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— HARD TIMES —

Back to plain vanilla?

By Michael Rudnick

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EXECUTIVE SUMMARY

- Under Peek the 101-year-old institution became an aggressive risk taker.
- When it emerges from its prepack, it could be shorn of many of the added businesses.
- Its historically profitable trade finance unit may stay intact.

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Throughout its 101-year history, **CIT Group Inc.** has seen cycles of growth followed by turbulence, at one point selling itself to **Tyco International Ltd.** in June 2001. But the venerable institution that chairman and CEO Jeffrey Peek turned into an aggressive midmarket lender finally ran out of luck.

Hit with credit losses, CIT clutched at every possible liquidity option -- asset sales, government support, rescue loans and equity raises. But weighed down by about \$32 billion in debt that it couldn't reduce and unable to tap the commercial paper markets for ongoing needs, it succumbed to a prepackaged Chapter 11 filing Nov. 1, becoming the fourth-largest bankruptcy in history, with roughly \$71 billion in assets.

There is little doubt that the lender's expansion into high-risk, high-return products under Peek's term helped lead to its undoing. "Peek's desire was to make it into a financial powerhouse from the sleepy, small-business lender it had been for years," says a source close to the situation.

Gordian Group's Peter Kaufman on CIT



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Now, if it emerges swiftly from Chapter 11 as planned, CIT will have clipped much of the businesses that grew dramatically under Peek. "I think it goes backwards, back to its midmarket roots," says James Rybakoff, president and CEO of investment bank **Akin Bay Co. LLC**. "It will be more plain vanilla, more straightforward -- no more mortgages and student loans."

Peek, a former president of Merrill Lynch & Co.'s asset management arm, joined CIT in 2003 and clearly had ambitions for the institution. He opened its global headquarters in New York (corporate headquarters remained in Livingston, N.J.). In April 2006, CIT unveiled a 28-story, glass office tower in midtown Manhattan, receiving a warm, red carpet welcome from Mayor Michael Bloomberg.

The firm, whose core businesses covered trade, transportation, vendor and corporate finance, expanded its student loans program. It acquired Education Lending Group Inc., with \$4 billion in student loans, in 2005 for \$381 million. Its appetite for risky subprime mortgages also got bigger.

CIT had had an active home-lending business since the mid-'90s. But after Peek came on board, the firm "relaxed its underwriting standards" and put a greater emphasis on subprime, argues one bondholder who requested anonymity.

A CIT spokesman declined to comment on Peek's role.

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Total assets soared to nearly \$90 billion in 2007, from \$53.5 billion in 2004. The company almost doubled originations to about \$40 billion in 2007, from about \$24 billion in 2004.

Student and home loans helped plunge CIT in eight consecutive quarterly losses starting in the second quarter of 2007. By April 2008, the company, holding about \$11.6 billion in student loans, had ceased student loan originations. In July 2008 it sold its \$9.3 billion home-lending business to **Lone Star Funds** for \$1.5 billion, including \$4.4 billion in debt, and its \$470 million manufactured home loan portfolio for \$300 million to **Vanderbilt Mortgage and Finance Inc.**

CIT's bondholders began calling the shots, using a \$3 billion rescue loan to cover an upcoming maturity. But by late October, CIT's bid to pare debt via a debt exchange had not received sufficient votes to avert bankruptcy, despite some last-minute maneuverings by shareholder Carl Icahn. Peek said he would step down on Dec. 31.

With overwhelming bondholder support for an in-court restructuring, CIT aims to have a short stay. It has the approval of Judge Allan Gropper of the U.S. Bankruptcy Court for the Southern District of New York in Manhattan to access \$150 million of a \$500 million postpetition loan to fund their continuing operations.

The real question is how slimmed down CIT will be post-restructuring. Rybakoff believes CIT should dramatically pare its corporate finance business, now at \$19 billion. "Once clean, I see CIT originating new loans in a smaller way," he says.

CIT's \$13 billion vendor finance unit, providing leasing and lending to manufacturers and distributors, may have to be run off, says a credit analyst. On the other hand, its historically profitable trade finance unit may stay intact, some sources say. Trade finance boasts the top global market share, with about \$5 billion in assets, and houses the world's largest factoring business, with about \$42 billion in 2008 volume.

But its ability to originate new loans in these businesses, predicated on transferring platforms into its deposit-taking bank, will require regulators' cooperation. Without it, there's still a chance CIT could fall into liquidation, CIT president and chief operating officer Alex Mason has acknowledged.

"Our restructuring plan will significantly deleverage our balance sheet, provide us with strong capital ratios and reduce our near-term demands for liquidity," Mason says.

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