

CIT Group

Q4 2017 Earnings Conference Call

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**CORPORATE PARTICIPANTS**

**Barbara Callahan** – *Head of Investor Relations*

**Ellen Alemany** – *Chairwoman and Chief Executive Officer*

**John Fawcett** – *Chief Financial Officer*

**Rob Rowe** – *Chief Risk Officer*

## **PRESENTATION**

### **Barbara Callahan**

Good morning and welcome to CIT's Fourth Quarter 2017 Earnings Conference Call. Our call today will be hosted by Ellen Alemany, Chairwoman and CEO, and John Fawcett, our CFO. After Ellen and John's prepared remarks, we will have a question and answer session. Also joining us for the Q&A discussion is our Chief Risk Officer, Rob Rowe.

As a courtesy to others on the call, we ask that you limit yourself to one question and one follow up and then return to the call queue if you have additional questions. We will do our best to answer as many questions as possible in the time we have this morning. Elements of this call are forward-looking in nature and may involve risks, uncertainties, and contingencies that may cause actual results to differ materially from those anticipated.

Any forward-looking statements relate only to the time and date of this call. We disclaim any duty to update these statements based on new information, future events, or otherwise. For information about risk factors relating to the business, please refer to our 2016 form 10-K. Any references to non-GAAP financial measures are meant to provide meaningful insights and are reconciled with GAAP in our press release.

Also, as part of the call this morning, we will be referencing a presentation that is available on the investor relations section of our website at [www.CIT.com](http://www.CIT.com).

Now, I'll turn the call over to Ellen Alemany.

### **Ellen Alemany**

Thank you, Barbara. Welcome and thank you for joining the call; 2017 was a significant year for CIT. We achieved a number of milestones on our plan and ended the year as a simpler and stronger company that is well-positioned to advance our growth strategy. Let me touch on a few highlights from the year.

We sold or reached agreement to sell more than \$12 billion in assets that were not strategic to the go-forward business model. We grew the average investment securities portfolio by 58%, we reduced operating expenses by about \$85 million, we reduced unsecured debt by \$6.9 billion, we repurchased \$3.4 billion of common stock, we increased our level of deposit funding to 77%, we resolved a number of legacy mortgage issues, and we invested in our core business lines by adding additional teams of industry experts and expanding our reach in key markets.

We ended the year with a net income of \$458 million or \$2.80 per common share. Excluding noteworthy items, net income was \$555 million or \$3.39 per common share. In the fourth quarter, we saw strong originations across the commercial businesses with the highest level of new business volume in over eight quarters. Despite elevated levels of pre-payments, we posted a 2% growth in core commercial loans and leases, which helped to drive strong operating performance in the quarter.

This was overshadowed by \$223 million of noteworthy items that included a goodwill impairment charge and a restructuring charge as we continued our transformation. As a result, we posted a net loss of \$98 million in the quarter or \$0.74 per common share. Excluding noteworthy items, however, we posted income from continuing operations of \$130 million or \$0.99 per common share reflecting strong operating performance.

With that, let me touch on some of the developments in our businesses. The priority over the last year was to reposition our Commercial Finance business to lead more deals and build deeper customer relationships. The team made significant progress in this area and had the left lead or sole lead position in 42 deals last year, up from 33 in 2016. This also helped to drive capital market fees, which were up 23% year-over-year.

Business Capital posted an increase in funded volume of 19% compared to the prior year as the group took a number of steps to add to its core capabilities, including expanding our direct origination channel and building teams in the industrial, material handling, restaurant franchise and technology verticals. We also invested in technology and launched a real time vendor point of sale financing platform.

We continue to manage through the cycle in rail and are seeing early signs of stabilization as rail loadings improved modestly and oil prices rebounded but are coming off very low levels. Overseas, the sale of the European rail business is ongoing, and we recently announced that the transaction is expected to take a bit longer than anticipated to allow more time for the buyer to address an anti-trust concern raised by the European regulators. We now anticipate the closing to occur in the second half of the year.

The Real Estate Finance business posted a 9% increase in funded volume compared to a year ago and added syndication capabilities to increase fee income. On the Consumer Banking front, the direct bank franchise continues to expand with 31,000 additional customers and 76,000 new deposit accounts as we advance our plans to build that franchise.

We continue to invest in this platform to improve the customer experience and have been gaining recognition for the consumer offerings at both the direct bank and branch network. As we start a New Year, we are poised for growth and continued expansion of our core capabilities in the middle market, small business and consumer deposits.

To further support these plans, we have added management capacity through the appointment of Mike Jones as Head of Business Capital, thereby positioning Steve Solk to focus full-time on Consumer Banking and Commercial Services. In addition, we announced Jeff Lytle as the incoming President for Rail as George Cashman retires later this year following an 18-year tenure with CIT.

We are fortunate to have highly experienced leaders like Mike and Jeff from our internal ranks step into these roles to seamlessly advance our strategic plans.

With that, let me turn it to John for more detailed accounts and results.

### **John Fawcett**

Thank you, Ellen, and good morning, everyone. Turning to our results on page 4 of the presentation, we posted a GAAP net loss for the quarter of \$98 million or \$0.74 per common share and a loss from continuing operations of \$93 million or \$0.70 per common share. Operating performance was strong this quarter; the net loss was driven by a goodwill impairment charge and we had a number of other noteworthy items that mostly offset.

I will spend a moment to take you through the noteworthy items listed on page 5 of the presentation. We recognized an after-tax goodwill impairment charge of \$222 million. This is a non-cash charge and had no impact on regulatory capital. The process for evaluating goodwill is very prescriptive. The impairment was primarily related to goodwill assigned to the equipment finance businesses within Business Capital and was a result of forecasted margin compression on new business due to a limited ability to fully pass on interest rate increases to our higher yielding customers, a shift in volume to lower

yielding, lower risk businesses that are not yet at scale, and finally, lower than expected end of lease activity.

Other noteworthy items mostly offset and included a \$20 million after-tax restructuring charge, mostly reflecting severance cost associated with reductions in operations and corporate functions. We expect the payback period to be around 18 months and do not anticipate any additional material restructuring charges in 2018 relating to the existing cost savings initiatives.

This quarter we changed the accounting policy for our low-income housing tax credits, or LIHTC, from the equity method to the proportional amortization method. Our LIHTC investments have been relatively small and did not have a material impact on our past quarterly results. We recorded accumulative earnings adjustment in the current quarter to reflect the accounting methodology change that resulted in an increase to other non-interest income of \$29 million and a tax expense of \$38 million netting to a \$9 million after-tax charge in the quarter.

We have started to increase these investments and the proportional amortization method is more widely used in the industry as a preferable alternative that reflects the economic performance of the investments cumulatively in the tax provision. We recognized a net \$12 million benefit from US Tax Reform. The benefit includes a revaluation of our modest federal net-DTL position, the reduction of our international DTL from unremitted earnings, and the revaluation of the LIHTC investment. The details are in the appendix of the presentation on page 31.

Finally, we recognize \$16 million in after-tax net benefits related to NACCO, our European rail business in held per sale, including \$10 million in other net tax benefits, which included the impact of French tax reform and \$6 million from suspended depreciation. Separately, as it relates to the NACCO disposition itself, we continue to support the buyer as they seek to gain antitrust clearance from European regulators which is taking longer than expected. We now anticipate the closing to occur in the second half of 2018.

Details of old and noteworthy items for the current, prior, and year ago quarters are listed on page 23 of the presentation.

Turning to page 6, income from continuing operations available to common shareholders, excluding noteworthy items, was \$130 million or \$0.99 per common share this quarter. This is down from \$139 million or \$1.02 per common share last quarter and up from \$125 million or \$0.62 per common share in the year ago quarter.

As a reminder, this quarter's results included the first semi-annual preferred stock dividend payment which included a small stub period from the second quarter. Semi-annual dividend payments of \$9.4 million are paid in June and December and are recognized in the second and fourth quarters. We also provide a full-year view of our financial results on page 7 of the presentation for your reference.

I will now go into further detail on our financial results for the quarter. Please note that in this discussion, I will refer to our results from continuing operations excluding noteworthy items unless otherwise noted.

Turning to page 8 of the presentation, net finance revenue was down \$2 million from the prior quarter while net finance margin increased 5 basis points. Compared to the year ago quarter, net finance revenue was down \$30 million while the margin was down 7 basis points. Purchase accounting accretion, net of negative interest on the indemnification asset (or, net PAA) declined while core net finance revenue, which excludes the impact of net PAA, grew from both the year ago quarter and the

prior quarter.

Purchase accounting accretion has declined from \$74 million in the year ago quarter to \$52 million last quarter and \$40 million in the current quarter reflecting the run-off of the Legacy Consumer Mortgage portfolio and high prepayments in Commercial Finance and Real Estate Finance. In addition, we froze the PAA on the reverse mortgages included in the Financial Freedom transaction, reducing the accretion by \$5 million this quarter.

We expect the purchase accounting accretion to continue to decline each quarter as the portfolio runs off. We now have \$730 million in total PAA remaining. Approximately \$640 million relates to the Legacy Consumer Mortgage portfolio, which runs off at about 10% to 15% annually. The remaining \$90 million relates to Commercial Finance and Real Estate Finance which runs off much faster, and we expect about 25% of it to accrete over the next 12 months.

As we indicated last quarter, the negative interest income on the indemnification asset increased to \$16 million from \$14 million last quarter and \$8 million in the year ago quarter due to a decline in expected reimbursable losses under the loss share agreement from better than expected credit performance of covered loans acquired from OneWest.

We expect the negative interest income to decline modestly each quarter until the loss share agreement expires in the first quarter of 2019. The increase in our core net finance revenue reflects a full quarter benefit from the redemption of \$800 million in unsecured debt at the end of September.

Turning to page 9, net finance margin increased by 5 basis points this quarter due to several factors. A reduction in lower yielding cash balances, along with higher interest income on loans and investments, added 14 basis points to the margin, and lower borrowing costs driven by the aforementioned debt redemption added 5 basis points. Offsetting these increases was lower net purchase accounting accretion as well as lower net operating lease revenue from our rail business.

Rail renewal rates, on average, repriced down 26% this quarter reflecting the mix of cars renewing. We continue to expect leases to reprice down an average of 20% to 30% through 2018 and into 2019 reflecting continued pressure from tank car lease rates which are starting to renew at a higher pace and coming off of peak levels. That said, the tank car market seems to have stabilized with crude oil and refined product opportunities developing in Canada and Mexico.

Compared to the year ago quarter, the decline in net finance margin was primarily due to the same trends I just described. Deposit rates have increased modestly over the past year despite three rate hikes, reflecting growth in non-maturity deposits and benefits from a reduction in higher cost brokered and commercial deposits. Deposit betas have been fairly low, around 5% to 10%, which I will discuss more later.

Turning to page 10, other non-interest income increased from the prior and year ago quarters, reflecting strong operating performances in both consumer and commercial banking and other corporate actions to improve returns. Fee revenue increased to the highest level in over a year, primarily driven by strong capital market fees in commercial banking. While factoring volumes have increased year-over-year, commissions remained relatively constant reflecting the mix of services provided and lower pricing.

Gains on investments this quarter, again, reflected a benefit of approximately \$10 million as we continue to optimize our investment securities portfolio, where the year ago quarter included a \$22 million gain on an investment related to a loan workout in Commercial Finance. We had \$7 million in net gains related to the reverse mortgages that impacted various line items.

As loans moved to held for sale in the third quarter, we stopped accreting the purchased discount in interest income, which was more than offset by gains from loan payoffs, liquidations and sales recognized in other non-interest income. We may continue to experience volatility until the financial freedom sale is completed, but amounts will vary depending on the loan activity.

In the third quarter, we initiated a bank-owned life insurance program, or BOLI. Other revenues include in \$6 million in income, reflecting a full quarter benefit from the investment. Other revenues also increased \$5 million from the prior quarter as we no longer have a drag on our LIHTC investments due to the change in accounting methodology discussed earlier.

Turning to page 11, operating expenses were down slightly from the prior quarter and down \$38 million from a year ago. The current quarter benefitted from a reversal of a litigation provision as well as a true up of FDIC insurance costs. We expect operating expenses to be up in the first quarter of 2018, primarily from payroll and benefit resets. We expect operating expenses will be lower at the end of 2018 as we reduce consulting services and other professional fees and continue to right size the organization. We remain on track to achieve our 2018 annual operating expense target of \$1.050 billion. Just a reminder, that this target excludes intangible amortization, which is about \$24 million annually.

Page 12 describes our consolidated average balance sheet. Average earning assets were down \$900 million, reflecting the deployment of our interest-bearing cash. Average investments, as well as loans and leases, increased while unsecured borrowings declined.

Page 13 provides more detail on average loans and leases by division. Commercial banking's average loans and leases grew about 2% from the prior quarter with strong origination activity in Commercial Finance, Real Estate Finance and Business Capital. Compared to a year ago, average loans and leases are up modestly, reflecting a reduction in Commercial Finance offset by growth in all other divisions.

While the middle market continues to be challenging and prepayments remain elevated, Commercial Finance grew 2% this quarter from strong originations in the healthcare and CNI industry verticals, initial volume from our newly established aviation lending vertical, as well as a small portfolio purchase of approximately \$80 million.

Real Estate Finance volumes remained strong this quarter while the overall portfolio remained flat excluding run-off from the Legacy Non-SFR portfolio acquired from OneWest. Real Estate Finance grew 1% from prior quarter and almost 6% compared to a year ago.

North America Rail's utilization remains around 95%. Assets are flat as modest new deliveries were offset by depreciation. In the near-term, we expect North America Rails' assets to continue to be relatively flat as the order book of approximately \$80 million in 2018 will be offset by portfolio management activities and depreciation.

Business Capital grew 4% from the prior quarter and 9% from the year ago quarter with growth across all businesses, especially in Commercial Services, direct capital and capital equipment finance. In Consumer Banking, the run-off of the Legacy Consumer Mortgage portfolio offset growth in other Consumer Banking businesses. Average loans in the mortgage lending business grew from strong originations in the retail channel as well as from purchased loans. We also experienced an increase in loans from our SBA lending platform.

Page 14 highlights our average funding mix. Compared to the prior quarter, deposits declined modestly while FHLB advances increased. The average funding mix also reflects the redemption of \$800 million in unsecured debt that closed at the end of the third quarter. Funding cost as a percent of average earning assets improved this quarter reflecting the debt reduction, offset by a modest increase in deposit costs.

As I mentioned last quarter, we are taking a comprehensive approach to address the impact from the sale of NACCO as well as other actions, including further reducing unsecured debt using excess liquidity and/or refinancing with lower cost debt in order to improve our overall funding cost.

Page 15 illustrates the deposit mix by type and channel. We are executing on a strategy to improve the composition of our deposits while optimizing price. This strategy includes reducing higher cost deposits from our brokered channel as well as institutional accounts within the commercial channel while growing lower cost deposits in the online channel.

The top chart illustrates the impact over time from this strategy as decreases in time deposits and money market sweeps from the brokered and commercial channels offset savings deposit growth in the online channel. The bottom chart illustrates this trend as well. Brokered and commercial deposits as a percent of total average deposits declined from 30% a year ago to 21%. This reduction was offset by the growth in the online channel.

Despite three rate hikes over the past year, overall deposit costs are up only 5 basis points from a year ago and only 2 basis points from the prior quarter, reflecting our strategy to optimize costs while improving the quality of our deposits. Deposit betas have been historically low through 2017. We expect betas to increase as loan growth picks up and interest rates continue to rise. It is difficult to determine, at this time, what the levels will be, and we continue to look for ways to optimize both the cost and mix of our deposits as we grow.

Page 16 highlights our credit trends which continue to reflect a favorable environment and we are not seeing substantial changes in overall trends. The credit provision this quarter of \$30 million was up \$15 million last quarter, reflecting the establishment of reserves due to loan growth but still below normalized levels. Net charge-offs were 26 basis points, a decline from both for the prior quarter and year ago quarters as both prior periods included the impact of assets transferred to held for sale.

New originations continue to come in at a lower risk rating than the overall performing portfolio. The decline in credit provision from the year ago quarter, which was \$37 million, continues to reflect a stable credit environment as well as positive changes in the credit quality of our portfolio.

Non-accrual loans ended the year at \$221 million, or 76 basis points of loans, down 17 basis points from the prior quarter and 18 basis points from the year ago quarter. The allowance for loan losses in commercial banking of \$174 million is relatively constant with the prior quarter and down from 1.81% from a year ago as the benefit of lower reserves on new originations offset the change in mix of the existing portfolio.

Turning to capital on page 17, the increase in our capital ratios from the prior quarter reflect the increase in earnings, excluding the write-off of goodwill, as that had no impact on regulatory capital. We repurchased \$6 million of common shares in the fourth quarter at a price of \$47.23 per share, completing our authorized 2017 repurchases and have \$100 million remaining that can be executed the first half of 2018 under the existing capital plan.

Page 18 highlights our performance metrics, both on a reported basis as well as excluding noteworthy

items. I want to take a moment to talk about the effective tax rate. We had a lot of noise this year on our effective tax rate from our strategic initiatives, US tax reform and other discrete items. When you cut through all the noise, the normalized effective tax rate for the year was about 34%. In 2018, we expect our effective tax rate, before discrete items, to be around 25% to 26%. This level is based on the new federal statutory tax rate of 21%, plus state income taxes as well as the non-deductibility of FDIC assessments, which we expect to be offset by tax benefits from BOLI and other tax advantaged investments.

Page 19 provides our 2018 outlook. My commentary will focus on full-year 2018 targets when compared to full-year 2017, excluding noteworthy items, and actual results may vary by quarter. We expect overall average earning assets in 2018 to be flat as mid-single digit growth in our core portfolios are offset by the sales of NACCO and the reverse mortgages, as well as the run-off of the Legacy Consumer Mortgage portfolio.

We have narrowed the net finance margin target range and expect it to drift down from the current level due to headwinds in Rail and lower net purchase accounting accretion from the run-off of the legacy portfolios and the sale of the Reverse Mortgage portfolio. These headwinds are expected to be partially offset by net benefits from higher interest rates resulting from our asset sensitivity position and potential future actions to reduce our unsecured debt costs.

Our outlook tracks the forward curve at year-end and assumes two rate hikes in 2018. Almost 60% of our assets are floating rate and mostly indexed to 1 and 3-month LIBOR. As such, loan yields will benefit from an increase in short-term rates which we expect will be partially offset by higher deposit costs, as I mentioned earlier. We had previously discussed our full-year 2018 expense target of \$1.050 billion which excludes the amortization of intangibles. We remain very focused on our operating costs and continue to look for opportunities to further reduce expenses as we simplify our infrastructure and streamline processes to drive efficiencies.

We are making progress on our net efficiency and targeting a mid-50s range for 2018. Improvements will mostly come from lower operating expenses as we expect total non-interest income to be flat to up modestly as targeted increases in fees, income from the BOLI investments, and changes in LIHTC accounting offset lower gains on sales of loans and investment securities.

As I mentioned earlier, we expect credit trends to remain relatively constant with net charge-offs ranging from 35 to 45 basis points, while a provision will also reflect growth in the core portfolios. Keep in mind that there may be some volatility around this range from discrete items. As I mentioned, the effective tax rate before the impact of discrete items is expected to be 25% to 26% reflecting US tax reform and the mix of our businesses. We think the change in the tax rate will result in an increase of our ROTCE of 100 to 125 basis points depending upon how much of the benefit ultimately falls to the bottom line, and we have updated our medium-term ROTCE target to 11% to 12%.

The fourth quarter's ROTCE, excluding noteworthy items, was 8.5%. When normalizing for the annual effective tax rate of 34% before discrete items and for the half of the preferred dividend, given its semi-annual payout, our ROTCE for the quarter was approximately 8.1%.

The sale of the Reverse Mortgage portfolio will result in approximately 70 to 75 basis points of headwind. That said, we expect to end 2018 with a ROTCE around 9.5% to 10% and a CET1 ratio of 11.5% to 12%, down from the current CET1 level of 14.4%. While we are still targeting the upper-end of the 10% to 11% CET1 ratio, given we ended the year at 14.5%, it may take longer than originally expected to reach our target. We will continue to work within the regulatory framework and our risk management discipline to return capital to shareholders as prudently and as efficiently as possible.

In 2019, we expect to continue to make progress towards the lower end of the 11% to 12% ROTCE target, primarily from revenue growth from our core businesses, continuous improvement in our efficiency ratio and further reduction in the CET1 ratio, and we will continue to update you on our progress.

Before I turn it back to Ellen, I also wanted to give you some thoughts on the first quarter outlook on page 20, which is compared to the fourth quarter of 2017. We expect total average earning assets to be relatively flat with low single-digit quarterly growth in our core portfolios, mostly offset by the run-off of the Legacy Consumer Mortgage portfolio.

We expect net finance margin to decline to the upper-end of the 2018 target range. We expect other non-interest income to be down and closer to the quarterly run rate as we have elevated activity this quarter that positively impacted this line item. As I mentioned, we expect operating expenses to be up in the first quarter reflecting benefit restarts.

We expect the credit provision will continue to reflect asset growth in our core portfolio. Net charge-offs should be within the annual target range of 35 to 45 basis points excluding any discrete items, and as I mentioned, we expect the effective tax rate before the impact of any discrete items to be between 25% and 26%.

With that, let me turn it back over to Ellen.

### **Ellen Alemany**

Thanks, John. To wrap up, we feel good about the progress that was achieved over the past year. We have charted our course for the future and are focused on executing our plan. We remain committed to delivering shareholder value and we expect the ROTCE to improve to 9.5% to 10% by the end of the year. As John mentioned, some of the improvement will come from benefits resulting from US tax reform, but we also expect to more than offset headwinds from the reverse mortgage sale with continuous progress on our plan.

We also know that the bar must continue to be raised and have updated our medium-term target to 11% to 12% and expect to make further improvements towards this target in 2019. Our plan is centered on maximizing the potential of our core businesses, enhancing operational efficiency, reducing funding costs, optimizing the capital structure, and maintaining strong risk management.

Now let me turn it back to the operator for Q&A.

## **QUESTIONS AND ANSWERS**

### **Moshe Orenbuch**

Great. Thanks. I guess I wanted to understand a little bit more detail about the guidance. I mean, you talked about mid-single digit loan growth, but earning assets are flat and that's where—I guess that's where the margin is driven and you're kind of coming into it with the benefit of the lower debt that you had in the fourth quarter and you cited some of the headwinds. But it seems like a pretty significant decline as we kind of think about what you're looking into 2018. And so I don't know, anything you can talk about in terms of your efforts to kind of offset that or anything?

### **John Fawcett**

Yes. I think your analysis is spot on, Moshe. The reality is that we're dealing with a lot of headwinds and I think we're going to continue to see that through a lot of '18. We talked about the sale of the

Reverse Mortgage portfolio, the Legacy Consumer Mortgage portfolio continues to run-off, purchase accounting accretion, negative yield adjustment on the indemnification asset is going to prove to be a drag, and then of course we've got the sale of NACCO. And then offsetting that is the business growth, and so I think in terms of the business growth, a lot of that is going to be driven by terms and conditions and the amount of prepayments that we see.

I think if you looked at the difference between the third quarter and the fourth quarter, prepayments moderated a bit and so we're hopeful that going into 2018 that trend continues a little bit. I think beyond that, in terms of the core nature of the business, we're starting to see some meaningful growth in the businesses. And I think as Ellen mentioned and as I said in my call script, we've actually seen growth in the fourth quarter which was a distinct difference from the second or third quarter. So we'll see. I think one quarter, the fourth quarter, does not make a trend, but we've seen a lot of the investments start to bear fruit.

### **Ellen Alemany**

Yes. I just want to comment on the asset growth. So as John mentioned, we had a very strong quarter for originations in the fourth quarter and we believe that this is our first step really in solid asset growth over the next couple of years. You know, the third quarter '17 in commercial was an inflection point for asset levels and we have a solid pipeline heading into 2018.

The new aviation vertical is working out well. We did the CIT Northbridge joint venture which really allows us to capture on some of the economics of deals in the ABL space that go into the non-bank space. Real Estate, going into the year with a strong pipeline. We're focusing pretty much on the Northeast and Southern California and also some other major MSAs like Chicago, Dallas, Houston, Portland. Rail, you know there's still significant capacity out there. Probably, we think the asset growth will be offset by depreciation and some asset sales portfolio management.

In Business Capital, we started 2018 with a robust backlog and we've now grown for four consecutive months. We have added new business development officers in industrial and franchise. We're transitioning the business to more of a direct model and we're cross-selling Direct Capital into the retail bank network. So we have really good business momentum going into the year.

### **Moshe Orenbuch**

Just as a follow up, the comment that you had made about it may take longer to kind of reach target capital ratios, is that a function of an expectation for the CCAR ask in the 2018 cycle, or is it a function of something else? I mean, can you elaborate on that?

### **John Fawcett**

Yes. I think it's a reflection of reality. I think we certainly didn't expect to be at 14.4%. I think there's a lot of moving pieces associated with that. If you go back to the very beginning of actually, this year, I think our CCAR ask was actually quite modest. I think we've underperformed in terms of growing the balance sheet.

I think in terms of all of the actions associated with the air transaction, we had better execution on a debt tender, better execution on the preferred, lower RWAs again as it challenged originations. And again, it was a very modest ask because this was CIT's first time through the CCAR process. So we are where we are at, call it 14.5%.

This'll be our second time through the CCAR process. I think if we got down from 14.5% to 11.5%, that would be a herculean effort. And as I say, we're working with our regulators within the confines of the framework that's provided for us.

**Moshe Orenbuck**

Got it. Thank you.

**Mark DeVries**

Yes. Thank you. You know, I think your guidance that you expect to close NACCO in the back-half of this year implies you do expect that to ultimately get approved by the regulators. Can you just talk about kind of what the issues are and what your confidence is that it can get approved at terms that are acceptable to the buyer?

**John Fawcett**

Yes, sure. It has to do with I guess antitrust issues right now in Germany. And so we're working aggressively with the buyer. You know, we filed an 8-K, VTG filed the equivalent of their 8-K within the last week and provided some insights on that. As I say, we're continuing to try and support the transaction. We have every expectation that it will close. It is taking longer than we ever anticipated.

I think our first guidance was in the fourth quarter of '17 then we moved it to the first quarter, and now as VTG gets deeper and deeper into negotiations with the Federal Cartel Office in Germany, they have to work through what the remedies are, but we remain committed to the transaction. They remain committed to the transaction and it's just a regulatory process that has to be worked through.

**Mark DeVries**

Okay. Got it. And could you comment on what, if any, impact tax reform has had on the punitive impact of you potentially selling rail and whether that has any kind of impact on your interest in doing that at some point in the future?

**John Fawcett**

We have no interest in doing that and the tax reform didn't provide any incremental impetus to do it, so it's not a consideration at all.

**Mark DeVries**

Okay. Got it. Thanks.

**John Fawcett**

You're welcome.

**Ken Zerbe**

Great. Thanks. Good morning. Just going back to the ROTCE target, the 9.5% to 10%. Presumably when you first issued that target, it was before we were seriously discussing tax reform, and tax reform obviously drove, or could potentially drive, a fair increase in ROTCE. Like how has your thinking changed? Because if you haven't changed your ROTCE target, yet we get tax reform, like how are you now thinking of hitting that number sort of between tax reform and capital return and other items? Thanks.

**John Fawcett**

I guess, Ken, the way I think about it is that we did change the target, and so in the third quarter we've walked back off of the 10% return on tangible common equity in the fourth quarter of '18, promised to come back with guidance. In the interim, tax reform happened and that creates the 100 to 125 basis points of improvement. And so you would look at that and you would say well, gee, shouldn't you necessarily be higher? And I think that would be true if you didn't consider the run off of the Legacy Consumer Mortgage portfolio, the sale of NACCO, the 70 to 80 basis points that comes out of the sale

of our G3 or the reverse mortgage portfolio. So all of those factors weigh, and it's not exactly a push, but if you factor those things in, they kind of almost net out the effect of the tax reform benefit that we're actually seeing. I hope that helps.

**Ken Zerbe**

Because none of those items were in your 10% target either.

**John Fawcett**

Correct.

**Ken Zerbe**

Okay. Got you. And then just a follow-up question. Thanks for all the guidance for 2018. Can you just address the potential sort of a good run rate for your fee income line? I understand there's a lot of gains in there, but just looking for something a little more core. Thanks.

**John Fawcett**

Yes. I think relative to other banks, as you probably will have recognized, we're very underweight fees. I think it basically tends to what I said on the call script in terms of what we're doing. I think in the rail business I think we'll continue to be opportunistic in terms of parsing that portfolio, and I think that George and his team and now Jeff and his team have been expert at that.

So we expect that as rates rise, you might expect that there'll be less opportunity in the investment securities portfolio. I think that's offset by obviously the LIHTC drag actually being moved out of non-interest income and into the tax provision line. That provides some lift. Then, of course, we'll have a full-year of BOLI income which is about \$6 million a quarter. So those are kind of the puts and the takes, and then the other wildcard is capital markets activity as it's tied to the level of commercial originations. So as commercial originations go, so goes capital markets.

**Ken Zerbe**

All right. Thank you.

**John Fawcett**

You're welcome.

**Arren Cyganovich**

Thanks. You had mentioned that you don't have a specific outlook on deposit betas, but you expect them to rise. Can you give us a little bit more color in terms of maybe the breakdown of expectations around online versus branch within your system?

**John Fawcett**

Yes. So obviously we do have an outlook on it. I think like most banks, historical betas have been wildly under what has been modeled. I think at this point what we're modeling in terms of non-maturity deposits for a 100 basis-point move over the course of a year is probably between 40% and 50%. I think across the entire cycle it's probably 65% to 75% in that area.

**Arren Cyganovich**

Okay. Thank you. That's helpful. In terms of the rail business, obviously the oil price increase has been beneficial. Are you seeing any increase in demand for those assets that support that business and any change in terms of your price outlook as the pressure's been hitting those tank cars and sand cars?

**Rob Rowe**

So, Arren, it's Rob. We still had to—as upon renewal—we're still moving rail cars out of the Bakken to other regions of the country to other types of energy use, whether it's ethanol or refined products. And we actually believe that for 2018 we will continue to have to do that. The reason is for that is there's still a fair amount of pipeline takeaway taken out of the Bakken that's underutilized, and so that has to get filled up first because that's lower cost service than rail service.

So we do think that the pressure that we've been seeing on yields will continue throughout 2018 because of that. But as you note, the oil price is picking up overall and production has picked up, that has helped stabilize the lease rates at a relatively low level though.

**Arren Cyganovich**

Okay. Thank you.

**Owen Lau**

Yes. Good morning. Thank you for taking my question. I just have a quick one about the tax rate. Try to reconcile with other banks, some other regional banks say the effective tax rate exceeds about 19%, 20%, and you're guiding to 25% to 26%, and I believe you also put some money into CDFI so you get some new mortgage tax credit as well. Just try to reconcile why your tax rate is higher than other regional banks.

**John Fawcett**

Yes. So you start with the 21% and then you're left with the impact of the state taxes, which is largely driven by where your people sit, where your property is and then where your business originations and loan and leasing operations are conducted. And so when you look at that for us, the three states are California, New York and New Jersey, which is not especially helpful.

I think the other element is that when you compare us to other regional banks in terms of tax advantaged assets—and we're working towards this obviously—we're light LIHTC, we're light BOLI, and just instituted BOLI, and we have no municipal tax advantage income to speak of. So when you factor all of those things in, you'll wind up where we are between 25% and 26% before any discrete items.

**Owen Lau**

Okay. Thank you. That's helpful. That's it for me.

**John Fawcett**

Thank you.

**Don Fandetti**

Good morning. Ellen, it sounds like there's still no interest to sell the rail business. The core business continues to face some challenging issues. I was curious how you sort of balance like a more strategic move such as the sale of the company versus continuing to move forward.

**Ellen Alemany**

Sure. You know, we think we're making very good progress against the strategic plan that we laid out a couple of years ago. We've executed on everything that we've committed to our shareholders and investors. In fact, I think we've executed better than most people had anticipated.

I would say kind of the two items in terms of what we originally set out in the third quarter of last year was the sale of the reverse mortgage portfolio that we would lose 60 to 70 basis points there. But we

thought it was a really important step in de-risking the company going forward and exiting the Financial Freedom business, and then the capital is subject to the regulators. With the change in the tax law, etc., we feel recommitted to getting to this target by the end of '18, the 9.5% to 10% range.

We feel in terms of reaching our medium term ROTCE target, we feel that we have really good revenue initiatives in all aspects of our business lines. We've ridden out the rail cycle this long and we do see some light at the end of the tunnel there.

With OPEX reduction, we started out on the OPEX reduction at \$1.2 billion. We've made great progress against it. We think we're going to get the full \$150 million out by the year end and we also think that there's opportunities beyond that to continue reducing our expenses. And we think there's still opportunity on the funding costs. We think there's further opportunities to reduce our rates on the remaining \$3.7 billion in unsecured debt, and so we feel pretty optimistic about making our medium-term targets and making continued progress at the company.

**Don Fandetti**

Thank you.

**Vincent Caintic**

Hey. Good morning. Thanks so much, guys. First question on the CET1 guidance for 2018, just first, why is your target 11.5% to 12%? Kind of how do you get to that range? And then just kind of if you can help us gain comfort in that. I think most of the investor questions I get is on getting to a 2% reduction and your CET1 is being aggressive. So any commentary or comfort you can give on that? And is it simply a matter of waiting for CCAR or are there other interim actions you can take to lower the CET1? Thanks.

**John Fawcett**

Yes. So I'm not going to comment on the interim actions. I will say we were operating within the regulatory framework that the government's provided us. You know, I'll go back to what I said before which is when your starting point is, and I'm rounding, 14.5%, getting 300 basis points out then to 11.5% to me feels quite herculean. I know it's not what investors want, but we're trying to do this as quickly and as prudently and expeditiously as we possibly can within a very prescriptive framework, and it's not a snap your finger exercise, it's working the process.

This company's been through CCAR exactly one time and we will be through it the second time this spring. We are in the same place that every other CCAR bank was when they did it the second time. I think maybe we're a little bit further ahead actually because we've got all of the lessons learned and a lot of the consultants are probably less busy. So they're helping us, but we are spending and investing in all of the infrastructure necessary to support a robust CCAR and capital planning process.

**Vincent Caintic**

Okay. Got it. Thank you. And shifting gears a bit, if you could talk about the deal pipeline and backlog and maybe the mix. Just wondering if there's any positive impact from tax reform as maybe some folks are spending more on capital expenditures. Thanks.

**Ellen Alemany**

Yes. I mean, just in terms of tax reform, our expectation is that tax reform will be positive for our lending and our leasing customers, and that this boost in economic activity should increase demand for financing, particularly in capital-intensive businesses. So I mean, I think the one word of caution is the potential for price pressure in the market place. I mean, we have a few anecdotal situations, but we also believe that markets are already competitive and we really see this on a widespread basis.

I do want to say, as I mentioned before, that we're going into the year with probably the best pipelines we've seen in Business Capital and our commercial banking businesses.

**Vincent Caintic**

Okay. Got it. Thank you.

**CONCLUSION**

**Barbara Callahan**

Thank you, everyone, for joining the call this morning. If you have any follow up questions, please feel free to contact me or any member of the Investor Relations team. You can find our contact information along with other information on CIT in the Investor Relations section of our website at [www.cit.com](http://www.cit.com). Thank you, again, for your time this morning and have a great day.