2016 Fourth Quarter Conference Call

January 19, 2017

Operator:

Good day and welcome to the GATX Fourth-Quarter Conference Call. As a reminder, today's conference is being recorded. At this time I'd like to turn the conference over to Chris LaHurd. Please go ahead.

Chris LaHurd:

Good morning, everyone, and thank you for listening to our fourth-quarter and 2016 year-end earnings conference call. With me today are Brian Kenney, President and CEO, and Bob Lyons, Executive Vice President and CFO. I will provide a very brief overview of the fourth-quarter and full-year results and then Brian will touch on 2016 as well as provide commentary on our 2017 expectations. Following Brian's comments we will open the call to your questions.

As always, I'd like to remind you 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 our forecast. For more information, please refer to the risk factors discussed in GATX's Form 10-K for 2015. GATX assumes no obligation to update or revise any forward-looking statements to reflect subsequent events or circumstances.

Today, GATX reported 2016 fourth-quarter net income of $30.9 million or $0.77 per diluted share. This compares to 2015 fourth-quarter net income of $58.2 million or $1.37 per diluted share. Both fourth-quarter 2016 and fourth-quarter 2015 results include a net negative impact from Tax Adjustments and Other Items of $0.37 per diluted share and $0.07 per diluted share, respectively.

We reported net income of $257.1 million or $6.29 per diluted share for the full-year 2016. This compares to net income of $205.3 million or $4.69 per diluted share for 2015. The 2016 full-year results include a net benefit from Tax Adjustments and Other Items of $0.52 per diluted share and the 2015 full-year results include a net negative impact from Tax Adjustments and Other Items of $0.68 per diluted share.

In 2016, GATX repurchased over 2.7 million shares for approximately $120 million. This compares to our 2015 repurchase activity of 2.4 million shares for approximately $125 million. As of 12/31/2016 we have approximately $180 million remaining under our existing $300 million repurchase authorization.

With that quick overview, I'll turn the call over to Brian.

Brian Kenney:

Thanks, Chris. As most of you know that have followed GATX for a while, normally we cut to Q&A very quickly on these calls and not make you sit through a long management presentation. We figure you probably don't listen to it anyway, but if you will indulge me for just a few minutes here I'll provide some color on the current market downturn as well as our 2017 outlook.

The North American rail market is now entering its third year of falling traffic and railcar overcapacity, but once again we enter the year in outstanding condition. Despite rapidly deteriorating market conditions in 2016, our rail business had another outstanding year. We're sitting here today with our North American fleet utilized near 99%, almost all of our 2017 new car deliveries are placed. And although not as low as coming into 2016, we still have a relatively low number of existing cars scheduled for renewal in 2017. So, the fleet's positioned very well to withstand this weaker market. Moving to that outlook in '17, in North American rail we expect lease revenues to decline. As you know, absolute lease rates have been declining for most car types of the past year or so. Combined with the fact that the average expiring rate for cars up for renewal in '17 is increasing, that should drive our average renewal lease rate to be over 30% lower than the average expiring rate in 2017.

As I said, we're able to hold utilization near 99% at year-end 2016. That is going to become more challenging as the tough market persists, so we could see a few point drop in utilization by year-end ‘17, as well. The impact of these negative revenue assumptions is muted somewhat by the fact that a little over 15,000 cars are scheduled for renewal coming into 2017. Now that's higher than the exposure coming into 2016, but much lower than the average number of cars that were renewing in the strong market of 2012 to ‘15. So the good work that was done by our commercial team in extending lease terms in the strong market is paying off now.

We also expect a slightly higher level of railcar investment in 2017 than in 2016. Again, our scheduled deliveries are almost already placed with customers, so new car additions will contribute positively to revenue in 2017.

As far as the net effect on revenue in North American rail, if you combine the placement of the new cars delivering with declining renewal rates on the existing fleet and somewhat lower fleet utilization, it's going to result in 2017 revenue that's expected to be down approximately 5% from 2016.

Another driver of segment profit is obviously net maintenance expense. We do continue our strategy to move more maintenance into our own network and away from certain third-party providers, particularly tank car and specialty freight car maintenance. We find that safety and quality is much higher when we perform this maintenance internally. And with the strides in efficiency we have made in our network over the last few years, we perform the maintenance more cost-effectively internally, as well.

Looking at tank car qualifications, that is a major maintenance cost driver. The number of cars actually due in 2017 is about 1,000 cars lower than what was due in 2016. So offsetting that potential maintenance decrease from lower scheduled compliance work will be more cars entering the maintenance network for commercial reasons primarily due to lower projected renewal success and thus more assignments of existing cars to other customers in 2017. Thus net maintenance expense in ‘17 is expected to be slightly higher than in ‘16.

The last factor I’ll mention for North American rail is remarketing income. We will continue to optimize our fleet through secondary market sales of railcars as we do every year including through the last downturn. We were surprised by the robustness of the secondary market throughout 2016, hence the higher-than-planned remarketing gains last year.

However, given where the market is continuing to go, we don't expect to see the car volumes or values as high as what we realized in ‘16, and thus we expect that remarketing income will be down somewhat this year. So summarizing, North American rail; the net effect of lower revenue; increased ownership costs from the new car investment; slightly higher maintenance expense, and lower remarketing income is expected to result in North America rail segment profit being down in 2017 over 20% from last year.

Let's move to International Rail and specifically GATX Rail Europe, or GRE as we refer to it. They will continue to modernize their fleet and focus on maintaining utilization in a continuing difficult market. Remember that 85% of GRE's fleet is geared towards petroleum products and our customers' refining margins continue to suffer.

As far as their new car investment, it should be similar in ‘17 as it was in ‘16: less than 1,000 cars, less than EUR100 million. Most of these years were down substantially from prior years. It just hasn’t -- had made sense to force new cars into the oversupplied petroleum market. But nevertheless, even at this reduced level, we still expect some net fleet growth in 2017.

Now that fleet growth, offset somewhat by lower lease rates that we anticipate will be required to maintain high utilization on the fleet, will result in slightly higher revenue expected in 2017 at GRE. Now, that small revenue increase will be offset by higher ownership costs from a growing fleet. Also on the cost side, we expect maintenance expense to be lower by about 10% at GATX Rail Europe in 2017. There are fewer scheduled car revisions and the amount of wheelset purchases and refurbishments will decline materially from 2016.

The last factor worth briefly mentioning within International Rail is GATX Rail India. We expect to see more fleet growth and fleet diversification in 2017. Although not yet a major contributor to our profitability, they did generate a few million of segment profit in 2016. They're well-positioned as the number one railcar lessor in a fast-growing economy and rail market. And honestly, their outlook fits well within GATX's long-term strategy of taking what we do well in North America and applying it in more attractive growth markets.

So summarizing the expectations for International Rail, fleet and revenue growth, as well as lower maintenance expense, is expected to result in low single-digit profit growth in euros in 2017, although if current euro dollar rates persist year-over-year, results could be flat to slightly down in dollars.

At American Steamship, excluding the $5 million of litigation accrual and vessel return charges that they took in the fourth quarter, they had a pretty flat year in 2016 operationally. They carried about 1 million fewer tons than in 2015 and honestly that decline from the prior year in tonnage was unanticipated by us coming into 2016. In addition to lower overall tonnage than expected, the mix of tonnage was not as favorable as we anticipated in 2016 and, in retrospect, probably could have been carried in fewer vessels.

Looking ahead to 2017, we anticipate ASC will carry tonnage similar to 2016. However, we expect a number of positive developments in 2017. Freight rates will be renegotiated on certain contracts, vessel ownership costs will decrease due to the return of those leased-in vessels. We plan on operating with 10 vessels instead of 11 and we should gain some efficiencies in labor contracts. And so despite our miss in 2016, we do expect a significant increase in American Steamship segment profit in 2017.

In Portfolio Management, they had a great 2016 -- continued strong financial and investment performance at our spare engine leasing partnerships with Rolls-Royce. And, you remember, the large residual sharing income we realized in the managed portfolio, primarily in the second quarter. So although we expect continued strong performance in this segment in '17, we also expect that segment profit will decrease significantly from last year. That's due to the lower scheduled remarketing opportunities in our own portfolio as well as lower engine remarketing gains in the Rolls-Royce joint ventures -- so truly driven by remarketing.

Moving to corporate expense, as planned, we did reduce SG&A by almost 5% in 2016. We expect a similar percentage decrease in 2017 primarily due to discretionary spending reductions. Also on the tax line, we expect a lower tax rate in 2017 versus recent years due to the fact that our U.S. operations, which are generally taxed at a higher rate than our foreign operations, will comprise a smaller percentage of pre-tax income in '17. So, consolidating all this individual segment guidance results in a 2017 total net income that's approximately 25% lower in 2016. And when you combine that with anticipated 2017 share repurchase, that results in our annual guidance of $4.40 to $4.60 per diluted share for 2017.

So a little more color on that guidance may be helpful. We're getting a lot of questions about what kind of economic assumptions we are using for 2017 as well as questions on our assumptions for railroad car loadings, railroad operating performance and a variety of other variables. As far as the economic backdrop, it's not really a direct input into how we build our model for our 2017 financial performance.

We build our 2017 expectations based on a lease contract by lease contract examination of what cars are scheduled for renewal in '17 -- what we think the commercial and operational outcome will be for those cars. And, obviously, those expectations are based on what we're hearing from our customers about their expectations for their business, but it's also based on what the railcar supply situation is in our market. I can say that our 2017 guidance does not reflect an increase in economic growth over what North America has been experiencing over the last few years.

Now, we're obviously aware of the recent optimism over the potential for higher economic growth and if it does materialize, it does present an upside to our guidance. But I'll talk about the magnitude of that upside in just a second. Also, as we indicated in the press release, in the fourth quarter we did see positive year-over-year moves in a number of market metrics that are relevant to our business. Railcar loadings, railcar velocity, scrap steel prices -- all positive indicators for railcar demand. But our experience has taught us that one quarter does not make a trend and thus we have not reflected any continued favorable movement in any of these metrics in our 2017 guidance.

I'm also receiving considerable interest from investors about what increased U.S. infrastructure spending would mean for GATX. Very simply, given the large size and diversity of our fleet, it would be very beneficial to our long-term outlook, from small-cube covered hoppers to coil and insulated tank cars to aggregate cars as well as other car types -- the supply and demand dynamics for each would improve significantly actually for the program to update our national infrastructure.

So if the economy does improve and recent changes in metrics do become a trend and a specific infrastructure program is actually announced, as opposed to just talked about, the question becomes what is the magnitude of the upside for our 2017 guidance? And that answer lies in the fact that one of the unique characteristics of our business is the term structure of our lease revenue. And that long average lease term is what has allowed us to be operating 2.5 years into a declining railcar leasing market and still announce record earnings as we just did for 2016. But also means that the fact that it takes a while for these market trends, if they turn into trends, to show up in a material way in our financial statements, as much of our revenue performance is fairly well-known coming into any given year.

So, for example, coming into 2017 as I said, we've placed virtually all of our new car deliveries at 2016 market rates. And, as I said, I think we have a pretty good view of what may happen with our scheduled 2017 lease renewals on our existing fleet.

So, if the positive signs that I mentioned for our business do continue, there will be minor upside to 2017 earnings guidance. But it will be much more impactful for our outlook in 2018 and beyond. So these are definitely volatile economic times. Our team is excited as ever about our future. On the one hand, if the railcar market continues to be weak, I think we've positioned the Company to outperform our competitors and take advantage of growth opportunities as asset prices fall. On the other hand, if some of these recent positive developments actually continue, there's upside to our outlook and we have done a great job of achieving our goal of insulating our financial performance from the extreme volatility in the railcar leasing business. Either way, the management team has been doing this for a long time and I'm confident of our continued success.

So one last point before I open it to questions. 2017 will mark our 98th consecutive year of paying a dividend, obviously a record very few companies can match. The GATX Board meets next week and will announce their dividend decision at that time. They understand the importance of the dividend and I think our century-long payout is the best example of our long-term record of success and our commitment to shareholders. So with that, let's go ahead and open it up to questions.

QUESTION AND ANSWER

Operator:

(Operator Instructions) And we'll now take our first question from Prashant Rao with Citi.

Prashant Rao:

Good morning. Thanks for taking the question. Brian, I wanted to ask, in your commentary regarding I can appreciate that you do a buildup method in terms of building up that guidance, but looking more broadly at the market, and I'm thinking about the impairment charge in the quarter as well, do you see -- where are we in terms of timing, in terms of moving some of that excess supply and capacity out of the market? Is it still early innings? Is there more to come in the market? And how would that impact how you're viewing your guidance in terms of upside? If you could even directionally speak to that, that would be great.

Brian Kenney:

Yeah, I can give you a few data points. As I said, absolute lease rates in the quarter, in the fourth quarter, were flat for the first time in two years. That's one of the positive signs that we referred to in the press release. But once again, not a trend yet but it's better than going down. As far as 2017 guidance, we've assumed that absolute lease rates don't really decline very much.

So as far as whether we're at the bottom if there's further to go and whether the market gets back to equilibrium, that's the $1 million question. It's very difficult to answer. I can describe the math for you and many of the variables involved in achieving that equilibrium, but I can't complete the calculation because many of those variables are just too uncertain. So some help there.

Utilization of the national railcar fleet is running in the high 70s. Utilization in this context being different than the GATX definition. That utilization means cars that have moved in the last 60 days. So that implies there's a lot of idle cars that need to either get moving or get scrapped in order for our market to recover. And how does that happen? Well, increased railcar demand obviously helps and underlying economic growth, commodity prices, railroad operating performance are a few of the big drivers of that demand.

In 2017, as I said, we haven't assumed a significant improvement in any of those variables. As far as supply you have continued production adding to the problem and scrapping helping to solve that problem. There's been a recent increase in scrap prices.

That's another of the variables that we referred to in the press release as being positive recently but not yet a trend. If that holds or continues to increase, that will increase scrapping activity and help attrition in that fleet in the idle fleet. So once again, we have not assumed that scrap price helps us materially in 2017.

Then there is adding to the fleet, so railcar production and there is some good news. Railcar manufacturers have cut back production, but they still have a very large stated backlog and that is the hardest variable for us to assess. They don't give any good detail on the nature of that backlog. We believe a lot of it was ordered for the energy boom. We're convinced that very little of that backlog is actually needed in the near term and we have no idea how real it is.

We don't know how much of it has been deferred, and although it's technically part of the number won't deliver for a number of years. We don't know how much of it will be canceled and we don't know how much of it was for manufacturers' captive lease fleets that can be easily deferred or canceled. So there's a lot of uncertainty about what's going to be added to this problem.

So what I can say is that in the status quo, which is no boost to economic growth, no new significant infrastructure projects, no improvement in railroad operating performance as it affects us, no pickup in scrap rates and no order deferrals or cancellations beyond that backlog, I think it's highly unlikely that we achieve market equilibrium in 2017 and honestly, it may not even happen in 2018. On the other hand, any pickup in those indicators I mentioned will help turn it faster. But for right now, it doesn't look like it's going to happen in 2017.

Prashant Rao:

Okay, that's super helpful. Thank you. I guess a follow-up also. In terms of the expense management, you guys did a great job this quarter and you called out what you can do on the maintenance side and a few other items. I was just thinking about outside of the maintenance expenses -- what are the other big levers in terms of expense management and what you could do in terms of preserving margin?

And also related to that, the exit of the marine investments helped to some degree on margin in the trailing few quarters. Is there other lower margin exit opportunities here that maybe might feed into remarketing income?

Brian Kenney:

Yeah, I will let Bob answer that question. As far as levers on the cost side, we mentioned maintenance expense -- we are getting much more efficient in maintenance. So we're doing most of our maintenance on tank and specialty freight. Now in-house it's over 80% in our own network. And that has really improved our efficiency for the reasons I stated.

The other lever is SG&A. As I said, we cut it 5% last year, we have a similar target this year, we will get there. Probably the best way to put SG&A in perspective at GATX is the prior peak in 2008. We had SG&A of $168 million, total assets -- a little over $5 million. 2016, obviously, was the recent peak earnings year. We had SG&A of $175 million and assets of well over $7 billion. So peak-to-peak assets increased by 40% and SG&A increased by only 4%. So that's what we want to continue doing. We want to continue growing our fleet but leveraging the current infrastructure and that's what we are aiming to do as we go forward. As far as the margin question I'll turn to Bob.

Bob Lyons:

Thank you. And just on marine side, the inland marine assets within Portfolio Management, just to give you an update on those. When we embarked on the plan to exit that pool of assets, we had roughly $250 million in net book value invested in inland marine. We have now effectively sold all but just under $50 million of that.

So we have about, call it, $45 million left of NBV in inland marine assets and targeted to sell those in 2017. So we'll largely be done with that activity and any costs associated with managing that have been reduced pretty dramatically. There won't be a lot left to take out with that final $50 million because most of those costs have already been taken out or those resources have been reallocated elsewhere within GATX.

Prashant Rao:

Okay, that's very helpful. Thanks, guys, for the time. I will turn it over.

Operator:

And we'll go next to Allison Poliniak with Wells Fargo.

Allison Poliniak:

Hi guys, good morning. I just want to talk about that optimism. You talked a bit about it, but just trying to get a sense -- I understand folks certainly don't want to get locked into a leasing contract at this point, but have you noticed a step-up in inquiries in certain car types. If things go a certain way we could see some movement there?

Brian Kenney:

Yeah, there are pockets of opportunity in very limited quantity in certain markets. But there's so much slack in the system in terms of the idle fleet -- in the North American rail fleet, in general, the industry fleet as well as our competitors. Now we're utilized 99%. But honestly, to get real impact and pricing, everybody's utilization is going to have to go up and then we can start talking about more traction in pricing.

Allison Poliniak:

That's fair. And then just on the stored cars, you guys have obviously a little bit more knowledge than I do, but what's your sense of what the real normalized storage level could be? Is it 200,000 cars where we bottomed out or is it theoretically a number lower than that? What's your sense? What number do we really need to reach before we start to see that?

Brian Kenney:

So now, let's see, it's at 23% on one point -- so it's over 300,000 cars. I don't think even at the peak of the market it got much below 200,000 cars. And the reason is that's not truly utilization as GATX and other lessors reported. That's cars that have moved in the last 60 days. So there's car types that don't move for 60 days that are still utilized technically, so I don't know that it will ever get much under 200,000. So it still has a ways to go especially in certain car types, but you're not ever going to see it, for instance, get close to zero.

Allison Poliniak:

Great, thank you.

Operator:

We'll now go to Justin Long with Stephens.

Justin Long:

Thanks and good morning. First, I just wanted to clarify the comment you made earlier on absolute lease rates being flat in the fourth quarter. Was that comment based on looking at rates on a sequential basis? Or was that year over year?

Brian Kenney:

Third quarter to fourth quarter, generally across our fleet, rates were pretty flat. Year over year, though, down substantially. So I don't want to get too granular by car type for competitive reasons, but for our freight car fleet over the last year, they probably dropped an average of around 25%. For the tank car fleet, on average, probably dropped about 50% year over year. It's just third quarter to fourth quarter for the first time in over two years, it was flat.

Bob Lyons:

And Justin, just to add on that, too, if you recall from the second to the third quarter, the freight rates were generally flat and tank was down about 15%. So then you roll that forward third to fourth and you get the numbers Brian referenced.

Justin Long:

Got it. That's helpful. Thanks for that. And I wanted to ask about the impairment charge, as well. It looks like after you adjust for that in the numbers, the remarketing income in North America was about $10 million in the quarter. So, first, I just wanted to make sure that I was thinking about that the right way. And, secondly, going forward I know you said remarketing would probably be down this year, but is there any more -- can you get a little bit more granular with what you are expecting in the 2017 guidance?

Bob Lyons:

Sure. Actually in the fourth quarter, Justin, when you look at the detailed tables in the press release you'll see that remarketing income for rail in the fourth quarter was actually $13 million. So another pretty active quarter and, quite honestly, a little bit more active than we anticipated going into the quarter. We are continuing to see very significant interest in our assets as we put them out for sale in the secondary market. So a good quarter overall. And when I'll talk about remarketing income for 2017 I will really focus my comments here around North American Rail because that will be the bulk of remarketing activity in 2017. We had a very big year in 2016 in Portfolio Management. Don't anticipate that happening again because those were very unique transactions.

North American Rail in 2016 we had roughly $46 million of remarketing income. Again, that's within the range we thought it would be coming into the year -- a little bit better. And in 2017, I'd see that number between $35 million and $40 million. I think that's a good range to be in right now based on what we see primarily in the first two, three quarters of the year.

Really where that number ends up playing out eventually will be dependent on capital market activity, the health of the capital markets and, again, the appetite for assets in the secondary market. But we feel comfortable in that $35 million, $40 million range right now.

Justin Long:

Got it. That's helpful. And you gave some good color on some of the big picture changes that could be occurring and how that could impact the model, but one thing I wanted to ask about was interest rates.

It seems like we're going to be in a rising interest rate environment. Could you just, from a high level, walk through your expectation on how this could impact your business and maybe in addition to that, the earnings sensitivity to interest rates based on the fixed variable structure you have in your debt structure today?

Brian Kenney:

Yeah, I'll let Bob comment on the last part of that. But higher real interest rates, contrary to what people often assume for our business, has no positive correlation with lease rates or a direct effect on our business. And probably the best example, if you look at the last few years up to early 2015, interest rates are at an all-time record low and yet in our business, we're seeing lease rates that were unprecedented in terms of how high they were.

So, higher inflation on the other hand, especially in commodity and asset prices, is obviously extraordinarily helpful to our business and the value of our fleet. And so inflation over the decades has been our friend. As far as its immediate impact on earnings --

Bob Lyons:

Sure. We've already baked into the guidance a gradually increasing interest rate environment in 2017. Not significant, but definitely an upward trend in those rates, and that's already baked into our forecast. But the fact of the matter is only about 27% or 28% of our entire debt book is variable. The balance of that is all fixed, and over the course of the last few years, given the strength of the capital markets overall, we have locked in extremely low interest rates for very long term. If you go back to 2006, for example, 2007, our average debt rate was about 6.5% and the average term was about 3.5 years. If you look today, our average debt rate is about 3.5% and our average term is about eight or nine years. So, much like we've done on the commercial side of the business, where we've locked in very attractive lease rates for a long term, we've done the same on the liability side in terms of locking in very attractive low interest rates for very long periods of time. So not a significant driver, even if there were more material volatility in interest rates in 2017.

Justin Long:

Great, that's helpful. I'll leave it at that. Thanks for the time.

Operator:

And we'll go next to Matt Brooklier with Longbow Research.

Matt Brooklier:

Thanks and good morning. I was wondering if you could provide a little bit more color on the plan that will service tank cars that were impaired. If you could talk to the number of cars that were impaired, what's remaining in the fleet and your potential plans for those cars as we get closer to, I think it's the first mandate deadline in '18?

Bob Lyons:

Sure. Well, overall we have – we have about 13,000 cars in flammable service with the vast majority of those not due for any regulatory focus beyond 2023 and beyond. These cars were a subset of that, roughly 2,400 cars that we focused our attention on. They had a starting net book value of roughly $90 million spread across those 2,400 cars.

And what was unique about these was the age of the cars. The fact that they are all in flammable service -- they were older, non-jacketed tank cars and cars that we believe are uneconomical to retrofit. So when we focus on those cars and do our impairment analysis, as we do across the fleet, we felt that these cars -- we were not going to recover the full book value on those; hence the $30 million impairment charge. I can tell you the rest of the flammable fleet in terms of the impairment test was in very good shape and far passed its recoverability in net book value. Not that those cars at times won't be challenging to place into service in the secondary market, but from an impairment standpoint, we don't see any other issues.

Matt Brooklier:

Okay, that's helpful. And then just in general, I've been a little surprised at the potential, I guess the rate of retrofit activity in the marketplace. I was just curious to hear your opinion on is the market falling behind in terms of doing retrofits?

Is it just a fact that crude-by-rail volume is still down pretty significantly and there's just not the demand for those cars and they're being sidelined and may not even come back? I guess I'm trying to get a sense for if where we are from an industry perspective in terms of retrofits and if we're going to see retrofits I guess accelerate into the crude, specifically into the crude mandate deadline?

Brian Kenney:

Are you referring to retrofits on legacy cars?

Matt Brooklier:

Yes.

Brian Kenney:

Yeah, so our position all along – we've been very public that we don't think that makes any economic sense at all. So we've been saying we're not going to do any legacy retrofits. We've been saying that for quite some time and honestly we have had zero, literally zero, retrofit requests from customers on legacy cars, except for one exploratory request from a customer on 150 very specialized cars that they lease from us. So, once again, we don't anticipate any legacy car retrofits.

As far as the CP-1232s jacketed, we will do those retrofits. In fact, we've already performed a few. They are very young, have a lot of useful life left and only require a reconfigured bottom outlet handle and some new stenciling, I think, to meet the standard. So a few thousand dollars. That makes sense. But on legacy cars, it doesn't make economic sense. We're not going to do it. And I know the industry geared up for it, but I don't think they've seen any volume and I don't think they will.

Matt Brooklier:

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

Operator:

And we'll go next to Gordon Johnson with Axiom Capital.

Gordon Johnson:

Thanks for taking my question and good morning.

Bob Lyons:

Good morning.

Gordon Johnson:

I guess first question, just a little something we're trying to figure out here with respect to the remarketing income. It looks like this quarter, I guess, the loss on the remarketing income line was about $31.8 million, or I guess that's an impairment.

It's being classified as an impairment this quarter. But if we look at all prior quarters when you guys had the loss on the sale of railcars, it wasn't classified as an impairment. So it seems like there was an accounting change in the way that you guys are recognizing this in the fourth quarter versus all prior quarters and also it seems like it could be significant potentially moving forward. So can you guys comment on that? Thank you.

Bob Lyons:

No, there is no accounting change. These cars weren't sold. We looked at the recoverability of the assets and we wrote them down to a level we felt would be recoverable over time. They are still in service, they are still part of the GATX fleet. We have just taken the appropriate step to adjust their value. Remarketing income, as you move up that line and look at disposition gains on owned assets, those are cars that are actually sold during the quarter or during the year. And you will see that there was a $13 million remarketing income or disposition gain on owned assets. Those were gains on cars that were actually sold. Very different than an impairment.

Gordon Johnson:

Okay, it just seems like if you guys were to sell these cars, would that be recognized as, I guess, income on a GAAP and non-GAAP basis?

Bob Lyons:

I'm not sure I even understand that question.

Gordon Johnson:

I guess the cars that you mark down, the new value -- if you were to sell those cars, would that be recognized on a GAAP and non-GAAP basis or would that be an impairment?

Bob Lyons:

If we sold them at a gain it would be -- it would show up in your disposition gained on owned assets line.

Gordon Johnson:

Okay, thank you. Then with respect to, I guess, the tax changes that a lot of people expect to come with the new President-elect, can you talk to us about, I guess, how the tax treatment is when you buy a new railcar? Is there a MACRS schedule and is there tax deferral for a number of years or do you guys expect there to be a significant benefit if there's a tax windfall to corporations?

Bob Lyons:

Yeah, there is MACRS, there's accelerated tax depreciation on railcar rolling stock. We do not expect there will be any significant change in that. Most of the discussion has been around the overall corporate tax rate being reduced, and if that were the case, obviously, we would see that effective tax rate come down along with every other U.S. public filer.

The thing I'd point out -- I think as most people who have followed GATX for a long time know that we try to manage our tax basis and our tax position such that we minimize our cash tax payments and we're very -- our tax team is very effective at doing that. We're not a significant cash taxpayer now, and that would not change in any way under any of the proposed or discussed tax changes. Again, I think we have a long way to go to get from a discussion point to an actual policy that's enacted. But we're certainly keeping a close eye on it.

Operator:

And we'll go next to Mike Baudendistel with Stifel.

Mike Baudendistel:

Thank you. I just wanted to ask you -- I think you mentioned that you could see some slight growth in the size of your lease fleet going forward. Can you just break that down for us in terms of new cars taking delivery out from the Trinity agreement versus any cars in the secondary market that you might buy and are prices low enough at all in the secondary market that you're more interested now?

Brian Kenney:

Yeah, so we've done some secondary market acquisitions in 2016. We're anticipating doing some in 2017 asset prices and people selling cars continues. It's still an active market. As far as new car deliveries, we anticipate taking between, say, 3,500 and 4,000 new cars in 2017, most of those from the Trinity agreement.

Mike Baudendistel:

Okay great. That's helpful. Then just also, I wanted to ask you in terms of potential for the Trinity agreement terms to change, when will we know whether those change or not? Because that could be a catalyst.

Brian Kenney:

Yeah, so we're actually in discussions right now because the way that agreement worked, it contained a provision that in January 2017, so this month, either party can initiate a review of the cost-plus pricing. We've done that. We're in conversations on this pricing topic and we'll let you know the resolution of those discussions when they are complete. Shockingly, we would like the price to come down and Trinity would like that not to happen. We're talking. [Laughter]

Mike Baudendistel:

Okay. That's all I had. Thank you.

Operator:

And we'll go next to Justin Bergner with Gabelli & Co.

Justin Bergner:

Good morning and thank you for taking my questions.

Bob Lyons:

Good morning.

Justin Bergner:

First question relates to cars in storage. Are you seeing any car types starting to come back on the market and come out of storage?

Brian Kenney:

Not in any meaningful commodity, no.

Justin Bergner:

Okay. Second question relates to lease, I guess, renewal rate. I'm not sure if you spoke to it yet this quarter, if so could you still please just review it for us?

Bob Lyons:

Sure. The fourth-quarter Lease Price Index was a negative 36%, outlined in the release. And then Brian gave an overview or commented on that as well in his opening comment for 2017 being down roughly 30%.

Justin Bergner:

Okay. But in terms of the actual renewal rate --

Bob Lyons:

I'm sorry, higher than that.

Brian Kenney:

Yes, the LPI in 2017, we expect will be negative 30% or more.

Bob Lyons:

Correct. Negative 20% was the full year of 2016.

Brian Kenney:

Right.

Chris LaHurd:

Justin, the renewal success rate for the fourth quarter was 64.7%.

Justin Bergner:

Okay. Is that a good indication of where you expect it to continue to as utilization goes forward through 2017?

Brian Kenney:

No, as I said in the opening, we actually expect that to come down a few points. So mid-60s in 2016, probably low 60s in 2017. Continued difficult market, and honestly, a little heavier schedule renewal year for coal for us. So we anticipate it'll be a little rougher in 2017.

Justin Bergner:

Okay. One more question I had is in light of the recent sale to Sumitomo by American Railcar Leasing of, I guess, about 29,000 railcars for a pretty hefty sum. Is GATX re-examining the underlying value of its portfolio and what that might mean for the pace of share repurchases or other capital allocation? I know that management is rather conservative, but on that transaction certainly had a more rosy view of the world.

Brian Kenney:

Well, I would agree with that. 29,000 cars at $2.8 billion, and then there is an option as well to sell another 4,800 cars for, I think, close to $600 million. So we don't know the specifics, but if you do the value per car, it sounds like a full price. So, obviously, that means if you try to somehow put that value on our fleet, yeah, we're trading well below that. But we're a public company. We're for sale every day. In terms of share repurchase, we'll continue to return capital to shareholders, and the assumption for 2017. Bob?

Bob Lyons:

Yeah, between '15 and '16 we've done $245 million and in 2017 baked into our forecast, we're assuming around $100 million of repurchase in 2017. And we have $180 million left under the current authorization.

Justin Bergner:

Great, thanks for taking my questions.

Operator:

And we'll go now to Kristine Kubacki with CLSA.

Kristine Kubacki:

Good morning. Thank you for squeezing me in. My question is about the renewal success rate which you guys just talked about. And I know I am asking this way early, but as we think about '18, and I know there's lots of puts and takes and maybe you can comment to that, but how should we think about the amount of portfolio that's going to come up for renewal in '18 and '19? Are we looking at a bubble, given that you've gone so short in duration on some of these cars, but can you just help us with our models as we're thinking about the out years in renewal?

Chris LaHurd:

Sure, Kristine. So we're a bit reluctant to get too far ahead of ourselves simply because 2018 is obviously going to be impacted by '17 activity. But sitting here today our scheduled lease expirations for 2018 -- it's only 12,700 cars. But when we talk about that number a year from today, January 2018, it's likely going to be a higher number just because of short-term leases across 2017.

Kristine Kubacki:

Okay, but you wouldn't think it would be say north of 20,000 cars?

Chris LaHurd:

No, that would be high.

Kristine Kubacki:

Okay, very good. Thank you very much. I appreciate it.

Operator:

And we'll take our last call from Steve O'Hara with Sidoti & Company.

Steve O'Hara:

Yes, good morning. Thanks for taking the question. Just curious on the utilization that you've baked into guidance. I know you said you could see that going down maybe 2 points or something like that. Is that what's baked into your guidance or not?

Brian Kenney:

That's what's baked into our guidance, correct. And once again, it's a heavy year for coal, as an example. But it's a continued difficult year overall, but heavy on coal this year. So it could drop as 2 points, sure.

Steve O'Hara:

Okay. But I mean 2 points from coal is going to be less impactful than 2 points from tank, right?

Brian Kenney:

Exactly. You had my follow-on comment, which usually we say one of the big swing factors in our guidance is utilization. That's less so if utilization maintains at 99% because that will mean we renewed coal cars which are already at a very low rate. So it's not that impactful to 2017 earnings if we maintain utilization where it is.

Steve O'Hara:

Okay, all right. Thank you very much.

Operator:

And that concludes our question-and-answer session for today. I will now turn the call back to Mr. LaHurd for any additional or closing remarks.

Chris LaHurd:

I'd like to thank everyone for their participation on the call. And please feel free to contact me with any follow-up questions. Thank you.

Operator:

That does conclude our conference for today. Thank you for your participation.