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Bank M&A: Now The Hard Part

Now that BofA, JPMorgan and Citi have come to the rescue of floundering banks, the integration process begins

BY GERELYN TERZO

When **John Thain** took the helm of **Merrill Lynch** last November, he entered into one of the most distinctive cultures of all the wire houses on Wall Street. "Mother Merrill," as the firm was endearingly referred to by many of its brokers, feeds off of an entrepreneurial spirit that since the firm's inception in 1914 has been rooted in an Irish, "good old boy" culture.

It's a country club that Thain—who was reared in a distinctly different culture at **Goldman Sachs**—was not instantly considered a part of, at least not by all, when he was named chief executive.

"Goldman is a very 'clubby' place, but very much managed with the interest of the partnership or company in mind. That's tough for some Merrill brokers to take because they are part of a very entrepreneurial crowd," says **Nancy Bush**, founder of New Jersey-based **NAB Research**.

Even with all of his loyal followers from Goldman, and those who sing his praises at the **New York Stock Exchange**, from where Thain defected to join Merrill, there was some disgruntlement among brokers. And while under Thain's leadership Merrill had begun to clean up its balance sheet and repair some of the damage left by former CEO **Stan O'Neal**, those territorial sentiments re-emerged when less than a year into his regime, he sold out to Charlotte-based **Bank of America**. The sale came on the weekend leading up to that fateful day of Sept. 15, when **Lehman Brothers** filed for Chapter 11 bankruptcy protection.

Thain himself admits that M&A was not in the original game plan. "It's fair to say that this isn't necessarily the outcome that I would have expected when I took this job," he said on a conference call with reporters on Sept. 15. But the dogmatic response was not enough for some Merrill brokers. And now that Thain's future is apparently sewn up, as on Oct. 2 BofA revealed he would stay on with the combined company as president of global banking, securities and wealth management, many of Merrill's employees are wondering whether or not he is going to step up to the plate for them.

Milestone's Jess Varughese: 'What people predicted would take decades has happened in 30 days.'

"They will say of his legacy that he prevented and saved Merrill Lynch from going bankrupt. But I'll bet a lot of Merrill guys wish he would have done what [**Morgan Stanley** CEO] **John Mack** did and kept the bank independent," says one recruiter who declined to be named.

Now that the wheels are in motion, Thain and BofA's CEO, **Ken Lewis**, are left to sort out one of the most vital pieces of the M&A puzzle—the integration of employees, clients and technology. And they're not alone.

Too much, too fast?

While few major institutions on Wall Street have been immune from the carnage of the credit crisis, BofA, **JPMorgan** and **Citigroup** have arguably been more protected than some of their rivals.

Firms like JPMorgan have somewhat less exposure to the more exotic securities created in recent years, though it does remain closely tied to the consumer-lending market, as do Citi and BofA. What they do offer, of course, is a mammoth base of deposits from their retail banking customers.

It seems reasonable, then, that this trio would play a role in Wall Street's recovery. But all three of the aforementioned model banks have taken on targets—for BofA, Merrill; for JPMorgan, **Washington Mutual**; and for Citi, **Wachovia**—that only 30 days ago were not necessarily at the center of their radar screens. They were shotgun marriages at best, arranged by father circumstance and mother opportunity. And all of them were done at a time when much of Wall Street is ducking for cover.

"What's worrisome is when you look at what just happened—the fastest-ever creation of a universal banking model. What people predicted would take decades has happened in 30 days. It has created an oligopoly which will have ramifications for the consumer over time, but none of that is of any real immediate consequence given the liquidity pressures the acquired institutions have been under," says **Jess Varughese**, managing partner at financial services consulting firm **Milestone**.

For BofA, the challenge of integrating a firm the size of Merrill, with a nearly 17,000-strong thundering herd of brokers compared with its 2,000 brokers, is daunting.

But combined with the fact that Lewis' firm only just finished the integration of **US Trust** and this month will wrap up the conversion of LaSalle Bank's systems, the task at hand seems that much more ambitious.

And this is all being done at a time when yet another acquisition, **Countrywide Financial**, is still being swallowed. The mortgage lender is expected to be fully absorbed into BofA by the third quarter of 2009. That leaves the biggest deal of them all, Merrill, which Lewis' team will not begin combining before early 2010.

"That is a core competency. We know how to manage transitions. I don't want to understate the size and the degree of difficulty ... but it will be done and it will be done very professionally, " said Lewis on the same call.

JPMorgan from its inception two centuries ago has been an acquisitive firm. This year it has been most ambitious. The integration of **Bear Stearns** was only formally completed over the summer, and **Jamie Dimon**, JPMorgan's chief, has already jumped right back into the M&A arena.

"Their aspirations for the West Coast were realized through the acquisition of WaMu," says Milestone partner **Doug McGann**. "JPMorgan's weak points were the Southeast and the West Coast, and it solved one of those items with this acquisition."

Dimon and **Sandy Weill** orchestrated a string of acquisitions from 1975 to 1988 that helped to build Citi into a banking giant. Since taking the helm at JPMorgan, Dimon has outperformed many of his peers.

"They integrate well and integrations don't tie them up as long as somebody who doesn't have the playbook JPMorgan has," says Milestone's Varughese.

The lesson in spades of what not to do when integrating a company is learned through Wachovia's 2007 acquisition of **AG Edwards**. "AG Edwards is a ship adrift at sea right now," says **Darin Manis**, CEO of Denver-based recruiting firm **RJ & Makay**. Manis expects there will be an "unprecedented exodus of brokers" from the firm as a result. "Many brokers are nervous and upset and feel left out to dry," he says. "I don't see many brokers joining AG Edwards right now. It's a complete mess over there."

A Wachovia spokeswoman refuted those comments, maintaining that the integration of retail brokerage AG Edwards is going "very well" and is on track for final conversion in Feb. 2009.

What to expect

The coming weeks are going to be especially telling as to how these newly-combined firms manage a key part of the integration process—their talent. According to Manis, the average attrition rate when a company takes over another brokerage house is 8%-15%. As a result, many are not taking any chances.

Manis' phones at the office have been ringing off the hook with calls from "poised" Merrill brokers and "panicked" AG Edwards financial advisors, Manis says. He has since transferred recruiters from other areas of his company to manage the volume.

Manis has launched an aggressive campaign to court Merrill and AG Edwards' brokers, trying to sell culture, platform, payouts and the mighty transition package to them. There are still more questions than answers, such as whether target firms will keep their name and how much of some departments will be integrated into the new firm, among others.

In many ways and despite the shrinking financial services arena, high-performing brokers appear to hold a lot of the cards. "Financial advisors will be determining what is best for their clients and their family," says Manis.

In addition to the human capital, there are huge logistical issues to address. "The technological and operational components of these deals are extremely significant given the size and breadth of the companies these organizations are taking on," says Milestone's McGann.

In traditional integrations, the buying company has to deliver some synergies, for instance to prove that it is saving money on a particular platform. But given the urgency driving much of M&A, there is less of a burden to sell a deal right now. "The traditional M&A model is out the window" says Milestone's Varughese. "These recent deals were shotgun integrations. You don't have to prove to shareholders you're getting a good deal when you are buying assets at firesale values."

One of the harshest criticisms of the rushed deals that have unfolded on Wall Street of late has been the apparent lack of due diligence. For instance, when Thain was meeting with US Treasury Secretary **Henry Paulson** on the weekend prior to the Lehman bankruptcy, BofA's Lewis was not even there.

It wasn't until Thain picked up the phone and called him on the morning of Saturday, Sept. 13, that the combination became a very real possibility and hours later, after some face time, a reality.

"That doesn't keep Lewis from saying due diligence was completely adequate. But let's be real," says **Gary Townsend**, of Maryland-based **Hill Townsend Capital**.

Others are more philosophical. "Don't let them fool you into thinking they haven't been looking at each other for a long time," says **Rob Hegarty**, managing director at research and advisory firm **TowerGroup**. "This was not a deal that was drummed up in the shower on Saturday morning and completed on Sunday night. These two firms are very familiar with each other."

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