GATX | GATX Corporation

2018 Fourth Quarter Conference Call **January 22, 2019**

Operator:

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

Jennifer McManus:

Good morning, everyone, and thank you for joining GATX's Fourth Quarter in 2018 Year-end Earnings Conference Call. I'm joined today by Brian Kenney, President and CEO; and Tom Ellman, 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 forecast. For more information, please refer to the risk factors discussed in GATX's Form 10-K for 2017. 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 2018 fourth-quarter and full-year results. And then Brian will provide some additional commentary on 2018 and what to expect going into 2019. After that, we will open it up for questions.

Today, GATX reported 2018 fourth quarter net income of $49.2 million or $1.30 per diluted share. This compares to 2017 fourth quarter net income of $342.1 million or $8.83 per diluted share. 2018 results include a net positive impact of $17.3 or $0.46 per diluted share related to Tax Adjustments and Other Items. 2017 results include a net positive impact of $315.9 million or $8.15 per diluted share, mainly attributable to the one-time, non-cash, net tax benefit resulting from the enactment of the Tax Cuts and Jobs Act signed into law on December 22, 2017.

For the full-year 2018, GATX reported net income of $211.3 million or $5.52 per diluted share. This compares to net income of $502 million or $12.75 per diluted share in 2017. 2018 and 2017 results include net positive impacts of $11.5 million or $0.30 per diluted share and $317 million or $8.05 per diluted share, respectively, associated with various Tax Adjustments and Other Items. These items are detailed on Page 13 of our earnings release.

In 2018, investment volume was $943.4 million as we increased investment in both Rail North America and Rail International. As noted in the earnings release, we made an attractive railcar portfolio acquisition close to year end and had strong investment activity in both Europe and India. In addition, we executed two long-term railcar supply agreements, which will allow us to grow our large and diverse fleet in North America. In 2018, GATX repurchased over 1.5 million shares for approximately $115 million. This brings our total repurchase activity over the past two years to approximately $215 million.

Lastly, as noted in the earnings release, we currently expect the 2019 earnings to be in the range of $4.85 to $5.15 per diluted share. This range incorporates a negative non-cash impact of $4 million, or approximately $0.11 per diluted share, resulting from the adoption of the new lease accounting standard. So with that quick overview, I will now turn the call over the Brian.

Brian Kenney:

Thanks, Jennifer. So I'll take the next few minutes to give you some color on our business outlook and guidance. But before I get to that, I thought it would be helpful to talk in a little more detail than I usually do about our 2018 results. So in '18 we considerably outperformed our earnings expectations coming into the year. And as the press release laid out this morning, we earned $5.22 per share after adjusting for the net positive effects of Tax Adjustments and Other Items. And that compares to our original expectation that was in the range of $4.55 to $4.75. North American Rail, International Rail, American Steamship and our Rolls-Royce joint ventures all produced earnings in excess of our expectations.

So that was strong performance to be sure, but I think it is important to look at two of the primary drivers of that outperformance. And the first driver was asset disposition gains in North American Rail. We originally forecasted them to be somewhat higher in 2018 than the prior year, but we ended up over $25 million higher than in

2017. And that was reflective both of higher average scrap prices and continuing premium valuations for the leased railcars that we were able to sell in the secondary market. Now, that was a lot stronger than we expected but it was a great economic result for the GATX shareholder. The prices we achieved significantly exceed the values we expected to realize if we continued to hold those cars, so it was a great result.

The second important driver I'd like to call out for the earnings outperformance is net maintenance expense in North American Rail. Now, coming into the year, I said we expected net maintenance to be higher in 2018 by approximately 3%. And if you remember, that was mostly due to higher scheduled tank qualification events. But as we described throughout the year, railroad service issues and an improving leasing market caused reluctance among our customers to send their cars in for maintenance. And we fell significantly short of the volume we anticipated. So combined with lower railroad repairs, this caused net maintenance expense to actually come in 7% lower than in 2017.

Now, there were obviously other variances from our original expectations, but I called out these two drivers for a reason. On asset disposition income, it's been consistently strong right through the weak railcar leasing market that started in 2015. Now, usually, asset disposition income declines sharply or even disappears in a down market, and you need to look at 2008 to 2010 recession to see that. But for all the reasons we stated on this call for the last few years: low interest rates, new financial players entering the market, unfettered access to capital, et cetera. The disposition gains have remained at a very high level throughout this down cycle. What I can say from experience, however, is that the secondary market is unlikely to always be that consistently strong. For example, interest rates increase, new financial players often exit and you saw some of that in 2018, the capital markets can have hiccups and the economic facility in railcars can change relatively quickly. So it's a little more uncertain than it appears.

Similarly, the unexpected lower net maintenance expense of 2018 is what I will call an anomaly. Specifically, that inability of ours to get tank car customers to send in their cars for compliance work was not a good economic result, despite driving higher earnings in 2018. It simply resulted in maintenance expense being deferred into an increasingly busy in-maintenance network in 2019 and beyond -- and that presents more of a challenge to our operations going forward and our costs, especially, as the level of tank compliance events starts to increase over the next.

Now, those two factors I just discussed are particularly relevant because they have significantly masked the revenue decline on the existing fleet during the weak railcar leasing market over the last few years. And it's the best example, as I originally expected North American lease revenue to decline 3.7% -- around $35 million I think it was in 2018, and it did. But segment profit actually increased year-over-year due to the asset disposition income and the unusually low maintenance. So if I summarize 2018, the North American railcar leasing market did improve. We've produced strong performance across all of the other businesses, and we significantly outperformed our original expectations.

Our balance sheet and liquidity are strong. We have a lot of attractive investment opportunities we are pursuing. However, with the combination of the factors I just discussed and the general economic and political uncertainty we see in North America today, I would best describe our near-term outlook as cautiously optimistic, and that's relative to what you might expect, given our out-performance in '18.

So now, let's talk about the 2019 outlook by each of our business segments. And I'm going to approach that a little differently this year than in prior calls. I want to -- instead of just marching down the income statement, I want to talk about what is really driving segment profit changes in each business.

So let's start with Rail North America. And we do expect segment profit to be lower in 2019 by approximately $40 million to $50 million. And the first driver of that decrease is the declining earnings on the existing fleet. Now, as you know, we saw widespread absolute lease rate increases throughout most of 2018. However, that positive rate momentum has stalled somewhat recently.

Although we do anticipate further strengthening in select car types, we don't currently forecast broad-based increases in absolute lease rates across the existing fleet in 2019. In addition, the average rate on expiring leases is expected to increase again in 2019. So total revenue is actually expected to be relatively flat in 2019 year-over-year, but that's due to the new car additions and our recent large portfolio exposition. So there's continued revenue pressure on the existing fleet as well as railcar sales that we've completed over the last few years, as I discussed. And that's going to degrade revenue on the existing fleet and that should contribute about $15 million to $25 million to the decrease in segment profit in 2019.

Looking at net maintenance expense, we currently expect a 7% to 10% increase in 2019, and that's primarily due, again, to higher tank qualification work -- both completing the work that was deferred from 2018, as well as trying to get a jump on the increasing level of tank qualifications that are due in 2020 and beyond. Now that increased maintenance cost is expected to contribute about $12 million to $20 million to the drop in segment profit in 2019. Increased interest rates, in the effect of the new lease accounting rules that Jennifer talked about, are also expected to negatively impact Rail North America segment profit in 2019. Currently estimate the effect of those items to be about $7 million to $12 million.

And the last factor I'll discuss on North American Rail is asset disposition income. Once again, we'll continue to optimize our fleet in 2019 through secondary market sales of the railcars, as we always do. But as I said a minute ago, we remain surprised by the robust secondary market in the last few years, despite the weakness in the railcar market, and we realize that history suggests that it may not last forever. So it's a little more uncertain. But our current expectation is that in 2019, it can approach the levels we saw in 2018. But in reality, we'll have to wait and see how the year unfolds, before we can discuss that with more certainty.

So, let's look at International Rail. And I'll start with GATX Rail Europe. As we discussed throughout 2018, the European mineral oil, LPG and chemical markets all showed increasing strength through the year. And now we're starting to see lease renewal rate increases in these markets and that's been a while.

In addition, their new car investment has added to segment profits, and that fleet growth is expected to accelerate in 2019. As you know, their fleet is historically comprised -- majority of which is tank cars, but their effort to find investment opportunities in new freight cars is paying off, and we'll see a lot of that investment volume materialize in 2019. So the segment profit growth from higher utilization and rates in Europe should be offset somewhat by higher interest rates and a weaker Euro compared to last year, and the net effect is, we expect to see a few million dollars of higher segment profit in Rail Europe in 2019.

Adding to the International Rail segment profit growth is GATX Rail India, which is a good news story. As we indicated in 2018, their fleet size doubled last year. We're starting to see some diversification into other car types. Their utilization is at 100%, and we have significant car investments committed to customers in 2019. I see a clear path for that fleet to grow well over -- to well over 3,000 cars in the next 12 months. We know we do have a higher return requirement for rail investment in India, and that's appropriately so, but the lease rate factors are attractive. And given all this, we expect segment profit growth in India to grow by a few million dollars in 2019, as well. When you combine that with GRE, or GATX Rail Europe, I should say, the expected segment profit growth for Rail International should be in the $4 million to $6 million range.

Looking at American Steamship, they had a great year in 2018. At the beginning of the year, we stated that we expected them to carry a lower tonnage than the prior year, but show higher segment profit because they would operate more efficiently with a smaller number of vessels. They did just that, and they actually realized contractual freight rate increases. And importantly, they operated in a much more favorable operating condition than normal during the entire year. And hence, their segment profit increased over $8 million. Importantly, also towards year end, they used the favorable market to lock up multi-year tonnage and bring on another vessel.

If you look to '19, tonnage is expected to be higher due to that strong market as well as the 12th vessel operating this year. So, in other words, their fleet will be fully utilized. So they will see a revenue increase there that should be offset somewhat by higher operating costs. You have to assume a more normal operating environment as well as higher maintenance costs due to more vessels deployed and a higher scheduled winter work. So the net effect is ASC segment profit should be up slightly in 2019.

And, lastly, in Portfolio Management, Rolls-Royce is projected to have another strong year in 2019, as investment opportunities and operating performance have been great. We also expect to see better financial performance in the remaining marine investments that we're trying to exit. But the net effect is that segment profit should also increase by a few million in Portfolio Management in 2019.

So that's what's driving segment profit in each business unit.

On a consolidated basis, moving to SG&A, we plan efficiency gains in 2019. We have certain expenses in 2018 that are associated with our headquarters' move that won't reoccur; we have lower plant compensation expense, and we expect SG&A to be lower in '19 by approximately $10 million. And if you combine that with the tax rate, that should be pretty similar to the one last year. We currently project net income to be lower in 2019 in the range of $15 million to $20 million and continued sharing -- assuming continued share repurchase that gets us to your guidance of $4.85 to $5.15 per diluted share this year.

So, I'll end by reminding you that 2019 marks our 101st consecutive year of paying a dividend, and that's a track record few companies can match.

Now, the GATX Board meets later this week, we'll announce their dividend decision at that time, but they understand the importance of the dividend, and I think our century-long streak is a great example of our record of success and commitment to our shareholders.

So that's all I had. Operator, let's go ahead and open it up to questions.

QUESTION AND ANSWER

Operator:

(Operator Instructions) We'll take our first question from Justin Long with Stephens. Please go ahead.

Justin Long:

Thank you and good morning. Brian, maybe to start with the comment you made on positive rate momentum in North America stalling a little bit here recently. Could you talk about the sequential trend that you've seen in lease rates in the fourth quarter? And then, maybe as you answer that question, provide an update on the anticipated impacts from PSR. We've seen railcars and storage come up in the last couple of months. Just curious if you think that trend will continue.

Tom Ellman:

Great. Justin, this is Tom. I'll take a shot at both of those. So, first of all, as far as sequential lease rate changes have gone, the quarter -- as you know, it always varies by car type, and across the tank car fleet, sequential lease rates were roughly flat. Across the freight car fleet, they were down a bit, less than 10% or so. As you mentioned, over the course of the year, up much more significantly, varying by tank car type, up as much year-over-year as 25% to 50% -- freight cars up slightly, again less than 10%.

As far as PSR goes, it's going to be years before we can fully gauge the impact of PSR, but it's important to note that it won't impact all car types equally. To the extent PSR increases railroad efficiency and increases railroad velocity, there will be an overall need for less cars in North America.

There's an often quoted rule of thumb that 1 mile per hour change in average velocity results in about 50,000 car change in total cars demanded in North America. However, this impact will be greatest for high-mileage cars, like coal and intermodal. The majority of car types in GATX's fleet are lower mileage. So, we would tend to be less impacted. A notable exception to that is boxcars that do tend to be higher mileage and have, indeed, been impacted by PSR. However, to date, we've experienced strong utilization in our boxcar fleet because the long-term attrition in the fleet has led to favorable supply-demand balance, and we expect this to continue for some time.

Justin Long:

Okay, great. That's all helpful. And looking at the 2019 guidance, could you provide what your expectation is for the LPI this year? And then maybe provide an update on the number of cars you have scheduled for renewal as well.

Tom Ellman:

Sure. So the LPI is a challenging one for us to forecast. And as we've mentioned previously, a relatively small number of transactions, in a given quarter, can certainly move the LPI. And as far as what we saw this quarter, where it being at the 0.9%, I wouldn't really view that as a material change in the market.

As I just stated, if you look at the sequential lease rates, tank car broadly flat and freight, in fact, down a little bit. As we turn to 2019, we do expect lease rates -- the lease rate environment that we saw at the end of the year to continue largely through 2019. So, again, if you look at what happened in most of the tank car types, the year-over-year comparison will be strong because the rates increased throughout the course of the year, and the freight car impact will be more modest, but also slightly positive.

The LPI is difficult to predict because ongoing renewal activity always causes that comparator rate to change, and for all these reasons, we think it makes more sense to provide a range of values for the 2019 LPI. And currently, we expect it to be somewhere between negative 10% and positive 5%. As far as the number of expirations that we expect to see in 2019, it should be a little bit higher than this year and maybe on the order of 17,000 to 20,000 cars.

Justin Long:

Okay, great. And then, maybe lastly to go back to maintenance expense. Brian, you gave some very helpful commentary on all of that. Is there a way to think about how much of the 7% to 10% increase in North American maintenance this year is essentially, catching up from last year? And then as we look to 2020 and beyond, what do you view as kind of a normalized run rate for maintenance expense? Does it grow low-single digits? Mid-single digits? Is there any commentary you can give us around that?

Tom Ellman:

Yeah. So again, Justin, I'll start with that. The total amount of TQs in a year don't present the full picture of what's going on with maintenance, but as we mentioned, they're a very important part of it. So as far as TQs that got deferred, we came into this year deferring about twice as many cars as would be typical. And while it's difficult to put an exact dollar amount on that because one of the key costs with the TQ is what else you find when you bring in the car for a TQ, but order of magnitude. We probably are picking up somewhere between $5 million and $10 million of deferred maintenance from the extra cars that -- doubling that we see versus normal. Probably much more important to look at is the total number of TQs we expect to do in the year.

In 2018, we did about 3,300 TQs. Between the catch-up and the fact that we're trying to get ahead of the TQ curve by doing more of them early, we expect to perform over 1500 more

TQs in '19 than we did in 2018. And that is already baked into the range of guidance that we gave. And we certainly have done that level before. We have done that number of TQs in the past, but it will be a challenge, and it's part of the reason for the range that Brian described at the beginning.

Brian Kenney:

And Justin, as far as what's due, it starts once again. The schedule changes as you pull cars forward, but it does start to ramp up in 2020 and beyond. So even if we're to even out that workflow, I think you'll see elevated maintenance expense over the next couple of years.

Justin Long:

Okay. That's all really helpful detail. I appreciate the time.

Operator:

And we'll move to our next question, and that is with Allison Poliniak of Wells Fargo.

Allison Poliniak:

Hi, guys. Good morning. Just to keep on that maintenance expense. Is -- I mean, I know we're pulling -- pushing some into '19. Is there any like specific weighting we should be aware of where the first half could be stronger? Or is it fairly balanced throughout the year?

Tom Ellman:

So the timing of it is really dictated by when the customers make the car available, but because of the way the regulations work, our expectation would be to see more early in the year, as people try to catch up from that deferral. But it's not something that we have a lot of control over, so it'll be dependent on when customers make those cars available.

Allison Poliniak:

Got it. And then that step-up in churn this quarter. Is that just a blip that we saw in Q2? I mean, anything to read into that in North America?

Tom Ellman:

Yeah. So we always caution people to take a given quarter with a grain of salt; but the broader message that over the course of 2018, the market continued to improve. So we have been trying to lengthen lease term. So you should look at that general lengthening as a sign of an improving market over the course of 2018.

Allison Poliniak:

Great. And then just lastly -- on the secondary market, you said '19 approaching, your asset gains approaching, what you did in '18, is that what is implied in the guidance that we should be assuming? How should we think about that?

Brian Kenney:

Well what we do is -- as I said, it's little more uncertain than it appears to be over the last couple of years. So we put a range in and that range is reflected in our guidance.

Allison Poliniak:

Perfect. Thank you.

Operator:

Our next question comes from Kristine Kubacki of Mizuho Securities.

Kristine Kubacki:

Hi. Good morning. I was just trying to reconcile a little bit -- if you could talk about the European market. I know the lease durations are a little bit shorter over there. And obviously, we've seen some choppiness in kind of the macro indicators, but it seems like the portfolio is doing quite well. Can you kind of talk about what your visibility is there? And is it a little bit disconnected from the macro PMIs that we see?

Brian Kenney:

Yeah, it is. It's Brian. It is a little bit disconnected. I mean, we saw utilization that's better than we expected coming into the year really across our fleet types, so mineral oil or petroleum, chemical, LPG and freight. Those environments have actually all improved for -- it's kind of a reverse of North America. If you look at the petroleum market, yes, the economy is perhaps a little choppier, as you stated, but there are some other factors that are helping the market.

So first of all, diesel fuel and gasoline -- there's continued high consumption even through the difficult petroleum market of prior years that continues in 2018 and into 2019. Some of the European railways are struggling to meet transport demand. They have locomotive driver shortages. There is changing transportation routes. There's track construction in Poland, so there's some other factors there. And then there's low water levels on the Rhine and other rivers, and that continues and customers are -- some customers are abandoning barge transportation. So there's a lot of things, combined with the manufacturing situation, where everybody is sold out for the most part in 2019. And what we're finally seeing in Europe is that their cars -- there's a shortage of cars. So we haven't seen that in quite a while. Hence the high renewal success, I think over 80% in 2018. And hence renewal rates turning up.

Now the choppiness in the economy that you mentioned -- probably, if I say we're exposed anywhere, we'd probably be in the chemical market. That was actually racing ahead as well in 2018, but softened a little bit in the fourth quarter. Having said that, I think that's probably our most utilized fleet, over 99%. So it is a little bit of a break from what's happening in the economy, but generally it looks pretty good in Europe right now.

Kristine Kubacki:

That's really helpful. Thank you. And then I guess, another larger picture question on the secondary market as -- I get it that it's a little bit harder to forecast at this time, but can you also talk about maybe the opportunities that are there? Obviously, the ECN deal that you did. What's the pipeline look like? And what do you expect even as the market maybe softens more that there might be more opportunities from a buy-side perceptive?

Brian Kenney:

Well, I guess, you're asking, is Element the first sign of financial players exiting? And I don't know.

There's two types of financial players from our perspective. One is ones with -- the ones who really have a low-funding cost, but seek railcars as a passive investment. And then there's the bank financial players that build platforms and bring very little funding cost in the industry. In our opinion, both categories have spurred excess investment in the industry beyond what is needed by shippers over the last five years.

And that's actually an obvious statement, if you look at the oversupply in the market. Whether this is the beginning of a pullback from that? We'll see. More opportunities? I don't know. But I think once again, in the long run, I think eventually people are going to have to deal with these fleets that I think are somewhat economically underwater. But honestly, even if I knew of a situation -- who is involved, I couldn't talk about it, but that's my general feel.

Kristine Kubacki:

Okay. Thank you very much. I appreciate the color.

Operator:

Next we'll hear from Matt Elkott of Cowen.

Matt Elkott:

Good morning. Thank you. My question is on the -- on renewals for 2019. Tom, can you tell us what is behind the higher-than-typical number of renewals this year? Is it random? Or is there anything to read into it? Or are there any customers that are trying to get out of leases and willing to pay cancellation fees?

Tom Ellman:

Yeah. As far as the renewal success percentage, it's been high on a historical level, and we expect that to continue going forward into 2019. And the renewal success percentage is really a function of: one, great work by our commercial team and the relationships that they maintain with the customers where we tend to get our cars back last. So, great job by that team. But in addition, a strengthening market over the course of the year. As we talked about previously, challenges with railroad velocity have also helped because again, as that continues to be low, the customers need the cars.

And then challenges in trucking and the alternative of going to truck. And some of that we've talked about in a different context, and that is related to the challenges we have getting our TQs in. But all those things contributed to a little stronger renewal success percentage.

As far as customers looking to get out of leases earlier or interested in that, that's a pretty rare phenomenon in any market. I mean, it does happen, occasionally, and we've talked about specific instances occasionally, but I wouldn't highlight that as any kind of trend.

Matt Elkott:

Okay, very helpful. And I think the last time I asked you guys in the third quarter about the DOT-117 fleet that you have -- I think you had a couple thousand of those. Are you planning to add materially to this fleet, this year?

Tom Ellman:

Yeah. So, as far as the flammable liquids cars, as we've talked about many times in the past, we do not plan to retrofit any legacy cars. So our growth has been on the new car side. Like we do with any market, we're going to participate in a measured way, and we have participated and will continue to do so. I wouldn't comment -- I wouldn't look for any like outside -- outsized investment in that area relative to other car types.

Matt Elkott:

Okay. And then just one last follow-up on the PSR front. I know you guys said that it would take years to find out what the impact will be. So, we did have previous examples of PSR with CN first and then CP and CSX, most recently, pretty much fully implementing PSR. And I know it may even historically be hard to quantify, but have you detected any type of trends or impact from the implementation of PSR on your business from those three railroads?

Tom Ellman:

Yeah. So, it kind of goes back to some of the commentary I made about the car types. So, specifically, because of the nature of our fleet and the nature of what's going on in the market, there was really nothing that we could pinpoint beyond boxcars. We've talked about -- in some previous calls, getting some boxcars back and remarketing them, but then remarketing them quite successfully because the market still needed those cars. So, as far as prior implementations and the impact on our fleet -- pretty minimal. The big thing we continue to be concerned about with PSR is other people getting cars back and us having to compete against them.

Matt Elkott:

Okay, great. Thank you very much.

Operator:

And from Buckingham Research, we will hear from Matt Brooklier.

Matt Brooklier:

Hey. Thanks and good morning. So, another PSR question for you. Do you have any exposure on the locomotive side of things? I think most of the PSR conversation has been around railcars, but you guys obviously have a smaller business leasing locomotives. Just curious to hear if you had any exposure to either UP or NS on the locomotive side of things?

Tom Ellman:

Yeah. So, we don't want to get too granular with specific customer exposure. But, in general, the nature of our fleet tends to be more with short lines and industrials. And over time, we're moving it more in that direction. So the direct impact due to PSR, as it's being implemented by the Class 1s, is not nearly as impactful as it would be if we had a different mix of locomotives. Ours are 4-axle, lower-horsepower locomotives, and with the customer base that we have.

Matt Brooklier:

Got you. That's helpful. And then on the -- so the maintenance -- another maintenance question. Your expectations are the maintenance cost could -- is it -- should be up a pretty fair amount, there's some deferred -- a good amount of deferred maintenance cost that's getting pushed from '18 to '19. But you said in your previous comments that some of the maintenance cost is pretty dependent on the customer getting that car back to you, right? And then for you to be able to shop it. So, I'm just curious as to how much volatility there is potentially this year with the maintenance expense? Could we be in a situation where if the tank car market's doing better, and it's been an area were that has arguably been stronger than the freight car market this year -- where that maintenance cost maybe comes in a little bit below where you guys would have expected it for '19?

Tom Ellman:

Yeah. I mean, you're hitting the nail on the head as far as some of the variability that we discussed. Over a long enough time frame, there's not that much variability. The cars have to come in. But as we saw this year that the timing might not be what we originally expected. And phrasing your question another way, could the same thing happen at the end of '19 that happened at the end of '18? In the right operating environment, it absolutely could and it would be a variability on our maintenance cost. Likewise, the opposite could happen. And if there was a recession or some other negative event, customers would be more willing to give up cars. So there is timing variability built in there.

Matt Brooklier:

Gotcha. Thank you for the time.

Operator:

From Susquehanna, we'll hear from Bascome Majors.

Bascome Majors:

Yeah, now that we're in 2019, I wanted to ask again on the sales force and the behaviors you're trying to incentivize with your performance-related compensation plans there -- what's the focus for 2019? Is it maximize lease rate? Is it maximize term? Is there really something else entirely in there that you're trying to incentivize? And just what's the nuance in how that's different than how you entered 2018? Thank you.

Tom Ellman:

Yeah. So, I think -- you might have asked this question before. It's something that we do look at and tweak every year to try to maximize that trade-off between utilization, rate optimization and term. And as we come into this year, with things being a little bit better than they were coming into 2018, we tend to put a little more emphasis on the rate and term side of it. Whereas, in the depths of the market, more emphasis on getting the cars placed, but that's something that we tweak and optimize every year. Can't get into the specifics of the individual plan for the year and exactly how much, but those are the things we look every year to optimize.

Brian Kenney:

Yeah. I would say, it's way more complicated this year. In a down market, you're always pushing for utilization and staying short and everybody's rolling in the same direction almost across the fleet. In the market of 2014 to '15 and '13, you saw us pushing rate as hard as we can and trying to extend term. Because we're at that inflection point where some cars are close to the long-term model rate and some aren't and some are below. I think it's varied across the fleet, as far as our tactics. In some cases, you'll be extending term and trying to push rate. And others, they're just trying to lock up the fleet. So it's -- I don't think there's any across-the-board emphasis this year. It will be much more on a car-type basis.

Bascome Majors:

So, it sounds like that mix of incentive is somewhere in between the cyclical extremes you would see in the bottoming or peaking market?

Brian Kenney:

I think that's a fair assessment, yeah.

Bascome Majors:

Thank you.

Operator:

And with Gabelli & Company, you will hear from Justin Bergner.

Justin Bergner:

Good morning and thank you for taking my questions. First off, I just want to start with PSR. You mentioned that the primary risk is, I guess, cars being returned to some of your leasing competitors. Could you just elaborate on that? Does that extend sort of the risk beyond the car types you referred to or just increase the car -- the risk in the car types that you previously referred to?

Tom Ellman:

Yeah. It's really more a question of the car types we previously referred to. What -- we're very thoughtful always about the term profiles that we have with various customers and when the expirations come off lease. And if you have an event -- any event, PSR or anything else where you get cars back, we are -- we really try to manage that exposure. If somebody else gets a lot of cars back at once, then we have to compete against those to challenge. But I wouldn't say that the mix of cars would be different than what I talked about earlier.

Justin Bergner:

Okay, great. And then as you discussed -- sort of flattish sequential leasing outlook going forward, which is a step-down, I guess, a deceleration from what was highlighted in the prior call. Would you say that, that's mainly due to economic factors and demand? Or is it also due to velocity and some of these PSR considerations related to cars going back into storage?

Tom Ellman:

Yeah. Again, for the car types in our fleet, which are relatively less impacted by PSR. The base assumption -- it's a continuation of the velocity levels we have seen, that if that's off, with the exception of boxcars, it won't be as impactful as some other car types, which are not as core to our fleet.

Justin Bergner:

Thank you. And then finally, just in terms of the repurchases -- it seems like you stepped up the activity in the fourth quarter to end the year at $115 million. Obviously, you're blacked out at various points earlier in the year. Should we think about the fourth quarter repurchase activity as an increase run rate going forward? Taking advantage of a weak share price? Or more just the fact that you're blacked out earlier in the year?

Tom Ellman:

Yeah. So, as we mentioned in the last call, we had targeted something in the range of $100 million for the year and we certainly were increasing the pace to try to get back to that level. As we move forward, subject to our GATX Board approval, we will be targeting a higher amount in 2019. We have approximately $135 million remaining on our current authorization.

Justin Bergner:

Thank you.

Operator:

From Walthausen & Company, we'll hear from DeForest Hinman.

DeForest Hinman:

Hi. Thank you for taking my questions. Just some clarity on the tax rate. I think on the third quarter '18 call, we had forecasted a tax rate around 25%. It came in significantly lower than that. And the prepared remarks at the beginning of the call said, the tax rate similar to last year -- 2018, I believe. So should we be thinking about a tax rate in the low teens in 2019, if I'm reading that correctly?

Tom Ellman:

Yeah. So, all of the guidance we provide, we're talking on a normalized basis. So the 17% that you're referring to is without looking at the various impacts of the Tax Act. On a normalized basis, that's much closer to the 25% range that we discussed, and we would expect something in a similar range going forward.

DeForest Hinman:

Around 17%?

Tom Ellman:

No, no. What I'm saying -- the normalized number, the normalized number, which is around 25%, when you make adjustments for the impacts of the Tax Act.

DeForest Hinman:

Okay. And then can you give us a little bit more color on the Rolls-Royce JV? Obviously, what you're saying is another strong year -- we'll get a little bit more color when the K comes out. But can you help us understand either the growth run rate there on the revenue side or the profitability side? From an expectation basis, clearly it's an area that's been very, very strong for a number of years.

Tom Ellman:

Yeah. So, usually for Rolls-Royce, the variability has to do with the timing of remarketing gains, which tend to be very lumpy. On an operating basis, the JV outperformed for 2018. But we expect the overall performance to be similar, roughly similar in 2019 when compared to '18. So, in '18, we were at about $60 million. Putting a range somewhere between, perhaps, $55 million and $65 million might be a good base level expectation. But depending on those remarketing gains, it can be -- there can be some variability.

Brian Kenney:

The other thing I'd add there, is that was a huge investment year at Rolls-Royce. I mean, we invested close to $1 billion in the Rolls-Royce joint venture in 2018.

DeForest Hinman:

Okay. And from a capital management perspective, on the share repurchase side, it's encouraging to see an outlook reflective of the amount similar to 2018, around $115 million -- we have $135 million remaining on that authorization. From a Board perspective, how soon does it get discussed whether or not we need to increase the share repurchase authorization?

Brian Kenney:

We have our Board meeting this Friday, and both the dividend and share repurchases will be discussed – so, shortly.

DeForest Hinman

Okay. That’s helpful. Thank you for taking the questions.

Operator:

And Willard Milby with Seaport Global is next.

Willard Milby:

Hey. Good morning, everybody. Just wanted to ask on the Rail North America -- I guess, remarketing income. Does that assume similar number of cars coming out of the fleet? I think, it was about 3,000 this year.

Tom Ellman:

Yeah. So, each year what we do is optimize the portfolio across a variety of metrics including customer exposure, car type exposure, the expiration profile. So, I wouldn't necessarily say it would be the same number of cars. But it will be the same kind of things we look at -- which is why we expect in the base case, subject to a lot of variability depending on how the market plays out, what we saw this year.

Willard Milby:

Okay. And as far as the overall North American fleet, I know you're picking up the beginning of the new car purchases from American Railcar, and I guess the continuation of the long-term deal with Trinity. As we, kind of, think of the overall portfolio of railcars, does that, kind of, look flat from where we ended the year here 2018, maybe a slight increase?

Tom Ellman:

Yeah. So, as far as the way the two supply agreements work, the old Trinity one was 2,500 cars per year. The combination of the two new ones, when they get going, are about 3,000 cars a year. 2019, itsel,f is a transitional year, as we ramp up at ARI. So as far as the supply agreement, going forward, you would see a slight increase over what we've seen historically.

Willard Milby:

Okay and all my other questions have been asked. I appreciate the time. Thanks.

Operator:

And from GAMCO Investors, we'll hear from Mario Gabelli.

Mario Gabelli:

Hi, thank you. Just a couple of nits. Is that your cash tax rate of 25% or is it your book -- it's your book tax rate, not your cash tax rate, correct?

Tom Ellman:

Yes, correct, that is book. Cash tax is --

Mario Gabelli:

All right. That's fine. The second question is that you mentioned $1 billion into the JV. How much cash did you pull out in 2017? How much cash in or out net in 2018? What do you think the cash out or in is in 2019?

Brian Kenney:

Depends on investment opportunities. I don't expect that big of an investment here, Mario. Typically, we get dividends of $30 million to $50 million.

Mario Gabelli:

So you didn't get that but you had cash out, you had cash in then in 2018?

Brian Kenney:

Correct.

Mario Gabelli:

All right. Now that's going to be a materially important swing. Now, you guys have talked about monetizing that asset. I don't have the Q -- the K, I mean. I don't know what the -- your cash in as opposed to earnings. You considered in the past taking your non-rail businesses and packaging them up and spinning them off to the shareholders in some form. So I just want to ask, what's your tax basis in the Rolls-Royce joint -- JV?

Brian Kenney:

Actually, I'm not sure about the tax --

Mario Gabelli:

No problem. We'll get that offline at another time. You talked about Element earlier in the call, but you didn't indicate that you are ready to share whether you're bidding on anything. Obviously, I don't care about that, I care about NDAs. Would you -- is your philosophy to share with your investors how many NDAs you have outstanding with regards to the fleet or fleet purchases?

[Laughter]

Mario Gabelli:

Okay, you don't want to do it that way. Come on, you have to try.

Brian Kenney:

But nice try, Mario.

Mario Gabelli:

I agree. Listen, that's what I get paid to do. Independent of all of that [Laughter], the philosophy we had about 40 years ago was asset-light where somebody else owns the fleet and you manage it, much like NetJets does for Berkshire. Have you changed any of your thinking about managing fleets at a more aggressive pace in the U.S. than you have in the past?

Brian Kenney:

Generally, managing fleets, Mario, is a fee business and I'm not interested in $5 per car per month, which some of the other competitors do in the industry.

Mario Gabelli:

I was just thinking about …

Brian Kenney:

We do occasionally propose those types of structures so we get a percentage of the upside and then people tend to lose interest. But in terms of just getting $5 per car, per month, that's not really exciting for us.

Mario Gabelli:

There's a lot of individuals that work for the brokerage firms that are on this call who would like to have fleets bought by their clients and take 100% write-off and you manage and then take a piece of the upside. Hey, thanks very much. I've got a lot already to absorb. Have a great day, congratulations. Just figure out why your stock is -- take care.

Operator:

It appears there are no further questions at this time. And I'd like to turn the conference back to our presenters for any additional or closing remarks.

Jennifer McManus:

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

Operator:

And this concludes today's conference. Thank you for your participation. You may now disconnect.