Business North Carolina

Tastes change

There's a dash of old First Union in CEO's new recipe for Wachovia.

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By Irwin Speizer

In an office atop Wachovia Corp. headquarters in downtown Charlotte, the phone rang. G. Kennedy Thompson, who runs the nation's fourth-largest bank, answered.

On the line was John Hammergren, chairman and CEO of San Francisco-based McKesson Corp., North America's largest pharmaceutical distributor and giant supplier of health-care software, which has been doing business with Wachovia for years. He's also a director of Hewlett-Packard Co. Starting with its messy ouster of CEO Carly Fiorina in 2005, the Silicon Valley icon's board had slipped into bickering and backbiting, with nasty leaks to the press, a phone-snooping scandal that led to a federal investigation and several resignations.

By the end of last year, it was shopping for a new member to shore up its tattered image. Was Thompson interested?

Indeed he was. Thompson, the bank's chief executive since 2000, had begun his assault on the West Coast by buying two California-based financial institutions. But those weren't megadeals, just a beachhead, and getting named an HP director last Nov. 16 raised his and his bank's profiles in Golden State business circles.

"I don't think it went unnoticed," says Kevin Fitzsimmons, a banking analyst with Sandler O'Neill + Partners in New York. Thompson's take on it? "It was like a lot of things. I knew John Hammergren very well, and I think he was pushing me there. And then I hit it off nicely with [HP CEO] Mark Hurd."

What looks like serendipity to some seems business as usual to Raleigh investment and merchant banker Lanty Smith, a longtime Wachovia director. "It wasn't luck at all. He's good at relationship building because he is such a genuine person. It comes natural to him. He's been doing it from early on."

Tony Plath saw evidence of this skill on a less intimate scale. When the associate professor of finance at UNC Charlotte helped run a bank planning conference in late 1999, he faced an auditorium of glum managers. "People felt abused," he recalls. "It was a harsh place to work." Returning in 2001, "I made some kind of offhanded comment about how people felt beat up and unappreciated, and I distinctly remember some people in the back of the room raising their hands and saying, 'No, it's different now.' I thought, 'Yeah, right, this is just window dressing.' But they were right. People were just a lot happier, more optimistic. It was a total reversal of the past culture."

Credit Thompson. He proved not only popular with customers and employees but deft at cleaning up the mess left by Ed Crutchfield, who had cobbled together a giant bank beset by mammoth problems. Thompson, who had worked for First Union Corp. since finishing business school, ironed out widespread customer-service problems and ditched poorly performing businesses. In September 2001, he capped the honeymoon by merging First Union and Winston-Salem-based Wachovia, winning not only its name but what had once been the

Southeast's most respected bank for a bargain price. Analysts lauded the deal as a steal and Thompson as a savior.

But lately, some who had praised his discipline have been spooked. They see the shadow of his old boss, who boasted of piling up billions until a merger target's resistance collapsed, in Thompson's willingness to shell out double-digit premiums for SouthTrust Corp., an Alabama bank; Golden West Financial Corp., a California thrift; and A.G. Edwards Inc., the St. Louis-based securities brokerage.

"People do not want to see Wachovia make acquisitions," says Richard Bove, a banking analyst with Punk, Ziegel & Co. in New York. "When Crutchfield was around, all he wanted to do was expand as rapidly as possible. What the company is doing now is the Crutchfield strategy."

Thompson considers talk of his metamorphosis amusing. "I am basically the same person now that I was then," he says. "But our company is very different."

Chatting with Thompson, who turns 57 this month, it's easy to ignore the critics. His low-key charm goes a long way toward explaining his warm relationship with bank staff and his far-flung network of business friendships. He may be a multimillionaire – last year alone, the bank paid him more than $27 million – but he still has the air of an unpretentious small-town guy. He's smart but not condescending, competitive but not in-your-face aggressive.

Crutchfield, a college football player, started his career in the hurly-burly of the bank's bond-trading floor. Thompson, in contrast, did an early, formative stint as head of human resources. "[Crutchfield] had a mercurial temper," Bove says. "He was a genius, but he was also brutal. Thompson understands that if you motivate employees, make them happy, customers will come back."

He grew up in Rocky Mount, son of a mill manager. Thompson played high-school baseball and football and worked in tobacco warehouses to earn pocket money. Gov. Mike Easley, a schoolmate, recalls him as popular and fun-loving but well-behaved, sticking to soft drinks when others snuck off to buy beer. "When a whole crowd of kids gets together, someone has to be the designated thinker. If Ken was in the group, you knew whatever it was you were doing was OK. He was sort of the Good Housekeeping seal of approval."

Easley was taken by surprise when he learned Thompson had won a prestigious Morehead Scholarship to UNC Chapel Hill; Thompson had never let on he was a high-achieving scholar as well as a jock.

During his senior year at Carolina, his mother learned she had cancer. After graduation, he returned to Rocky Mount to spend time with her and his father. He painted houses for about a year and, after his mother died, enrolled in Wake Forest's business school. Graduating in 1976, he landed a job with First Union. He soon caught Crutchfield's attention and ended up with a series of increasingly challenging jobs, including the stint as HR chief. "It made me visible to senior management early on, and that clearly didn't hurt my career," he says. In 1987, Crutchfield sent him to Jacksonville to head First Union's Florida unit, which was growing quickly on account of all the mergers. The job required knitting a disparate bunch of acquired banks into an efficient operation. He did and was promoted to head of the capital-markets division.

First Union faltered in the late '90s as Crutchfield's merger machine sputtered. The bank had gotten too big too fast. Its 1998 acquisition of Philadelphia-based CoreStates Financial Corp. proved especially vexing, with First Union losing more than a fifth of CoreStates' customers amid operational blunders. First Union stock fell from a high of $65 in 1998 to about $20 by late 2000. As it laid off thousands, morale collapsed, which only compounded the customer-service problems. In March 2000, Crutchfield announced that he had lymphoma and would step down for treatment. He recommended Thompson, who had been named president in 1999

upon John Georgious' early retirement, as his replacement ("*Reluctant Rebel," November 2000*). Crutchfield, who has since recovered, is an investor and serves on corporate boards.
Thompson began his tenure by visiting First Union offices around the country. "I was barnstorming," he recalls. "I spent a lot of time talking to and listening to and getting information from people." Under pressure to take drastic action, he didn't disappoint. Thompson closed The Money Store, a California-based subprime lender acquired less than two years earlier, writing off $1.7 billion as part of $2.8 billion in total restructuring charges. He sold branches, a mortgage-servicing business and credit-card portfolios. He even slashed the dividend – an always unpopular and painful choice for a CEO.
Reversing Crutchfield's decisions, he never openly criticized his predecessor. The difference in their styles may have been rebuke enough. Crutchfield's first round of cutbacks had come as a surprise edict, stunning employees. Thompson, in contrast, tried to soften the blow of his by shuttling hundreds of managers to Charlotte for meetings to explain his plan. He would talk 10 to 15 minutes, then take questions. The sessions could hardly be described as upbeat, but at least managers had time to process the idea of layoffs and, just as important, could see that their boss understood the emotional toll.
Thompson cemented his reputation with the rank and file when he promoted popular company veteran Ben Jenkins to head the company's biggest division, retail banking. He gave him authority to increase staff, hoping to repair the company's damaged relationship with customers. "Our staffing levels were below those required to get good service," Thompson says. "As hard as people tried, they didn't have the tools at their fingers. In spite of the fact that our earnings were challenged, we said nothing will work if we don't give good customer service. So we invested nine-figure dollars in restaffing, in buying tools, buying systems. That was a significant leap of faith on our part."
To ensure that the money was well spent, Jenkins began to devise a series of productivity measurements. Bonuses were tied to good grades. Consistently lousy numbers could get you fired. Tracking performance isn't unusual, but the speed with which the bank developed and applied its new metrics helped to salvage its reputation with customers. "They can slice and dice every sort of measurement, down to the business level, down to the branch level, down to the teller level," says Fitzsimmons, the banking analyst. "You are constantly seeing what areas are doing well, which are not. You are addressing problems earlier. You are able to weed out underperformers and elevate out-performers faster. Other banks get lots of reports, but here they actually use them. And they focus on the right things."
The turnaround showed up first in happier customers. The bank's performance on the American Customer Satisfaction Index, a University of Michigan ranking, went from near the bottom among large banks to first place by 2002 and has stayed high. Customer attrition, which stood at an alarming 20% in 1999, began dropping and today is 10%. The tougher task was shoring up the balance sheet. First Union reported net income of $3.2 billion in 1999. But the restructuring, combined with the decline in performance, dashed earnings, and the company ended 2000 with net income of $92 million. Net income bounced back the next year, hitting $1.6 billion. Last year, it was $7.8 billion, $4.63 a share, on revenue of $29.9 billion.
With earnings and the stock rising, Thompson was well situated to do an acquisition – if he dared. An irresistible one came when the company of one of his old business acquaintances found itself in trouble. Despite the competition between their companies, Thompson had long had a rapport with Bud Baker, chief executive of Winston-Salem-based Wachovia. After the old Wachovia saw a sharp increase in problem loans in 2000, their occasional chats turned toward talk of a friendly merger. Thompson offered to pay a modest 6% premium for Wachovia's stock. A bank its size and historical quality could have commanded two or three times as much.

Thompson spent several weeks shuttling between Charlotte and a Comfort Inn in Salisbury, sweet-talking his Wachovia counterparts. He argued that they might find a richer partner but not one that could better merge their operations and serve their shareholders, customers and employees.

Once the banks announced the deal, he had to beat back a rival bid from Atlanta-based SunTrust Banks, which initially came in 10% higher. Thompson put up a pit-bull defense, not only appealing to shareholders but also calling in chits in Raleigh. He persuaded the General Assembly to adopt an emergency bill aimed at weakening SunTrust's position in the state. The deal closed in September 2001. The combined bank took Wachovia's name, a concession to its executives – and a convenient way to ditch the tarnished First Union brand. "The Wachovia merger has to be viewed as one of the best in the banking industry," Bove says. Even so, gaining national recognition for the unusual Wachovia name proved a challenge. (People's initial reaction, inevitably, seems to be, "Wah-CHO-vee-ya? What's that mean?") Here again, Thompson's assiduousness in cultivating business relationships paid off.

The PGA Tour is headquartered in Ponte Vedra Beach, Fla., near Jacksonville. When based there, Thompson, an 11-handicap golfer, had struck up a friendship with PGA Commissioner Tim Finchem. During a 2002 visit to Jacksonville, they met for breakfast. Finchem mentioned that the Tour might soon make a rare addition to its tournaments. Thompson is a member of Quail Hollow Club in Charlotte, and developer Johnny Harris, the club's president, was eager to host a PGA event. So Thompson pledged money, Harris offered up the course, and Finchem provided a date. The result: the Wachovia Championship, launched in 2003. "It was a happy confluence of events," Thompson says. "It came up at the same time as the Wachovia merger, and we saw it as a way to brand the name worldwide." This year, 27 of the world's top 30 players, including Tiger Woods, played, and the event was broadcast globally. Needless to say, the announcers got the name right.

With the Wachovia merger behind him, Thompson started looking to do more deals. In 2004, he found an opportunity in Alabama, buying Birmingham-based SouthTrust. That gave Wachovia a branch network stretching deep into Texas. But it paid dearly – $14.3 billion, a 20% premium. Two years later, in May 2006, came Golden West, which had 285 branches, mostly in its home state. This time, Thompson paid $25.5 billion – a 15% premium. Then, earlier this year, followed A.G. Edwards, for which he offered $6.8 billion – a 16% premium.

Bove, despite his endorsement of the Wachovia-First Union pairing, hasn't found much to like since. He says SouthTrust cost too much, given its relatively small number of branches in Texas, where Wachovia really needed to be. Golden West delivered a big California footprint but brought a balance sheet gouty with mortgages just as the industry was teetering toward trouble. And A.G. Edwards is the sort of old-fashioned brokerage that's struggling to compete against low-cost online outfits. "I'm not sure SouthTrust was a good deal," Bove says. "I'm convinced Golden West was not a good deal. And with A.G. Edwards, you are buying a business where you are being undercut by direct-access firms like E*TRADE and Ameritrade. Who needs it?"

Knowing his recent deals aren't playing well on Wall Street, Thompson is eager to ease concerns. "We have our heads down right now. We are very focused on the integration of Golden West and on the closing of the A.G. Edwards [deal]." At a Lehman Brothers banking conference in September, he put his priorities in plainer language: "We simply aren't focused on acquisitions." But he insists that success depends on capturing significant shares of new markets. "We have plans for growth in the Southwest and West. Over time, we have plans for growing our percentage of revenue from international markets. If we are successful, we will experience significant growth in earnings, and our shareholders will do extremely well." Deals are part of that plan. He's convinced that if he moves too slowly Wachovia will be left behind. Bank of America blanketed California by way of one big merger – the one in which it got its latest name – in 1998. These days, it's not only the nation's second-largest bank but one of the better-run ones; its return on common equity in 2006 was 16%, compared with Wachovia's 14%.

Judging by his compensation, Wachovia's board believes in Thompson's strategy. According to the latest Business North Carolina CEO pay survey, he pulled down $27.8 million in salary, bonuses, stock and options last year, second in the state and slightly more than BofA CEO Ken Lewis received. "It was a troubled company when he took over," Lanty Smith says. "Look at the stock price today and when he went into the job. Wachovia and Ken's performance look very competitive and attractive." The share price has increased, but given how badly the bank was faring then, that seems cold comfort. Over the last five years, it has only barely bested the Dow Jones bank stock index. Over the last two – during the period of the Golden West and A.G. Edwards deals – it has fallen short of it. So far this year, as the index has dropped, Wachovia's price has fallen farther, losing more than 9% of its value through the beginning of October.

As shares slumped, Thompson has met with analysts and investors to evangelize. He concedes that Golden West brought with it a sharp rise in problem loans – Wachovia set aside $179 million in the second quarter to cover future losses, triple the amount set aside a year earlier. But he says his bank's size should allow it to easily absorb losses. And with many lenders leaving the mortgage industry in the recent shakeout, Wachovia should be poised for growth as a survivor in a decimated market. As for A.G. Edwards, it will create the nation's second-largest brokerage and add to the company's bottom line with a little sales training for its brokers. "Earnings can be enhanced simply by increasing A.G. Edwards's productivity to Wachovia Securities standards," Thompson told the crowd at the Lehman conference. Why he paid a hefty premium for a less productive outfit remains an open question.

Deal making, he adds, represents only part of his expansion strategy. The bank also is building branches in Texas, California and New York and investing in high-profile marketing. This summer, for example, Wachovia put its name on concerts and other events at the Staples Center in Los Angeles.

His HP duties will add to an already busy travel schedule. He spends about half his time traveling, mainly between Wachovia offices on a company jet. When not poring over company reports, his reading tends toward history and biography. He recently finished "Why Elephants Can't Dance," former IBM Chairman Lou Gerstner's account of his company's turnaround, and was one of the first in line for Alan Greenspan's "The Age of Turbulence: Adventures in a New World." In it, the former Fed chairman describes what he calls "irrational exuberance." Sunny though his views on his recent deals might be, Thompson won't see any resemblance.