activity in 2018 will be North American Rail.

Steve O'Hara:

Okay, okay. And then just on SG&A. You've mentioned that you thought there was some one-time items. I think it was in the fourth quarter -- pretty big jump there. I mean, overall, you expect SG&A to be kind of flattish, does that make sense?

Robert Lyons:

Yeah, down a little bit in 2018 from where we finished the year at $181 and change. So hopefully, coming in maybe a little less than the $180 number. I'd also point out that this past year was our fifth straight year of when you kind of normalize for pension items and others that we've called out before being in that $175, $180 range. So I think we've held the line pretty well on SG&A despite the fact -- obviously, we continue to invest heavily and grow the business. We have a bigger balance sheet today and a much bigger European presence today -- emerging market presence today, than we had five years ago. But SG&A is pretty much in the same range.

Brian Kenney:

To give you some data there about how I look at that -- in 2008, and that was our last peak earnings year, SG&A was about $168 million. We had assets just over $5 billion. So if we can get to that $175 level in '18, with our assets will be more in the $8 billion range -- that's 50% growth, and SG&A will increase less than 5%. So we're really focused on leveraging our current infrastructure and just trying to stay where we are.

Steve O'Hara:

Okay, okay. Thank you very much.

Operator:

And we'll take our next question from Justin Long with Stephens.

Justin Long:

Thanks for the follow-up. Just had a quick question I wanted to fit in on the LPI. Do you have an expectation for where that shakes out in 2018? And when you [inaudible]?

Robert Lyons:

Justin, you were breaking up there a little bit. We did catch the first part of the question, which was kind of '18 and the LPI. So we'll go and answer that one. But we missed the back half of your question.

Brian Kenney:

So in '17, I believe we said 30%-plus decline in the LPI. We ended up just under 30%. If I have to put a range on 2018, it's going to be in the 25%-plus range down on LPI.

Justin Long:

That's helpful. And if you can hear me a little bit better now, the second part of that question was on the car type mix of renewals. I think you mentioned around 14,000 cars renewing. So I know that's a consideration when thinking about that LPI number. So just curious if those renewals will be more weighted towards a particular car type?

Brian Kenney:

Actually, the LPI is a constant weighting of our current fleet. So it is influenced by activity, but not by the amount of activity. As far as -- I did say utilization might slip a little bit, we have a much better expectation there than we did coming into 2017, although we outperformed. We do have -- was it, 2,500 coal renewals?

Jennifer McManus:

Yes.

Brian Kenney:

So, less, but there's still enough that it's a tough market, you could see a little bit of slippage there.

Justin Long:

Okay, that helpful. Thanks again for the time.

Operator:

And we'll take our last question from Willard Milby with Seaport Global Assets. Please go ahead.

Willard Milby:

Thanks for the follow-up. On the North American gains on dispositions, are you all aware of any quarterly lumpiness at this point? Anything we should be aware of?

Robert Lyons:

Yes, that's actually a good question. Probably should have pointed that out when we were talking about it earlier. Where we sit today, quarterly, it's a little hard to lay out exactly. But certainly, I think we'll see more of that -- probably materially more of that, in the early part of the year. Call it first half of the year, just based on the level of activity we have underway, currently.

Willard Milby:

Alright. Thanks very much.

Operator:

And that does conclude our question-and-answer session. I'd like to turn the conference back over to Jennifer for any additional or closing remarks.

Jennifer McManus:

I'd like to thank everyone for their participation on the Call this morning. So please contact me with any follow-up questions. Thanks.

Operator:

And once again, that concludes today's presentation. We thank you all for your participation and you may now disconnect.