# CIT Group

## 2Q 2020 CIT Group Inc. Earnings Conference Call

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**CORPORATE PARTICIPANTS**

**Ellen Alemany**

**John Fawcett**

**Marisa Harney**

**Barbara Callahan**

**PRESENTATION**

**Operator**
Good morning, and welcome to CIT's second quarter 2020 earnings conference call. My name is Rocco and I will be your operator today. At this time all participants are in a listen-only mode. There will be a question and answer session later in the call. To ask a question you may press "*" then "1" on a touch tone phone. To withdraw your question please press "*" then "2". If at any time during the call you require assistance, please press "*" then "0" and an operator will be happy to assist you. As a reminder, this conference is being recorded.

I would now like to turn the call over to Barbara Callahan, Head of Investor Relations. Please proceed ma'am.

**Barbara Callahan**
Thank you, Rocco. Good morning, and welcome to CIT's second quarter 2020 earnings conference call. Our call today will be hosted by Ellen Alemany, Chairwoman and CEO and John Fawcett, our CFO. Also joining us for the Q&A discussion is our Chief Credit Officer Marisa Harney.

During this call we will be referencing a presentation that is available on the Investor Relations section of our website at CIT.com. Our forward-looking statements, disclosure, and non-gap reconciliations are included in today's earnings materials and within our SEC filing. These cover our presentation materials, prepared comments, and the question and answer segment of today's call. With that I'll now turn it over to Ellen Alemany.

**Ellen Alemany**
Thanks, Barbara. Good morning, everyone and thank you for joining the call. The COVID-19 pandemic has continued to affect the broader economy and that has carried over to our financial results in the second quarter, although to a lesser degree than we experienced in the first quarter. As a result, we posted a net loss this period of $98 million, or 99 cents per diluted common share.

CIT began this year in a position of strength, with a multi-year strategic transformation reinforcing our foundation and the completion of the recent acquisition adding to our franchise capability. That strength along with the agility of our team will help us to continue to navigate through this unprecedented time. John will go into a detailed account of the drivers in the quarter, but some key factors in the performance were lower net finance revenue primarily due to lower interest rates and holding elevated levels of liquidity during this turbulent period, lower factoring commissions due to retail store closures, and a $73 million net charge off related to a single factoring bankruptcy exposure.

We also continued to build our allowance for credit losses, but with the substantial reserve build in the first quarter, the impact on our provision was much lower. Despite these factors there were also pockets of strength in the quarter. Our average deposit costs declined by 27 basis points and we were able to use some excess liquidity to repurchase $235 million of unsecured bank notes at a discount.

Our average loans and leases were up two percent from last quarter, which included defensive draws on revolvers in March as well as new originations in stronger segments of the commercial market. Our capital and liquidity positions remain strong. Our integration plan from the recent acquisition is on track and we are unlocking greater operating efficiencies than originally anticipated.

Our operations continued uninterrupted with all our branches remaining open and our customer operations running smoothly, many in a remote model. And we are proactively managing our credit risk through this dynamic period.

I want to spend some time on what we're seeing in the business and how we're leveraging our strengths in the current environment. First and foremost, CIT's business model is very diverse. We operate across a variety of commercial segments that have deep industry and asset class expertise to support those segments.

That is a tremendous advantage across market cycle. It enables us to pivot quickly, take advantage of attractive opportunities, and manage our exposure in areas that are more directly impacted by the current environment. And that's exactly what we've done for this pandemic. Let me focus on a few of the opportunities first.

The Power and Renewables business has continued to be very active with virtually no disruption through the pandemic, and CIT is a leader in this space, ranking third in the lead tables. We closed five deals where we were the lead or co-lead since March. We have another 10 lead deals in the pipeline for the second half. Most recently, we announced the $118 million deal for 112-megawatt solar facility in North Carolina, which demonstrates the continued demand for renewable power.

In addition, we are seeing strong transaction activity in the Technology, Media, and Telecom division as stay at home guidelines have supported continued investment in telecom infrastructure, cloud-based data centers, as well as additional streaming media content production and distribution.

Our Capital Equipment Finance division had a record quarter, as borrowers were looking to leverage their fixed assets. We were able to finance several investment grade and near investment grade borrowers given our deep asset class expertise. There are good yields in this asset class, and we were also able to opportunistically purchase small portfolios from larger banks looking to manage obligor limits.

CIT has a long history in the asset-based lending business and this is an area where we are expanding as we see some solid opportunities in the pipeline for the second half that align with our capabilities. And on the Business Capital front we began to see an uptick in applications and volume toward the end of the quarter as certain businesses started to return to their operations. As a result, our volumes in June were consistent with where they were a year ago.

In short, we are seeing opportunities open up and our agility, expertise, and balance sheet strength have allowed us to capture those opportunities. Credit, of course, does remain a challenge in this environment, but many of the qualities I mentioned that help us originate business also help us manage our risk. Our size, industry knowledge, and asset class expertise allow us to adapt quickly and proactively manage issues when they arise.

As soon as the pandemic began, we implemented heightened monitoring and portfolio management practices. That included a loan by loan review, daily portfolio and industry reporting, and redeployment of resources to help manage portfolios that are affected by the economic disruption. We have granted relief across more than 10,000 smaller ticket Business Capital loans and leases and about 200 Commercial Finance and real estate contracts, totaling about two billion in net investment combined. And we are underwriting each larger ticket loan modification to ensure there is a path to recovery.

We participated in the PPP program with the majority of customers accessing the program being community based small businesses in our branch footprint. We also recently launched the Main Street Lending Program for our mid-sized clients. We are staying disciplined to find new opportunities and assist our current customers through this period, when possible.

Before I pass it to John, I want to touch on some of our strategic initiatives. The integration of our recent acquisition of the former Mutual of Omaha Bank is progressing nicely and remains on track for this year and ahead of schedule on operating efficiencies. Despite all the complexity the pandemic has brought, the team is making great progress in bringing together the teams, technology, products, and footprint.

The homeowner association deposit team is hitting their goals with average HOA deposits of eight percent to $5.3 billion. This is great progress and was a key driver of the acquisition. Continuing to build out this channel will give us even greater funding flexibility and at lower costs.

Likewise, the newly integrated Treasury and Payment Services team is bringing in additional commercial deposits from new and existing clients also at lower costs. These average deposits are up 18% in the quarter to $3.9 billion, with costs down to 43 basis points. Build out of these deposit channels complement our consumer deposits in the direct and branch channels and provide greater funding flexibility and diversity.

As part of our integration efforts we also recently signed an agreement to sell the wealth management business that was part of the former Mutual of Omaha Bank private offering. As we conduct a strategic review of the business, we determined it was not the right fit for our model. It's a very small transaction and it's more about CIT focusing on areas of strength and divesting of activities that are not aligned to our strategy.

We expect the deal to close in the coming months, and we will provide additional detail at that time. As I mentioned, we are unlocking synergies through the acquisition faster than anticipated and, as a result, will be realizing about $25 million of our 2021 cost saves ahead of schedule this year.

In recent years, CIT has proven time and time again that we have a culture of performance and the fortitude to deliver on our commitments and continuously improve. That spirit remains through this pandemic. We understand the economic disruption is not behind us yet. However, we took prudent actions in the first half of the year to anticipate the impact of this downturn based on the best available information.

While the environment remains dynamic, based on what we know today we are cautiously optimistic for the second half of the year and in our ability to restore a modest level of profitability assuming the macroeconomic environment does not deteriorate further. With that I'll turn it to John.

**John Fawcett**
Thank you, Ellen, and good morning, everyone. As mentioned, we reported a gap net loss of $98 million, or 99 cents per diluted common shared. And a loss of $61 million, or 62 cents per share excluding noteworthy items.

Our results this quarter continue to reflect the ongoing global pandemic and low interest rates as we manage through the current environment. Overall business activity slowed in the earlier part of the quarter, but in June we began to see activity pick up in many sectors where we have strong capabilities. Assuming there is no significant change in the current or forecasted macroenvironment or any expected credit performance of our portfolio, we expect to return to profitability and generate modest, positive earnings in both the third and fourth quarters of 2020.

Last quarter we were proactive in our implementation of CECL and appropriately added substantial reserves reflecting the COVID-19 environment. While this quarter's credit provision was considerably lower than in the prior quarter, it remained elevated as we continue to bolster reserves and incurred a $73 million charge related to the bankruptcy of a single factoring customer in the retail industry.

The factoring loss was a result of a unique circumstance directly related to the precipitous economic shutdown and store closures. While we have reserve for additional charges in the retain industry, we do not anticipate another single customer loss of that magnitude in our factoring business. Overall based on our forecasted view of the macroenvironment, we expect a provision to continue to moderate next quarter, obviously subject to conditions which remain fluid.

Our net finance revenue and margin were significantly impacted this quarter by lower market rates, primarily LIBOR which reduced our floating rate loan yields. In addition, we had higher levels of excess cash primarily due to strong deposit growth, which we estimate reduced our margin by 30 basis points, as it earned only about 10 basis points at the Fed.

We took actions to offset some of this margin pressure by lowering our deposit costs throughout the quarter. Particularly in our online channel, where we lowered our Savings Builder rate by 80 basis points to below one percent at quarter end. We utilized some of our excess cash to tender for our unsecured bank notes, repurchasing $235 million at a discount, recognizing a $15 million gain and reducing interest expense by approximately $7 million annually.

Assuming LIBOR rates remain relatively constant, we believe the margin has bottomed and we will see a 10 to 20 basis point improvement over the course of the third and fourth quarters as the benefits of lower deposit costs continue to be realized and we reduce our excess liquidity.

Other non-interest income was impacted this quarter by lower factoring commissions as volumes declined considerably due to retail store closures. We also had lower gains on asset sales, as we've suspended some of our portfolio management activities. Factoring volumes improved in the first half of July and we have been running at approximately 98% of 2019 levels as retailers replenish inventory.

While we expect factoring volumes and commissions to improve from the second quarter levels, uncertainty around the back to school season may temper that improvement. We are also seeing renewed opportunities to resume selling pools of loans in our legacy consumer mortgage portfolio and would expect to complete a transaction if existing conditions continue to prevail.

We continue to look for opportunities to improve upon our operating efficiency. This quarter we took a restructuring charge of $37 million primarily related to employee cost and contract terminations. $15 million was already planned as part of the Mutual of Omaha Bank merger and integration costs, while the other $22 million related to cost reduction initiatives that we expect to realize over the next 12 to 18 months.

We are lowering our full year 2020 operating expense target, excluding noteworthy items and intangible asset amortization by $25 million to approximately $1.185 billion, as we are realizing some of our 2021 cost savings ahead of schedule. This reduction includes the acceleration of cost synergies related to the integration of Mutual of Omaha Bank as we bring our two businesses together. In addition, we are responding quickly to the current environment which has allowed us to accelerate our plans to rationalize our footprint, including the optimization of former Mutual of Omaha Bank branches and the streamlining of office locations.

We plan to reduce our occupancy by 500,000 square feet, representing 30% of our total footprint. These actions are expected to result in an impairment charge of approximately $15 million in the fourth quarter with an estimated payback period of 18 months or less. We remain focused on continuous improvement and will provide an update to our [2021] operating expense target as we gain more clarity on the operating environment.

I will now provide some additional color on our operating trends and refer to our earnings presentation starting with net finance revenue and margin on slides seven and eight. As I mentioned, a sharp decline in both net finance revenue and margin were primarily driven by lower market rates and a higher mix of cash. Average LIBOR rapidly declined by around 100 basis points this quarter, impacting margin by approximately 40 basis points as our floating rate loan yields declined.

About 60% of our floating rate loans have interest rate floors, and since the downturn we have been getting LIBOR floors of 75 to 100 basis points on most new commercial loan originations and Commercial Finance and seeing improvement in spreads in many of our industry verticals. As I mentioned, the higher mix of cash coupled with lower rates also negatively impacted our margin by 30 basis points. We expect some of this to reverse as we deploy our excess liquidity and higher cost term CDs run off.

Lower Rail utilization of renewal rates as well as increase storage costs for cars off lease reduce margin by 10 basis points in the quarter. The North American industry Rail car fleet continues to be over supplied, with 32% of the fleet now in storage driven by the general slowdown in economic activity.

While our fleet is diverse and representative of the broader economy, many car types saw a reduction in utilization and pricing on new leases. Our Rail utilization declined approximately 300 basis points to 88% and lease renewals we priced down 30% this quarter, reflecting current market conditions and the mix of cars that came up for renewal.

In particular, sand cars used in the E&P space weighed heavily on repricing activity this quarter while grain cars, plastic colored covered hoppers, and certain box cars continue to renew at above average rates. Macro indicators in recent weeks are starting to show some rail recovery from COVID-19 as many factories have resumed at least partial production late in the quarter. And although still well below 2019 levels, rail loadings have improved over the past few weeks from the COVID-19 trough levels.

As the economy starts to recover and commodity prices drift higher, we expect rail utilization and pricing to improve. Although with a bit of a lag as excess capacity from cars in storage but still on lease will be brought online first. With that background, assuming the forecasted macro environment we anticipate a modest reduction in net rail yields over the next two quarters as leases continue to reprice down.

We expect utilization to push back up into the low 90% area over the next few quarters and improve to the mid 90% area by the end of 2021. We believe our young, diverse fleet with more high load capacity cars are competitive advantages, resulting in higher demand for our rail cars while sand cars used in E&P space, particularly fracking, are expected to continue to weigh on the recovery.

On the liability side, to offset the impact of lower rates on our assets, we have been aggressively lowering deposit costs. We improved our margin by 21 basis points in the quarter as CDs repriced lower and we lowered on non-maturity deposit rates across all deposit channels. The biggest rate decline in the quarter was in our Online channel where we lowered our Savings Builder rate by 80 basis points, ending the quarter below one percent.

We also grew average lower cost HOA and commercial deposits by about one billion dollars, further contributing to lower deposit costs. The HOA deposit channel reached its highest level ever at $5.3 billion and growth in commercial deposits who's driven by both new and existing commercial clients while costs declined by about 20 basis points.

As Ellen indicated, we are pleased with the progress we are making expanding these channels and remain on pace to realize growth projections in the HOA channel. As I indicated earlier, we expect the margins will improve over the course of the third and fourth quarters by 10 to 20 basis points as the full impact of the recent rate reductions are realized along with continued downward repricing for reduction in maturing CDs and growth of lower cost HOA and commercial deposit channels. In addition, we continue to look for opportunities to reduce non-maturity deposit rates while balancing our liquidity needs.

Slide 12 provides more detail on average loans and leases by division. Average loans and leases grew by two percent this quarter which includes the impact of increased defensive revolver draws in Commercial Finance at the end of March, new business volume in key sectors where we are seeing opportunities in the current environment and a lower level of prepayments.

End of period balances declined as repayment of factoring invoices outpaced new factoring volume and defensive revolver draws from the end of the last quarter were repaid. While origination volumes were down reflecting the current environment, we continue to close deals for our clients and are seeing opportunities in certain industry verticals. And equipment leasing, lending where we we have strong leadership as well as industry and asset class expertise.

New business activity in Commercial Finance was driven by key verticals such as Power and Renewables and Technology, Media, and Telecom which included opportunities for capital markets and derivative fees. As Ellen indicated, we are also seeing good opportunities in the current environment within Capital Equipment Finance. Overall pipelines and Commercial Finance are lower than last year, reflecting the business slowdown. But we continue to see increased activity in the areas I just mentioned along with Healthcare and asset-based lending.

We are also seeing wider spreads in structural improvements including LIBOR floors on new originations. In Business Capital, Equipment Finance is taking market share as other small ticket equipment lenders have paused or exited the market. We are also seeing increased demand in programs where we partner with technology manufacturers to provide financing to their customers.

In Small Business Solutions we are taking a more focused approach in providing lending in industries less impacted by the COVID-19 pandemic while pulling back from certain higher risk industries. Overall, Business Capital applications which had slowed considerably earlier this quarter have seen a pickup in the past several weeks as June origination volume increased to June 2019 levels.

We remain cautiously optimistic for an increase in origination activity in the third quarter in select areas. As Ellen mentioned, we continue to work with our customers to provide payment deferrals for qualifying customers impacted by the economic events brought upon by COVID-19. As of the end of the quarter, we had granted relief requests to about 1,700 consumer customers with a carrying value of approximately $630 million.

We also granted about $1.4 billion in relief requests for over 200 commercial transactions across Commercial Finance and Real Estate Finance as well as $550 million representing approximately 10,000 smaller ticket equipment contracts in Business Capital. And another $180 million over 100 contracts in our Small Business Administration business.

It is still early days as some of the first deferrals are just expiring. But so far, the trends are relatively consistent with our expectations. And we have been staying close with our customers. As an example, we conducted a comprehensive calling campaign making about 9,000 outbound calls to our Small Business Solutions customers over the quarter and continue to be in touch with them as their deferral period ends.

In our middle market loan book, we have not experienced a large second wave of deferrals yet, but expect deferral requests in the third quarter as borrowers begin refining their 12-18month financial forecasts. We are closely monitoring this activity and have provided some additional information on slide three of the presentation. Overall, we think average loans and leases will be relatively flat next quarter, reflecting the lower end of period second quarter balances and as we continue to support our customers and focus on our originations activity on strong risk adjusted opportunities that play to our strengths.

Slide 15 and 16 highlights our credit trends and provision. Net charge-offs increased significantly this quarter to $170 million. Apart from the one factoring customer bankruptcy of $73 million that I previously mentioned, net charge offs were $97 million, or 1.02% of loans. About three-quarters of which we already [specifically] reserved for and therefore did not have a [significant] impact on our provision.

The retail sector had been facing headwinds prior to this current crisis and we had been actively reducing exposure to trouble retailers prior to the onset of COVID-19. The $73 million charge related to a single factoring bankruptcy was unanticipated and a direct result of the retail shut down which precipitated a voluntary bankruptcy. While there were a number of retail bankruptcies this quarter, with the exception of the one I just mentioned we did not have exposure to those names, or we had previously exited or reduced our exposures to low levels prior to the bankruptcy.
We expect continued pressure in this industry, and we are monitoring the developments in this sector closely and remain in constant contact with our customers and clients. Our current factoring exposure in the retail sector is approximately $1.7 billion, down considerably from $2.9

billion at the end of last quarter as collections have outpaced new factoring volume, driven by store closures brought on by the COVID-19 pandemic.

In addition, only $250 million of receivables had extended terms at the end of June, down from $900 million in April. Our top 25 exposures include traditional retailers as well as well-known online, big box and discount retailers. The top five customers which are rated single A to double A comprise a little over 40% of total factored retail exposure. The next 10 largest exposures are between $25 to just under $50 million, of which five are investment grade with the largest being non-investment grade.

After that, the remaining customer base comprising approximately $600 million of exposure, is very diversified across approximately 28,000 accounts. As I mentioned, so far July activity has been surprisingly strong as retailers look to restock depleted inventory levels. We are also seeing strength in the furniture sector and increased factoring volume with discount retailers. That said, a second wave of COVID-19, which could result in reduced traffic and or store closures remains a concern.

We have a robust approval and monitoring framework in place to review customer exposures on a weekly and monthly basis, and where appropriate we continue to implement risk mitigation actions and price enhancements.

With respect to our credit reserves, this quarter we established reserves of $58 million on individually evaluated accounts and increased our collectively evaluated reserves by $107 million for on balance sheet exposures. This quarter, we utilized the June baseline scenario from a provider well known in the industry that assumed a more severe V-shaped recession and longer recovery than the March baseline scenarios that we had used to determine our credit provision in the first quarter.

We also applied a qualitative overlay for other factors that include macro uncertainty, model uncertainty, and sensitivity to changes in assumptions as well as additional risk to specific industries or portfolio segments such as oil and gas, factoring, and small ticket commercial loans. As a result, our coverage ratio increased approximately 40 basis points to 3.5% on commercial banking loans and 30 basis points to 3.2% for total loans.

Assuming no significant change in the outlook, we expect the provision to continue to moderate next quarter. Non-accrual loans increased significantly in the quarter, primarily driven by loans and Commercial Finance and Real Estate Finance. As Ellen indicated, we have put in place heightened monitoring to carefully watch specific industry trends and indicators of delinquencies.

In Commercial Finance, Real Estate Finance, and Rail, we have conducted a loan by loan review, identified high risk exposures, performed stress analyses, and prioritized our most vulnerable accounts. We are monitoring revolver advances and borrower relief requests for vulnerable borrowers on a daily basis. We have also adjusted our underwriting to reflect the current environment. We are individually underwriting each transaction request for modification in Commercial Finance and Real Estate Finance and Rail to ensure the borrower has a path to recovery.
We have restricted our underwriting of the most distressed industries and suspended auto decisioning in acute areas of risk. We are staying disciplined in our pricing and structures while continuing to evaluate opportunities that utilize our capital most efficiently. We have updated our

slides and the appendix for additional information on portions of our portfolio expected to be more impacted by the current environment.

Slide 17 highlights our liquidity position at quarter end. Our liquidity remains robust at both the bank and the bank holding company. During the quarter we issued $500 million of unsecured debt at just 3.929% at the bank holding company and our next maturity is not until March of 2021. And it's for the same amount with a coupon of four and an eight. At the bank we increased our available borrowing capacity at the federal home loan bank with the assets acquired from Mutual of Omaha Bank substantially increasing our sources of contingent liquidity.

Turning to slide 18, our common equity tier one ratio advanced 30 basis points in the quarter and remains strong at 10%, well in excess of the Federal Reserve's minimum levels with the capital conservation buffer. The growth in the ratio this quarter was driven by the decline in the end of period loans and a mix shift to lower risk weighted assets including cash and PPP loans, which have risk weightings of zero.

As the economy starts to recover and business activity improves, we expect the risk weighted assets to increase from the deployment of excess liquidity and a lower level of PPP loans. We also expect positive earnings will offset the deployment of capital. Over the next two quarters, assuming the current forecasted macroenvironment, we expect our common equity level to remain in the 9.8 to 10% range depending on the mix of lower risk weighted assets.

And with that I will turn it back over to Ellen.

**Ellen Alemany**
Thanks, John. As I've mentioned before, the work we have done to transform CIT over the last few years has strengthened us, tested us, and best positioned us to navigate this period. The business is diverse and adaptable, the company is as strong as its ever been, and our deposit costs are declining. The management team is seasoned, agile, and resilient. We established a considerable appropriate reserve in the first half to increase our allowance for credit losses and actively manage risk. And we are heading into the second half cautiously optimistic, but also mindful that this is a rapidly changing environment.

With that we're happy to take your questions.

**QUESTION AND ANSWER**

**Operator**
Thank you. We will now begin the question and answer session. To ask a question you may press "*" then "1" on your touchtone phone. If you're using a speakerphone, we ask that you please pick up your handset before pressing the keys. To withdraw your question please press "*" then "2".

Today's first question comes from Moshe Orenbuch with Credit Suisse. Go ahead.

**Moshe Orenbuch**
Great, thanks. John, you had talked about the 10 to 20 basis points recovery in the margin. I guess given the cuts you made in deposit costs, I'm surprised that it isn't bigger. Could you just

talk a little bit about what we might see in Q3 in terms of trends in the margin and in net interest income in dollars or net finance revenue in dollars? Thanks.

**John Fawcett**
Yeah, so, Moshe, it's important I think to have a perspective on when the cutting began. And so, I think if very early you looked in the second quarter, we put our toe in the water a little bit and we had some very minor cuts across April because we were concerned about that there would be significant amounts of attrition. As we've gone further and further, we've realized that a lot of the strategy that we built out in the non-maturing portfolio in the online bank is actually taking hold.

And across 13 weeks in the quarter we've actually reduced rates 80 basis points across 10 cuts and actually had consistent growth across all 13 weeks. Which is kind of interesting. So, to answer your question, we expected a lot of the benefit that will go through that, in terms of the cuts that we need in the second quarter, will continue to play through into the third quarter and beyond.

Separately what I would say is is that we think that there is continued opportunity to kind of drag pricing down even further, especially in the non-maturity deposit space. But I think across the board we've done actually a pretty good job in terms of all the deposit channels. In terms of the broader question around net interest income, you know the second quarter was pretty challenging. I think it was, you know, clearly the bottom for us. And just in terms of business volumes, I think in my script, we talk about Business Capital kind of coming back online.

We're starting to see some green chutes come out of the factoring business through the first I want to say 17 days of July, factoring volumes were at 97% of what they were last year. Business Capital which was down 30% in the first quarter actually hit what it had done in June of 2019. Our Business Capital guys are now thinking that notwithstanding the impact of the second quarter we expect to get to 90% of origination volumes.

And so, the business feels like it's transitioning. And these are essential use equipment in Business Capital. It's our fastest growing business in terms of imaging technology and phone systems.

As I said, more runway in the deposits. We know that there are some deposit cliffs in CDs that will reprice down substantially and also lead to some runoffs. And I think the lower rates may push some of the excess liquidity out at the same time as business starts to re-inflate. Hopefully it'll consume with some of the excess liquidity.

You know, I'm not going to give you dollar amounts in terms of what expectations are in the third and fourth quarter. It's obviously incredibly fluid and as we've said, these are modest levels of returns of profitability. I think the last driver in the net finance margin and net interest income is obviously going to be around rail. And so, we've again started to see some green chutes in Rail. And it got whacked pretty good in the second quarter but coming into June and July what we've seen in terms of Rail loadings, that's actually started to go up.

And so, we expect the utilization will continue to crawl up. We've seen hopefully the worst in terms of storage, freight, and switching costs. And you know, renewal rates notwithstanding the fact that utilization will increase, renewal rates we're still forecasting to be down around 20% until we see some of the larger North American excess capacity utilized.
**Moshe Orenbuch**

So maybe if I could just take this from a slightly different angle, you had PPNR that was about $200 million in the fourth quarter down to $180 million in the first quarter. Maybe $110 million or so this quarter. You know, that would benefit from some of the things you talked about on the fee income side and expenses. I mean I guess are you confident that number will be higher in the third quarter?

**John Fawcett**
Yeah, I am confident. I mean based on what we're seeing now, look. These are very fluid times. And so, at this nanosecond I feel pretty confident that the third quarter's going to be better. As you start to look at non-interest income as I said we're seeing factoring volumes kind of ramp back up. Rail sales in the second quarter were slightly diminished and a little bit off of what our forecast was of 20. We expect we'll be on 20 as some of the dislocation in that market normalizes.

We completely suspended legacy consumer mortgage portfolio sales in the second quarter. The pricing had just completely collapsed and we're not distressed sellers. And so, we just took a pause. We expect that the activity that we didn't see in the second quarter will transition into the third quarter and we'll probably see a double size sale. What comes with that is not only the gain on the disposition of the LCM portfolio but also a provision release related to the gross up of purchase account accretion. Securities gains should hold in and capital markets fees I think will continue to kind of trend as the market starts to advance.

And then I think on expense we're all over expenses. You know, reducing our footprint by 30% and taking out another body of heads. We're very focused and so--

**Ellen Alemany**
--We accelerated another $25 million in expenses this year from Mutual of Omaha that's supposed to come out next year. I would say business overall is significantly up in June. I would say in commercial April and May were very slow, but we really started to see increased activity in June in certain industry verticals. And in Business Capital we had the same volumes in June as we had June of last year. And its technology related mostly. It's lender finance and business capital.

So, we think we're really, you know, well positioned in some of these industry niches right now. And as John mentioned, you know, in rail we think we've seen the trough in rail. Basically, with the U.S. China phase one trade agreement we're seeing renewed activity in Rail. We had a really large order. We've seen the largest corn order from rail from China recently. And we also think that the trade one agreement is going to impact other markets like crude oil, refined products and housing activity balances driving some demand for lumber products.

So we're seeing some activity there.

**Moshe Orenbuch**
Great. Thanks very much.

**John Fawcett**
Of course.

**Operator**
And our next question today comes from Arren Cyganovich with Citi. Please go ahead.

**Arren Cyganovich**
Thanks. The net finance margin I think you mentioned was depressed from excess cash. I think you said around 30 basis points. How much of that is incorporated in the improvement of 10 to 20 basis points and, you know, I guess how do you expect to deploy that cash over the coming quarters?

**John Fawcett**
Well hopefully, these two things that are the principle dynamics, one is is that as we continue to reduce pricing on the deposit product you would expect to see some deposits attrite and I think that's okay. I think the other thing is is that we've got some fairly high deposit cliffs that are actually coming in terms of CDs across the third quarter. And so, some of that will attrite.

What would be best is if we could actually put the deposits to work in growth that we're seeing on the balance sheet as we kind of re-inflate. I think the interesting thing about the whole deposit phenomenon is the last time this happened, it happened during the financial crisis of, '08, '09 and '10. And if you looked at, you know, surge deposits, which is I guess what they call it now. But hoarding of cash now, the hoarding of cash like the quality, exit of equities and money market funds, delayed investments, all of that kind of activity, that actually ran its course over four or five years and so, hypothetically, this could be something that we're living with for a long time. Not just us but all banks as cash continues to be, you know, trapped in a balance sheet. I think what's different about this financial crisis is, this one's bacterial. The last one was a real financial crisis.

And so as, you know, vaccines and we start to live with this maybe it'll be a little bit different. But right now, we're sitting with two to three billion dollars of excess liquidity in cash on the balance sheet. And the expectation is it will start to moderate. But it's anyone's guess as to how long it will take. We will be aggressive in terms of lowering our rates and I think that that'll take care of some of the problem. But it might be a multi-quarter issue for sure.

**Arren Cyganovich**
Okay. And then on the payment deferral side, frankly I'm a little bit surprised that some of the deferral numbers are low. Just I guess for example Real Estate Finance. I think there's only five percent of the total. You know, compared to some of the other statistics I've seen from other banks. And then concurrent with that is the NPA's rising. You know, what are the situations where you have stuff that is moving to NPA versus getting a deferral and what are those situations where it just is so dire that you, you know, can't seem to be able to even come up with a plan from a deferral strategy?

**Ellen Alemany**
Marisa, you want to comment on that?

**Marisa Harney**
Yeah. I think there were three questions in there. Let me see if I can get them. The low level of deferrals I would say we took an early approach to, and I don't know how different we are from others. I've had some anecdotal feedback. But we were pretty cautious with granting deferrals. For example, although you can have a deferral for up to 180 days, we chose to do a 90-day deferral with a subsequent 90 days upon further information.

We also have a commercial book that has a lot of private equity structures in it. And in many cases although, you know, the operation of a company might be stressed due to the pandemic the sponsor continues to have liquidity to support, and this is particularly true in Real Estate Finance, to support those borrowers.

And so, we chose not to automatically grant a deferral or to push a deferral in those situations but rather to press investors to try to solve that with some liquidity. And that in particular is true in Real Estate Finance which tends to be a more institutional book and therefore has more, you know, well-heeled sponsorship behind it.

With respect to NPAs, we took the approach that if a business, an operation was shut down or had significant disruption due to the pandemic, however we felt that the recovery period whenever and wherever that might be was going to be particularly extended and would result in that particular business not being restored to its, for lack of a better term, normal, whatever that is, state, that we would handle that as we would normally handle a credit that was distressed.

So, for example, if a hospitality property is closed, we feel that the hospitality industry has a long recovery ahead of it. That's also true for passenger airlines for example. And in those cases, and those are two areas that drove our increase in NPAs this quarter.

**Arren Cyganovich**
Okay. Thank you.

**Marisa Harney**
Sure.

**Operator**
Ladies and gentlemen, as a reminder, if you'd like to ask a question please press "*" then "1" at this time. Today's next question comes from Vincent Caintic with Stephens. Please go ahead.

**Vincent Caintic**
Hey thanks, good morning. Two questions. First one a quick one on just how you're thinking about the dividend. So, your capital levels have remained strong but I'm wondering if there are any changes to your thinking about the dividend level just given that EPS coverage has been low with the past two quarters.

**John Fawcett**
Look, I think it's a quarter to quarter exercise. I think it's obviously a conversation we have with our board. I think it's obviously a conversation that we have with our regulatory partners. You know, my view is is that we're in a good place. I think we've been very good stewards of capital. You know, when you think about the Mutual of Omaha Bank transaction, well ahead of that transaction, we suspended share repurchases. We've always maintained a fairly modest dividend to payout ratio, [and[ to the extent that we believe that we're returning to modest level of profitability.

It feels like the horses are out of the barn. We've kind of done a significant amount of reserving in the first quarter and took our lumps in the first quarter and augmented that in the second quarter. The impact on common equity tier one ratio is about seven basis points. You know, we have ample liquidity at the holding company, ample liquidity at the bank. You know, and the principle driver of the first half financial performance has been provision, which essentially is a transfer of loss absorbency from capital to ACL.
And, you know, if you actually want to get wonky about [SR] 09-04 which actually governs our ability to pay dividends and the conversation we talked to the Fed about, it was written in 2009

when gap relied on incurred losses and less on the notion of the crystal ballism embedded in CECL. So, there's a kind of very fundamental misalignment between supervision and regulation guidance established in 2009 phase GAAP which accelerated loss recognition in an almost spontaneous way.

And so that's a challenge. And I guess the last couple of points, and you said it, is you know, our capital ratios are strong and above capital conservation buffers. And we've maintained a very robust capital planning process. So, notwithstanding the fact that we're not a CCAR bank, we're no longer a SIFI. I'm not sure why we ever were. But we've maintained all those protocols and I think our regulators understand that and appreciate the fact that we didn't throw out the baby in the bathwater.

We've continued to operate with very heightened standards around capital and capital planning. That's a long-winded way of saying I'm pretty relaxed with it. One man's view.

**Vincent Caintic**
Okay, great. Thank you, very helpful. Second question. So, you had commentary, your commentary on June is, you know, was very positive and your baseline assumptions for a V shaped recovery. Just wondering if you've had maybe any updates from July so far. If there's been any let up just from what we're kind of seeing in the news about maybe a second wave or some states shutting down. Just any updates from what you're seeing here. Thank you.

**Ellen Alemany**
The business volume, you know, we do monthly reviews with the businesses. And, most of that activity was, June reported activity and it's very, very current. And Marisa can you just comment on the credit side if you've seen anything in terms of pockets.

**Marisa Harney**
Yeah, no. I mean obviously we're watching the situation very closely. Clearly at the end of March the economy was shocked by a complete shutdown. My opinion, I don't think we're going to see a wholesale nationwide shut down again. I just don't think it's politically expedient.

However, local markets are clearly experiencing a variety of different stresses. Probably the finger on the pulse of that is in our factoring business where clients who are typically, you know, wholesalers or manufacturers are seeing orders pick up as retailing has opened. And we're still seeing factoring volume pretty strong at the beginning of the month of July. But it's obviously kind of too soon to tell whether we're going to see, you know, significant shutdowns ordered, or involuntary, meaning people just don't show up in some of the bigger markets.

But no. I don’t see anything particular that's changed in credit between June and July.

**Vincent Caintic**
Great. Thank you very much.

**Operator**
And ladies and gentlemen this concludes the question and answer session. I'd like to turn the conference back over to the management team for any follow comments.

**Barbara Callahan**
Thank you everyone for joining this morning. If you have any follow up questions, please feel free to contact Investor Relations. You can find our contact information along with other information on CIT at CIT.com. Thank you again for your time and have a great day.

**Operator**
Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.