CIT Group
Q2 2017 Earnings Conference Call
July 25, 2017 at 8:00 a.m. Eastern

CORPORATE PARTICIPANTS
Barbara Callahan – Head of Investor Relations
Ellen Alemany – Chairwoman and CEO
John Fawcett – CFO
Rob Rowe – Chief Risk Officer
PRESENTATION

Operator
Good morning, and welcome to CIT’s Second Quarter 2017 Earnings Conference Call. My name is Keith 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. When the question session begins, you may ask a question by pressing star then one on your touch tone phone. Press star then two to remove yourself from the list. If at any time during the call you require assistance, please press star and zero and an operator will be happy to assist you. As a reminder, this conference call 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
Good morning, and welcome to CIT’s Second 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 any 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 in the Investor Relations section of our website at www.cit.com.

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

Ellen Alemany
Good morning, everyone and thank you for joining the call. I want to first start off by welcoming John Fawcett, our new CFO. As you may know, John joined CIT at the end of April and he brings extensive banking experience with him. The transition has been seamless and we are happy to have him here.

Now, turning to results. The second quarter was another period of tremendous progress as we continue to advance our strategic plan to strengthen and simplify the company. Let me share some highlights. As you know, we completed the sale of Commercial Air in early April, and quickly initiated nearly $9.5 billion in capital and liability management actions during the quarter. We reduced our unsecured debt by $5.8 billion, thereby decreasing our reliance on the wholesale funding markets. We repurchased $3.3 billion of common stock and we issued $325 million of tier 1, qualifying preferred stock at a 5.8% dividend, which created a more efficient capital composition.

I’m also pleased to report that we received a non-objection on our 2017 capital plan, which included up to $225 million in common stock repurchases over the next four quarters. On the simplification front, we reached an agreement to sell NACCO, our European rail leasing business and our last remaining ongoing overseas business. We expect the deal to close in the fourth quarter and this transaction further supports our shift to a largely deposit-funded business model.
During the quarter, we also made progress in resolving legacy reverse mortgage matters related to the OneWest acquisition. We reached agreements to resolve certain servicing related obligations with the HUD OIG and DOJ, as well as with the FDIC and Fannie Mae and we are pleased to have these issues behind us. We remain on track to achieve our operating expense target in 2018.

Turning to performance in the quarter, we posted net income of $157 million or $0.85 per common share in the second quarter. Results were affected by a number of noteworthy items related to the strategic transformation and, when excluding those, we posted $126 million in net income in continuing operations or $0.68 per share. John will provide more detail on our financial results shortly but I first wanted to touch on a few key business updates.

Our funded volume was up from last quarter but our overall asset growth was affected by higher pre-payments in commercial finance and real estate finance divisions. While it’s still early days, the lending pipeline is looking positive for the second half of the year.

Our strategic focus is to be the leading bank serving the middle market and small businesses nationwide, and we continue to make progress in repositioning the business, tapping into our core strengths and pursuing growth strategies that are in line with our plan. A few weeks ago, we announced a partnership between our commercial finance business and Allstate. This joint venture allows us to draw upon our ABL origination capability as well as provide another avenue for revenue growth from our minority interest and fee income from our role as investment advisor. While we expect the near-term financial impact to be modest, there is potential to grow this venture over time.

Shifting to business capital, today the Equipment Leasing and Finance Association announced that the Direct Capital Unit was recognized with an Excellence Award for the digital solution we created for a major technology client. The platform enables small businesses to shop online and receive business financing for technology products in a fast and simple way. This is an example of the client-focused approach we take day in and day out.

Adding to our momentum, CIT Bank was ranked for the first time on the American Banker Reputation Institute Annual Survey of Bank Reputations and the bank was listed in the top five by our customers. We are very encouraged with the progress we are making in transforming the company.

On the deposit front, we continue to manage pricing thoughtfully despite being in a rising rate environment and are working to improve our product mix. For example, at our National Direct Bank CIT Bank, we recently launched a premier, high-yield savings account which will contribute to our shift from time deposits. This product is for new customers and is structured to target the optimal segment for the Direct Bank, the more affluent savers.

Before I turn it to John, I want to highlight page 2 of the slide deck, which is where we have provided a bit more context on our strategic priorities to simplify, strengthen and grow CIT. This is the roadmap: maximizing the potential of our core businesses—we have really strong franchises and deep expertise in a number of industry segments and we plan to drive more connectivity across the businesses to unlock the full potential; enhance our operational efficiency through expense reduction and technology improvements; reducing our overall funding costs by continuing to increase our percentage of deposit funding; optimizing our capital structure by efficiently managing and deploying capital and maintaining a strong risk management framework. We remain focused on attaining a 10% return on tangible common equity by the end of 2018 and this is the path that will drive us.

With that, let me turn it to John.
John Fawcett
Good morning, everyone and thank you, Ellen. It’s great to be here at CIT. Turning to our results on page 3 of the presentation, GAAP net income for the quarter was $157 million or $0.85 per common share, and income from continuing operations was $41 million or $0.22 per common share.

On page 4, you will see the volume and magnitude of noteworthy items, primarily related to the successful disposition of Commercial Air, had a meaningful impact on our results in both continuing and discontinued operations. Income from continuing operations, excluding noteworthy items, was $126 million or $0.68 per common share this quarter.

Noteworthy items in continuing operations were mostly related to our liability management actions as we reduced unsecured debt by $5.8 billion in the quarter. We also incurred excess interest expense in net finance revenue from the timing difference between when we received the proceeds from the Commercial Air sale in early April and when we completed the liability and capital actions in May and June. The timing difference also impacted continuing operations, interest-bearing deposits as well as average earning assets in the quarter.

Most of the impact of noteworthy items in discontinued operations was from the recognition of the gain of the Commercial Air sale. I would like to note that the total impact of the sale in the second quarter was a net loss of $9 million, better than our previous estimate of reduction to net income of $140 million, mainly due to lower-than-expected related taxes. Details of the impact from the sale are laid out on page 27 of the earnings presentation.

Turning to page 5, income from continuing operations excluding noteworthy items, was up from $109 million or $0.54 per common share last quarter, and $94 million of $0.46 per common share in the year-ago quarter. Details of all noteworthy items for the current, prior and year-ago quarters are listed on page 21 of this presentation.

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

Turning to page 6 of the presentation, net finance revenue was down $13 million from the prior quarter resulting in a 13 basis point reduction in margin. Compared to the year-ago quarter, net finance revenue was down $31 million while the margin was down 19 basis points.

Page 7 describes the change in net finance margin from the prior quarter and year-ago quarter in more detail. The reduction from prior quarter was primarily due to higher borrowing costs resulting from the change in interest expense allocated to discontinued operations between the prior and current quarters. In the prior quarter, approximately $15 million of interest costs were reflected in discontinued operations which is now in continuing operations. However, when compared to the year-ago quarter, borrowing costs have remained relatively stable.

We have excess liquidity at the bank holding company and are currently reviewing opportunities to further reduce debt which will help reduce our overall interest expense. Absent that noise, net finance margin was also negatively impacted by 3 basis points this quarter from a decline in net operating lease revenue in rail. Offsetting these reductions by 6 basis points was an increase in purchase accounting accretion and pre-payment related fees resulting from higher pre-payments in commercial banking.

Growth in the investment portfolio, yield changes on our loans resulting from an increase in LIBOR and
the mix of assets, added 2 basis points to the margin this quarter. Compared to the year-ago quarter, the decline in net finance margin was primarily due to lower net operating lease revenue driven by a reduction in rail yields of approximately 150 basis points as leases re-priced down and utilization remained constant. We expect this trend to persist through 2018 as more tank cars carrying crude come up for renewal. We also had a 5% increase in rail maintenance costs reflecting lease transition and other carrying costs. In addition, purchase accounting accretion declined which was offset by improvements in our loan yields, investment portfolio growth and lower deposit costs.

Turning to page 8, other non-interest income was relatively flat compared to prior quarter and down compared to the year-ago quarter. The year-ago quarter included mark-to-market benefits on certain securities and the total return swap. As you may recall, a large component of the total return swap was terminated in December which significantly reduced the mark-to-market volatility in our earnings.

Turning to page 9, operating expenses before the amortization of intangibles were $286 million, down $5 million from the prior quarter and $7 million from the year-ago quarter. The current quarter reflects lower professional fees as we completed our CCAR process, partially offset by higher advertising and marketing costs related to our deposit strategy. Compensation costs were up from prior quarter reflecting non-restructuring severance charges of $3 million that were partially offset by seasonal declines in payroll costs. We also incurred a $5 million charge this quarter related to the NACCO business that is non-recurring. We continue to be on track with our cost savings target for 2018 but certain planned expenditures in the second half of the year, particularly in information technology, are likely to offset additional savings during that period.

Page 10 describes our consolidated average balance sheet which includes discontinued operations. With the sale of Commercial Air, the only remaining items in discontinued operations relate to the financial freedom reverse mortgage servicing operations and Business Air. With respect to continuing operations, you can see from the pie chart that more than 80% of our average loans and leases are commercial, and now less than 20% of debt is funded in the wholesale markets.

Turning to page 11, commercial banking's average loans and leases have been relatively flat, notwithstanding our portfolio repositioning initiatives in commercial finance, which were designed to focus on more strategic customer base. Over the past five quarters, we sold almost $1 billion of loans and leases of which over $600 million was in commercial finance. Loan growth in commercial finance and real estate finance was also impacted by higher pre-payment activity. You can see from the chart that business capital's average loans and leases grew over 10% from the year-ago quarter, while rail's growth is primarily from the order book. Rail's utilization rate has been holding steady at 94% over the past four quarters, while taking delivery of almost $600 million of cars from the order book. Our remaining order book in North America is currently $100 million, primarily comprised of covered hoppers which will be delivered over the next 18 months. The continued runoff of legacy consumer mortgage business was the driver of the reduction in average loans in consumer banking.

Page 12 highlights the improvement in our funding mix. Deposits increased to 75% of our total average funding this quarter, while unsecured borrowings declined to 15% from 22% a year ago. The loan and lease-to-deposit ratio for the company declined to 1.2 times from 1.5 times while the bank remains at 1 to 1.

Page 13 illustrates the deposit mix by type and channel. Average deposit cost increased four basis points from the prior quarter reflecting a shift in mix away from higher beta commercial deposits with certain clients that were below the average rate but would have re-priced above it this quarter. Deposit cost declined by one basis point from a year ago despite three rate hikes. You can see in the upper chart that we have been shifting the mix over the past year from time deposits to non-maturity deposits.

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The bottom chart highlights the reduction in deposits in the higher cost brokered channel.

Page 14 highlights our credit trends which continue to reflect a favorable credit environment, and we are seeing no substantive change in overall trends. The credit provision was $4 million this quarter, well below the normalized run rate and principally reflects lower loan balances and net credit benefits from changes in portfolio mix within commercial banking. Non-accrual loans remain at 0.9% of total loans, while the allowance for loan losses in commercial banking is 1.78%, down slightly from prior quarter, reflecting charge off of previously established specific reserves on impaired loans and up slightly from 1.64% in the year-ago quarter.

There have been a number of questions on our retail exposure and we added slide 15 to help illustrate how we think about it. There are certain segments of the retail industry that are being impacted by e-commerce, shifts in buying patterns and, in some cases, exacerbated by highly-leveraged capital structures. These include department stores, apparel, electronics and others. Our exposure to retailers in these affected segments is approximately $930 million, which represents 2.6% of our total loans and leases. I would point out that about a third of this exposure is related to loans in our real estate finance division, of which less than $75 million is related to malls.

Finally, this does not include exposure and commercial services, our factoring business, whose exposure to these retailers is limited to short-dated trade receivables of 60 to 90 days. I’d also emphasize that our lines in commercial services are completely discretionary. We also updated our energy exposure which can be found later in the appendix. Our lending exposure is a little over $600 million, split between E&P, midstream and energy services loans and we comfortable with the exposure, the carrying values and the reserves.

Turning to capital on page 16, during the quarter, we repurchased $3.3 billion of common stock, including $2.75 billion tendered at $48 per share, $38 million through open market repurchase at $46.45 per share and the remaining $512 million through an ASR which will be completed by the end of September. These actions reduced the number of shares from 203 million at the beginning of the quarter to 135 million as of June 30th.

As Ellen mentioned, we are very pleased with the execution on the $325 million preferred stock issuance. The 5.8% dividend is in line with higher-rated issuers. On this slide, you will see our capital position remains strong with a common equity tier 1 ratio of 14.4%, up slightly from the prior quarter as the reduction in common equity was offered by a reduction in risk-weighted assets and a capital build from net earnings. And, as Ellen mentioned, we received approval for our capital plan which will allow us to increase our dividend up to $0.16 per share starting next quarter and to repurchase up to $225 million of additional shares over the next four quarters.

Our normalized effective tax rate was approximately 35% excluding discrete benefits from a resolution of a legacy tax item and the recognition of a deferred tax asset related to the pending NACCO sale. Finally, in financial freedom which is in discontinued operations, we settled our servicing-related obligations with the FDIC, Fannie Mae and HUD OIG, which enabled us to release some of the interest curtailment reserve. We also took an additional impairment on the mortgage servicing rights. These items resulted in an after tax net benefit of $12 million.

Page 18 provides our current outlook for the second half of 2017. Based on what we are currently seeing for the second half of the year, we expect to grow our average loan and leases of the core business in low, single digits with most of the growth in the fourth quarter. Excluding the impact from the sale of NACCO, which we expect to close sometime in the fourth quarter, total loans and leases in the second half of the year are expected to be flat, given the runoff portfolios. We continue to expect
net finance margin to be in the mid to upper end of the target range, or $325 million to $350 million, reflecting headwinds from rail and the runoff of purchase accounting accretion, partially offset by an increase in income from the investment securities portfolio build out.

We continue to expect the credit provision to be within the target range of 25 to 50 basis points of average earning assets. Going forward, we will migrate this metric to be a percent of average loans. With operating expenses, we expect further improvements to be offset by investment expenditures this year, particularly in the information technology area, and remain on target to meet our expense reduction commitment in 2018.

Our normalized effective tax rate has been running in the mid-30% range. As noted on slide 28 of the presentation, although we paid minimal cash taxes, we utilized $4 billion of the $6 billion Federal net operating loss with the Commercial Air sale. At the end of 2016, and pro forma for the sale, approximately $2 billion of the Federal NOL remains of which $1.3 billion is still subject to limitations.

As mentioned last quarter, we designed our CCAR to achieve a common equity tier 1 ratio of approximately 11% towards the end of 2018. This is at the upper end of our target common equity tier 1 ratio of 10% to 11% and remains subject to regulatory approval.

Before I turn it back to Ellen, I wanted to address some questions regarding the financial impact from the sale of NACCO, our European rail business. As indicated, we expect the transaction to close in the fourth quarter following approvals that are mostly anti-trust related, principally in Europe. We are selling approximately 14,000 freight cars, or $1 billion in assets, including $65 million in goodwill and we expect a modest after-tax gain after transaction costs. We expect the transaction to create $250 million in excess capital from the RWA reduction as well as a reduction in goodwill.

We currently fund the business with local debt of $250 million, which is expected to transfer to the buyer and unsecured debt of $500 million which will create excess liquidity at the parent. After the sale, we expect a reduction to pre-tax earnings of approximately $20 million to $25 million on an annual basis, depending on the amount of allocated cost that will remain and assuming the repayment of unsecured debt. Assuming the capital is returned and debt is repaid, the transaction is expected to be modestly accretive to return on tangible common equity.

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

Ellen Alemany
In closing, I want to say that we’re encouraged by our significant progress to deliver on what we said we would do. We know there’s more work ahead and we have our roadmap to simplify, strengthen and grow the company. We’re focused on our five priorities: maximizing the potential of our core businesses, enhancing our operational efficiency, reducing our overall funding costs, optimizing our capital structure and maintaining strong risk management practices. We remain committed to delivering on all of these dimensions over the next six quarters.

With that, let me turn it back to our operator, Keith, for Q&A.

QUESTIONS AND ANSWERS

Operator
At this time, we will begin the question and answer session. If you would like to ask a question, you may do so by pressing star then one on your touchtone phone. To withdraw your question, please press star then two. If you’re using a speakerphone, please pick up your handset to ensure good
sound quality. Again, that’s star then one to ask a question, star then two to withdraw the question.

This morning’s first question comes from Mark Devries with Barclays.

Mark Devries
Yes, thanks. My question is around the NACCO sale. I think you indicated that it should free up $250 million of excess capital. Would you anticipate seeking approval from the Fed when that closes to return that capital and also, should we expect that more towards the back end of 4Q than the beginning?

John Fawcett
Yes. If you were going to model it, I’d probably model it in the beginning. We’d like to get it done sooner rather than later. I think what we have in the box right now is an early November close but obviously it’s subject to regulatory considerations in Europe.

In terms of the capital, I think it’s part of a larger overall capital question and I think we’re looking at all of our options that are available to us. This just becomes a part of a larger problem in terms of how do we get the capital returned. I think it’s just going to be part and parcel of an issue we’re already grappling with.

Mark Devries
But I think in the past, a lot of institutions that have sold assets within CCAR cycle have often sought and gotten approval. Do you think that would be any different for you?

John Fawcett
I don't think it would be any different but I think if we’re going to make the ask for $250 million, it’s conceivable that given our common equity tier 1 ratio is at 14.5% that we’re going to probably look to do more than that. That’s why I think it’s not going to be necessarily a one-off. It conceivably could work out that it will be a one-off but I think we’re going to probably go for a more comprehensive phased solution to get us to where we need to be by the end of 2018.

Mark Devries
Got it. Thank you.

Operator
The next question comes from Ken Zerbe with Morgan Stanley.

Ken Zerbe
First question, just a really quick one, the $150 million expense cut target that you guys have by 2018, does that include the lower expenses associated with businesses you sell like the European rail business or is that excluding all the sales? Thanks.

Ellen Alemany
It excludes them, the asset divestitures.

Ken Zerbe
So, in essence, your expenses will go down more than the $150 million when you sell European rail.

Ellen Alemany
Correct.
Ken Zerbe
Then just a follow up on the loan comment—that they would accelerate in fourth quarter. Can you just explain that a little bit more? Presumably it sounds like third quarter based on what you’re seeing might be a little weaker but why would it accelerate in fourth quarter? Was there something unusual about that particular quarter? Thanks.

Rob Rowe
The pipeline, actually, is a little bit stronger right now than it was at this time three months ago so we are seeing some positive activity in market conditions in the commercial finance space. The reason for the fourth quarter is the pre-payment activity was fairly high in the second quarter and so that was a little bit different than the norm and we would expect, based on the typical cycles that by the end of the year, we would see the upward trends holding strong. We’re not saying that in the third quarter that wouldn’t be the case. We’re just saying that over a longer period of time, we would see that the pipeline is starting to show up in the asset growth.

Operator
The next question comes from Moshe Orenbuch with Credit Suisse.

Moshe Orenbuch
Could you talk a little bit about your plan to reduce that, I don’t know what you’d call it, the stranded debt that’s being moved back to continuing ops and obviously that’s going to increase with the sale of NACCO, the timing and cost of doing that?

John Fawcett
I think one of the challenges around the interest expense is there’s two elements to it. The first one is, obviously, the timing difference of when we settled the Air transaction and when we actually did the debt and I think the second issue is around the geography differences between continuing and discontinued operations. I think to the extent that a lot of these are driven by those geography challenges, that will be kind of self-curing into the third quarter.

I think the other thing, in terms of the excess liquidity of the franchise, obviously there’s an opportunity to reduce unsecured debt but at the same time, I think we’re also looking to kind of deploy some of the capital in terms of building out the investment portfolio. It’s still kind of early days for me here and so I think we’re working through all the arithmetic in terms of how to most opportunistically use the liquidity but we recognize that we have it.

Moshe Orenbuch
I guess I’m going to have to come back on this because the increase in interest expense, even if you ignore the piece that related to stuff that was kind of self-curing during the second quarter, is still roughly $100 million at an annual rate or just over $90 million so I guess that’s what I’m trying to understand and you basically just told us that the NACCO would kind of free up another $500 million of corporate debt. So, how does that interest expense either get reduced or offset and over what time frame?

John Fawcett
As I said, it’s going to be self-curing in the third quarter. I think we’re going to look at opportunities to repurchase the debt. The expectation is on the $500 million of unsecured debt that, in the holdco related to the NACCO sale, we would expect that that would go with the transaction, or be redeemed or settled as part of the transaction. Separately, as I said, in the broader context of liquidity, we’re looking to reduce other aspects of the debt structure as well. I can’t tell you any more than we’re looking and...
evaluating options around deploying liquidity.

Operator
The next question comes from Owen Lau with Oppenheimer.

Owen Lau
Good morning and thank you for taking my question. So, CIT has been selling on core and on US-based assets and it is looking more like a regional bank. In the K, it mentioned that CIT stopped funding the old [ph] Maritime transactions. Can you talk about the strategy of this portfolio? Are you going to run it off or sell it? Thank you.

Rob Rowe
For us, Maritime is about $1.3 billion of outstandings right now. We had peak about $1.7 billion. Because of market conditions in the space, we have not been doing new deals. As you know, many of the charter rates and the spot rates in the Maritime space have dropped a lot over the last few years. That has not impacted the quality of the credit portfolio because we underwrote these at 50% to 60% loan-to-values but it has impacted the ability to do new deals. If market conditions improve to our liking, certainly we are ready to finance some more opportunities in Maritime. It’s really a reflection of market conditions, not necessarily risk appetite.

I would add that Maritime, for us, we have many US borrowers that play in that space, the US dollar loans, and so although not typical for a regional bank, we find that they’re pretty good risk-adjusted returns.

Owen Lau
That’s good color. If I may, then how should we think about their earnings contribution and capital allocated to this portfolio? Thank you.

Rob Rowe
I don’t think we would want to get into the details of the capital assigned to a particular portfolio, but this is consistent with fixed asset lending that we do at the firm in many other asset classes so we don’t really see it any different than that. The yields are pretty solid compared to the other fixed asset lending that we do and, as I said, we have been doing it for five years and have not had any credit losses at all on the portfolio in somewhat difficult market conditions.

Operator
Once again, please press star then one if you would like to ask a question. The next question comes from Arren Cyganovich with D.A. Davidson.

Arren Cyganovich
John, just kind of touching on the comments you made on the capital return. You’d indicated a comprehensive phase solution by the end of 2018. Does that include an intra-CCAR result ask given that you have the ability to do that with the, kind of on Mark’s question, with the sale of the assets or are you just thinking about the longer term and having to wait? Because it’s a pretty big delta from $225 million you got approved for this year versus the $1 billion plus that you have to return to get to the target level.

John Fawcett
I probably can’t give you too many specifics. Again, very early days for me but I think we’re going to do everything we can—we understand the challenge we face, we understand the return of capital objective
and we’re going to press all the buttons and pull all the levers. I’ve met with the Fed team in New York and I haven’t been down to Washington. I think it’s important that the right people get in the right seats before we even begin to have some of these conversations. So I don’t want to talk on an earnings call before I’ve even talked to our regulators in terms of what the art of the possible is. You should probably take solace in the fact that we are going to be looking at everything and understand what our obligations are in terms of returning the capital to shareholders or otherwise deploying it.

**Arren Cyganovich**

That’s fair enough. It’s a high quality problem so I appreciate that. Then, Ellen, in terms of the lending pipeline that you mentioned being stronger in the second half, can we have a little bit more detail in terms of what areas that might be—are they traditional middle market loans, ABL, maybe some specifics on what’s driving that M&A activity etc.?

**Ellen Alemany**

We’re cautiously optimistic about the pipeline for the second half of the year. I think commercial finance was really impacted in the first half of the year just because of the market activity. There was just a lot of higher pre-payments and portfolio repositioning activity and it was a really issuer-friendly environment. In fact, covenant light transactions in middle market was at a record high in the first half of the year and we’re really trying to keep the discipline here.

The good news in commercial finance is that we entered into the JV with Allstate, we have initiatives that we really want to drive more fee income through the franchise. Our capital market fees were 58% higher than the same period last year and we have a good pipeline in industry segments like healthcare, energy, power and aerospace in commercial finance.

In business capital, I think that the confidence level in this market is really at the highest level that I’ve seen it in a long time, especially in segments like franchise, industrial and office imaging and we’re continuing to win vendor programs. We’re leveraging our technology in this space. We built a capital markets team here. We’re hiring more sales people. We have a lot of supply chain transactions in the pipeline so we think that the second half of the year will continue to be strong for business capital pretty much in industrial, franchise and technology.

With rail, there’s still the surplus of equipment across the market. That being said, though, there was a pick up in the sand market due to increased crude drilling activity so utilization and renewal rates improved for the sand market in the second quarter, but we’re really uncertain whether this uptick is going to be sustainable given the recent crude prices.

Despite that, our team has successfully maintained utilization around 94%. We continue to be a leader in providing efficient equipment to the market and portfolio management, customer service and equipment quality are key differentiators for us in the rail space.

**Operator**

The next question comes from Vincent Caintic with Stephens.

**Vincent Caintic**

Good morning. Ellen, I was wondering if you could talk about some of the initiatives you’ve been taking on the deposit side to improve the deposit quality here. I’ve certainly been seeing some of the ads, so how’s the progress been so far and how do you think about deposit beta and your funding mix going forward? Thanks.
Ellen Alemany
We’ve been making good progress on the deposit side. I would say it’s like turning a ship but despite three rate hikes in the last 12 months, we were essentially keeping our deposit costs flat. We’ve put all the basics in place in the franchise. I like to talk about the different channels because we raised deposits through the branches, through Direct Bank and the commercial deposits. But we’ve put in all the pricing models and tools, we’ve done our segmentation, we’ve changed the incentive programs in the franchise, we also have incentives for cross-selling, we’ve put out all new marketing materials, we’ve allocated marketing dollars to the team and in the branch space, we launched the lazy dollar campaign earlier this year. We had good results from that. The Direct Bank, our strategy is there. It’s our Direct Bank that’s going to be our flexible source of funding. This is a National market for us. It’s highly scalable. We’re doing a lot to invest in our digital experience and we just recently launched our new HYSA account there.

Then, on the commercial side, we’re incentivizing our bankers to ask from deposits for customers. We’ve seen some progress there but not having a solid investment grade rating is a little bit of a headwind but we’re also, in all the channels, getting rid of our high cost—our goal is to reduce high cost broker deposits over time. So, as I said, we’re making good progress. It’s slow but it’s coming and we’re at a one-to-one deposit ratio at the bank.

Vincent Caintic
Got it. That’s very helpful. Then separately on this joint venture with Allstate, I think that’s pretty interesting. I’m wondering if you could maybe talk a little bit about the strategy for that and so what sort of, assets kind of grow within that joint venture versus what goes into your balance sheet and what sort of fees and how large can that grow over time? Thanks.

Ellen Alemany
We don’t want to share the details of the joint venture, they haven’t been disclosed, but I think the rationale behind the joint venture is really to allow us to leverage our origination capability in the ABL space and really capture some of the economics of the deals that are being done in the non-bank space. So, we’ll provide revolving and term loan commitments to middle market companies across industries and then we’re serving as an investment advisor for the venture and we receive a fee for the service. So, the way the JV is built is that we will get fee income that will build over time. It’s not going to move the needle substantially in the first 12 to 18 months but I think it’s going to provide a good platform for growth and also to play in space that we normally wouldn’t be able to play.

Vincent Caintic
Thanks, Ellen.

CONCLUSION

Operator
As there are no more questions at the present time, I would like to return the call to management for any closing comments.

Barbara Callahan
Thank you everyone, for joining 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. Thanks again for your time this morning and have a great day.

Operator
This concludes the conference call. Thank you for attending today’s presentation. You may now disconnect.