CIT

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Ken Zerbe: All right, good morning everybody. I'm Ken Zerbe, the midcap banks analyst at Morgan Stanley. Our next presentation is CIT Group. We have Ellen Alemany, Chairwoman and CEO; and John Fawcett, CFO of the company. I know they have some prepared remarks, but before we go into the prepared remarks let's just run through a couple polling questions if you don't mind.

So I guess the first question, what is your expectation for CIT's medium term ROTCE? For reference, it was about 6.4% in first quarter, guidance is 11% to 12% over the medium term. What do you think they can do?

Ken Zerbe: All right, Ellen, we have something to discuss there with the "unlikely to reach the target." Next question please. All right, relative to last year's CCAR approval which was just over a $1 billion, including the excess, what's your expectation for CIT, CCAR if let's assume they get approval? I know there's a lot of questions around CCAR process, so bear with me on this one, over the next four quarters?

Okay, so about a billion or more actually. Okay, next question. Which of these is the most important for CIT to focus on in the near term? Simplification, capital return, net finance margin or balance sheet growth?

Ken Zerbe: Oh, can you guys rerun that question? Is that okay? Oh, I see polling is closed. This was such an important question too. Are you guys able to fix it? No. Okay, well how about this, in the interest of time, maybe we can hit it at the very end. But with that, let me turn it over to Ellen who's got some prepared remarks. Thank you.

Ellen Alemany: Thank you, Ken. Good morning everyone. John and I are pleased to be here with you this morning and give you an update on CIT. About two years ago we launched a multi-year strategic plan to transform the company into a leading national bank. And I'm pleased to say that a lot of progress was achieved thus far. Today CIT is a simpler, stronger, and well positioned to build on its core strengths and grow.

Before we start, I want to point to the Safe Harbor language on Slide 2. For those on the webcast, you can access our presentation on the IR section of CIT.com. So let's get started.

On Slide 3, you'll see an overview of CIT today. We're a top 50 bank focused on serving the middle markets, small business, and helping consumers grow their savings. We have about $50 billion in assets, $39 billion in loans and leases and $30 billion in deposits. The deposit operation which today provides over 75% of our funding includes our national direct bank as well as a network of branches in southern California.

We have strong positions in our key markets, and this will allow us to continue to build and grow the franchise. We are a leader in middle market lending and factoring services. We are a top ten provider of equipment financing. A top five provider of railcar leasing. We have two leading digital platforms. One is our direct bank and the other is our small business lending platform. And, we are headquartered in Southern California which gives us a strong connection to that important community.

On Slide 4, we'll highlight some of the key accomplishments that were achieved thus far to simplify, strengthen and grow CIT. The transformation at CIT has been significant. In short, we simplified the company to apply more focus on our core businesses. We strengthen the financial and risk profile and addressed legacy issues. We positioned CIT for growth and expansion and delivered shareholder value.

A few highlights of the transformation include: selling or exiting our non-strategic businesses which reduced our operating leases and forward commitments; Exiting our overseas operations with the NACCO sale being the last divestiture in this area and on pace to close in the second half of this year; Reducing over $1.5 billion of leveraged loans as we repositioned commercial finance business; Strengthening our funding profile and optimizing our capital position; Bringing closure to a number of legacy mortgage issues, including most recently, selling the reverse mortgage servicing operation, and expanding our presence in a number of industry verticals creating joint ventures for additional asset management activities; And, something I'm particularly proud of, we returned $4.3 billion in capital to shareholders and increased our dividend. We know there's more to do, but with a number of these efforts in the rearview mirror, we are squarely focused on growth and delivering on our profitability goals.

Helping to lead the charge on our transformation and the go forward strategy is a strong and diverse board and leadership team which is highlighted on Slide 5. We have brought together a highly experienced team of leaders with strong banking and business capabilities to deliver on the strategic plan and grow the company in the future. Most of these executives came to CIT from other larger bank institutions and have been able to hit the ground running to enhance our functional activities.

On the business side, we have a great mix of seasoned CIT leaders with deep expertise and leaders that are new to the company or new to their role that brings fresh perspective to these areas of the business. We're also fortunate to have a strong board with diverse experiences. Roughly 40 percent of our directors joined CIT within the past three years, and the remaining members have deeper roots and understanding of the company's evolution.

Our directors hold a range of experience in banking, business, governance, regulation, technology to name a few categories. Having the right leadership and governance is critical to successfully delivering the type of transformation that we have undertaken. And I wanted to just highlight the work that we've done in this area.

This is the team driving the strategy, and on the next two slides we'll dig a little deeper into our core franchises. As I mentioned earlier, this year we are focused on growth and that entails building on our core competencies and leading market positions in commercial banking.

On Slide 6, we outline our four commercial banking divisions and our strengths in these markets. Commercial finance is currently our largest business and we have deep roots in that part of the world. This business has a lot of diversification across a number of mid-market segments from energy to healthcare to C&I to technology. Our strengths include industry expertise across these verticals that allow us to provide customized financing solutions for clients to help them realize their goals.

Last year we were the left lead or sole lead position in 42 deals up from 33 in 2016. And the business is off to a strong start in 2018 with 4% growth in average loans and leases in the first quarter compared to the prior quarter. One example that demonstrates our presence in the commercial space is the merger of Jordan Health Services and Great Lakes Caring. Each company was a CIT customer for several years and we had done about ten transactions between them. Now these entities we're merging to create a top-three home health platform in the U.S. It was a complicated deal that required structuring expertise and given our presence in healthcare financing we were able to retain the lead role in this deal as well as pursue capital markets, fees, and the deposit business.

This is where we can lead in this space. We know the landscape, we know how to work through complicated transactions, and we can provide other services to deliver for our customers. Last year we also entered into a joint venture relationship with Allstate that expands our addressable market in the ABL space. And I'm pleased to say that the CIT Northbridge joint venture has closed six deals for $127 million of commitments thus far.

Our Business Capital unit provides equipment financing solutions to small, mid, and large cap businesses mainly through technology-based platforms. We've expanded the number of teams in this area over the last year, and built direct origination capability for the capital equipment finance business which supports our client-focused approach. We bring the technology, industry expertise, and unique knowledge of residual value to our clients to help their businesses grow. This combination gives us a strong position in this market and in the first quarter the business posted 3% growth quarter-over-quarter, excluding the factoring business.

Whether it's financing equipment for a metal recycling center across their 18 East Coast locations, or leasing equipment for an auto parts company in Michigan, or being the one-stop shop for online financing for a printing company, our Business Capital team has the expertise and comprehensive client centric approach to win these deals. And our factoring business continues to diversify across industries and geographies.

Rail car leasing is also a key business for us, and we are one of the top participants in the industry. While the market cycle for rail has been a bit challenging in recent years, our portfolio management and customer service has been strong and part of why we are a leader in the business. We have a young and diverse fleet across a range of industries that helps to ensure demand for our cars. And, we also enjoy long tenured relationships in this market.

Lastly, our Commercial Real Estate business specializes in construction and bridge lending, mainly in two prominent geographies, the Northeast Corridor and Southern California. We bring high touch service and expertise to these transactions, and are focused on prudent growth and further expansion of our syndication activities. As you can see, our commercial businesses are highly diversified, well positioned for future growth, and supported by deep industry, knowledge, technology and relationships. We are focused on continuing to unlock potential in these areas.

On the next slide, I want to touch on consumer banking which is largely composed of our deposit businesses. As I mentioned earlier, we have two deposit franchises - a highly scalable nationwide direct bank, and a more localized high touch branch network in a desirable footprint. The direct bank continues to have a lot of runway with our value proposition built on competitive saving products through a digital experience which is on trend with customer preferences.

The branch bank offers strong customer service experience and localized connection to the community. The focus on relationships is evidenced by our average customer relationship which is more than 12 years. The lending side of the consumer business is modest and mainly comprised of some mortgage assets and small business loans. It brings incremental diversification and allows us to support Southern California banking. Our consumer banking segment delivers stable and efficient funding and a growing base of customers.

On Slide 8, I want to touch on technology and innovation and we really approach this from two fronts. The first is using technology and digitization as a means to drive greater efficiency, and the second is a way to enhance the customer experience and support growth. First, let's touch on efficiency. We've taken a number of steps to improve our operational efficiency by using technology to streamline, reduce complexity and enable greater scalability in our operations.

Some of these efforts will ultimately support our expense goals as we drive more automation through our operations. Next, we have used technology and innovation to improve the customer experience and support our growth efforts. We recently took a number of steps to improve the direct bank application process and customer experience. This is an area we will continue to build on as the direct bank expands. On the commercial side, we launched an award winning point of sale digital platform that enables clients to offer their business customers online or in-store financing for purchases. We have signed on one major technology client to this platform, and hope to expand use to other companies that are looking for that digital offering for their customers.

We also continue to invest in our Flexibility platform which is an important differentiator in our equipment finance platform. It's a key digital platform that allows a vendor to manage sales, invoicing, marketing, and servicing all for one comprehensive system.

On Slide 9, we outline our strategic plan and the five components that serve as a roadmap to simplify, strengthen, and grow the company. We've made significant progress thus far and we're focused on consistently delivering shareholder value. Our ROTCE target for the end of the year remains between 9.5 to 10%, and as previously disclosed this year we increased our ROTCE target to 11% to be achieved at the end of 2019.

The next several slides touch on each of the five components of the plan. On Slide 10, we outline some of the opportunities for growth in our core business line. We expect a compounded annual growth rate for average loans and leases in the mid-digits in our core portfolios. While our businesses are very diverse, the plan for growth is straight forward. We're leveraging our experience and talent in the industry verticals to pursue additional growth opportunities in some areas we bolster talent but across the board we've instilled a prudent growth mindset.

We're pursuing additional fee income opportunities in capital markets and syndication activities. We're continuing to invest in technology to improve the customer experience and create a differentiated offering. We're actively managing our rail portfolio. We're presenting our products and services to customers in a more holistic way as opposed to keeping customer relationships aligned to only one business area. For example, our digital small business lending product is now being offered to our customers in our California branches.

We have posted solid business growth over the last two quarters and remain committed to our plan and the various initiatives in place to maximize the value of our core franchises. With that, let me turn it over to John.

John Fawcett: Okay, thank you, Ellen and good morning to everyone. Turning to Slide 11 on operating efficiency, we remain on track to meet our 2018 operating expense target of $1.05 billion, and we will continue to look for opportunities to further reduce our costs. In the medium term, improvement in our net efficiency ratio will mostly come from reducing operating expenses, although we also expect revenue growth as our core portfolios grow and as some of our initiatives to improve non-interest income start to take hold. But, we need to grow at a pace that will more than offset the reduction from the NACCO and Financial Freedom reverse mortgage portfolios sold and those that are in runoff, so we think most of the increase in revenues will come in 2019.

People, professional fees and operations and technology constitute about 75% of our cost base and remain a focus for expense reduction. We are working aggressively to reduce our reliance on contractors and other professional services, to right size the organization, to complete the rationalization of applications, on automation of processes and to improve our infrastructure. In addition, although our branch footprint is modest, even here, we are looking at strategies to reduce costs.

Turning to Slide 12 on our funding, we continue to reduce and refinance our unsecured debt. In 2017, we reduced unsecured senior debt by nearly $7 billion, and in the first half of 2018 we refinanced nearly $900 million, extending our maturities that would have been due early in 2019, into 2021 and 2025, paying 2 basis points for 4 years of average duration.

We currently have $3.9 billion of unsecured senior debt remaining with an average coupon of 4.83% and an average life of just over four years. Virtually all unsecured debt is financing operations that reside outside of the bank. We will continue to look for opportunities to manage and reduce overall debt costs by refinancing, extending maturities, and lowering the absolute level of unsecured senior debt.

On the deposit side of funding, retail deposits comprise 80% of our total deposits split close to 50/50 between our online and branch deposits. We are executing on a strategy to improve the mix of our deposits, while optimizing costs. This strategy includes reducing higher cost deposits from our broker channel, as well as institutional accounts within the commercial channel, while growing lower cost deposits in the online channel. The chart illustrates this strategy as brokered and commercial channels declined to 20% of deposits in the first quarter of 2018 from 31% in the year ago quarter, while non-maturity deposits from our on line channel grew from 12% to 21%.

Despite three rate hikes over the past year, overall deposit costs are up a modest 13 basis points from a year ago, reflecting our strategy to optimize costs, while improving the quality of our deposits. Deposit betas have been historically low. Since the tightening began in December of 2015, deposit betas have been 10% to 15%. Over the past 12 months, betas on total deposits have been around 20% to 25%. We expect our betas to increase as interest rates continue to rise. We are modeling 65% to 75% through the cycle for nonmaturity deposits which are currently a little over 50% of our deposit base and expected to grow over time. We continue to look for ways to optimize both the cost and the mix of our deposits as we grow.

Turning to Slide 13, our capital structure, we are optimizing our capital structure to be more in line with midcap banks by deploying excess capital in a way that improves equity returns over the long term. We are targeting a 10% to 11% common equity Tier 1 ratio and expect to achieve the upper end of the target range by the end of 2019 subject to regulatory approval. We have also shifted the mix of our capital to include preferred and Tier 2 qualifying subordinated debt.

We recently completed a $609 million common equity tender offer, bringing our total capital return through share repurchases in the first half of the year to approximately $875 million. We expect to get the results of our 2018 capital plan in the next week or two, and we are targeting to reduce our common equity Tier 1 ratio to the 11.5% to 12% range by the end of 2018. We know there's more to do, and 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.

Turning to Slide 14 on risk management, maintaining a strong risk management discipline is a cornerstone to our strategy to achieve and maintain an appropriate return through the cycle. We have improved the diversification of our loan and lease mix, while reducing the overall risk profile. The top chart illustrates this shift. We have reduced our concentration of cash flow loans as we've repositioned our Commercial Finance business, reduced our transportation leases with the sale of our Commercial Air portfolio, and increased our commercial real estate assets.

Credit trends continue to reflect a favorable environment, and we are not seeing substantive changes in overall trends. New originations continue to come in at a lower risk rating than the overall performing portfolio and nonaccrual loans remain at historically low levels. The allowance for loan losses as a percent of both commercial and consumer loans in aggregate has been around 150 basis points in the past two years. The credit provision in the first quarter of 2018 was above the level we've experienced due to a $22 million charge off of a single commercial exposure in the quarter, principally within Commercial Finance. This charge was episodic in nature, and we have provided guidance indicating that we expect our credit provision to return to approximately the levels we have seen in previous recent quarters.

Turning to our key performance metrics, on slide 15, on our first quarter earnings call we reiterated our 2018 outlook, which excludes noteworthy items. Actual results may vary by quarter, and the second quarter is expected to include about $18 million in debt extinguishment costs related to unsecured senior debt refinancing, a $20 to $30 million gain related to the sale of the reverse mortgages before any impact from an indemnification reserve, and approximately $9 million of suspended depreciation related to the NACCO transaction. All of these items are pre-tax and part of our strategic execution to simplify the business, and with the exception of any indemnification reserve, will be reported in continuing operations. Also, since we closed the reverse mortgage sale, at the end of May, continuing operations in the second quarter will reflect only two months of related revenue. We expect overall earning assets in 2018 to be flat. Mid to single digit growth in our core portfolios is mostly offset by the sale of the reverse mortgages and the runoff of the legacy consumer mortgage portfolio.

The net finance margin target range remains at 3.20% to 3.40% and is expected to be below the 2017 level due to headwinds in Rail, lower net purchase accounting accretion from the runoff of the legacy mortgage portfolio, and the sale of the reverse mortgage portfolio, partially offset by net benefits from higher interest rates and potential future actions to reduce unsecured debt costs.

Our full year 2018 expense target is $1.05 billion, which excludes the amortization of intangibles, and we are targeting a net efficiency ratio in the mid-50s range for 2018. We expect net charge offs in the 35 to 45 basis point range and the credit provision in the $30 to $40 million range per quarter in the near term. The effective tax rate before the impact of discrete items is expected to be in the 26% to 28% range, reflecting U. S. tax reform and the mix of our businesses. As a result, we still expect to achieve a return on tangible common equity around 9.5 to 10% and a common equity Tier 1 ratio of 11.5% to 12% in the fourth quarter of 2018.

Turning to Slide 16, in 2019 we expect to continue to improve our return on tangible common equity to 11%, the lower end of our medium term target range. We expect to achieve this primarily from revenue growth in our core businesses, continuous improvement in our efficiency ratio, and further reduction of our common equity tier one ratio to the upper end of our 10% to 11% target range.

This slide is a return on tangible common equity walk that takes us from 8.1% on a normalized basis in the fourth quarter of 2017 to about 11% in the fourth quarter of 2019 including the elements we need to execute against. Moving through the walk, the net income impact of asset sales, namely the sale of NACCO, our European rail business, which is expected to close in the second half of the year, and the sale of our reverse mortgage portfolio, which occurred at the end of May, is a reduction of 1% to 1.2%. That excludes any benefit for related debt or capital actions that we may take. We expect these headwinds to be fully offset by the benefit of lower tax rate from tax reform.

Moving through the stack, growth in net income from our businesses of 70 to 90 basis points includes the offsetting impact of rail headwinds and lower net purchase accounting accretion from the runoff of legacy consumer mortgage portfolio. We also expect to deliver against our commitments to reduce net operating expenses which should drive 20 to 40 basis points of improvement.

We will continue to evaluate options to reduce our unsecured senior debt costs as well as options to deploy our excess capital over the next couple of years which we expect to serve as another significant driver of improved returns.

Finally, turning to Slide 17, we have made significant progress over the past two years transforming CIT into a leading national bank focused on lending and leasing to the middle market and small businesses. We are well positioned for growth and believe the first quarter was a solid start for the year. We have more work to do, and continue to take actions to simplify, strengthen, and grow CIT. Our plan is centered on maximizing the potential of our core businesses, enhancing operational efficiencies, reducing funding cost, optimizing the capital structure and maintaining strong risk management.

Now I’ll just turn it back to Ken and see if there’s any time for questions.

Ken Zerbe: Actually, I think we don't, so let's go ahead and wrap it up there. I want to thank Ellen and John from CIT for being here. So thank you very much.

Ellen Alemany: Thank you, Ken

Ken Zerbe: I appreciate it.