

Zions Bancorp and First Security Bank

In late March 2000, John Scott*, a member of the board of directors for Zions Bancorp, gazed westward across the cityscape of downtown Salt Lake City as the sun dipped below the Oquirrh mountains. Scott had been a director for Zions for nearly ten years. In that time Zions had acquired scores of smaller banks. Tomorrow the board would address shareholders before they voted on Zions' most important acquisition to-date – that of rival First Security Bank.

Although the merger announcement had been hailed months earlier as a triumph for both Zions, First Security and even Salt Lake City, the vote would be anything but routine. Scott faced a quagmire of competing realities. As one securities analyst noted: “Management spent over a year putting the merger together, with the company ready to be integrated at the push of a button. It’s a tremendous loss if the deal doesn’t go through.”¹ The proposed merger was in line with a flurry of merger activity as the commercial banking industry continued its radical realignment. (See Exhibits 1-4 for financial statements on both banks.)

The Commercial Banking Industry

When the provisions of the Gramm-Leach-Bliley Financial Services Modernization Act came into effect in March of 2000 it marked the culmination of two decades of momentous change in the commercial banking industry. Enacted in 1996, the Gramm-Leach-Bliley Act eliminated most legal barriers separating the insurance, banking and securities industries. But the metamorphosis of commercial banking pre-dates this significant shift in regulatory and legislative policy. The transformation of commercial banking is underscored by three important realities: 1) the concentration of profitability among large and medium-sized banks, 2) the growth of non-interest income as a percentage of revenues, and 3) the growing number of investment and financing alternatives to commercial banks.

Profitability is largely concentrated at the large and medium sized banks (the 1,000 largest of 8,620 total banks). A June 2000 Federal Reserve Bulletin reported that in 1999, the ten largest banks had an average ROE of 13.6%— over 3 percentage points higher than in 1998. The rapid increase was directly related to a drop-off in merger activity in 1999 from 1998. The next 90 banks recorded 1.3-percentage point increase for an average ROE of 18.6%. The next 900 had an average ROE of 16.2%. The average return on equity for the remaining 7,600 banks dipped to 11.4%. These factors were part of the driving forces behind the industry consolidation (see Exhibit 5).

Although 1999 represented a year in which industry profits reached record levels, the proportion of banks that reported net losses grew for a fifth straight year to 7.4%. The Fed report noted that, “The profitability gap between large and small banks would have been greater but for the growth in recent years in the number of small banks that have elected corporate status under subchapter S of the Internal Revenue Code.”² In effect, subchapter S corporations are largely shielded from federal corporate income tax. The favorable tax treatment ultimately increases the profitability of S-corps by half relative to a comparable bank not incorporated under subchapter S. A number of restrictions prevent most firms from incorporating under subchapter S – they are limited to no more than 75 shareholders and stockholders cannot be other companies. However, without S corps, the profitability bias toward larger banks would have been even greater. According to a report published by the Federal Reserve, approximately 15 percent of insured commercial banks in 1999 claimed S status and made up approximately two percent of industry assets.³

A critical factor in driving the industry-wide consolidation was the growing importance of non-interest income. In 1999, the banking industry booked record profits as non-interest income boomed. Non-interest income as a percent of assets jumped 25 basis points (the largest increase ever) while its share of revenues grew by 2½ percentage points. Non-interest income was comprised of trading income and non-deposit fees and services.

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*Disguised name.

Trading income comes from equity, commodity, and foreign currency exposures (see Exhibit 6). The Federal Reserve noted: “The rapid growth of securities lending over the past decade, spurred on by the desire to increase earnings on assets held in trust, has also likely contributed to the increase in non-deposit fees” (see Exhibit 7).⁴ Non-deposit fees and services included corporate and personal financial advisory services, credit enhancement fees, derivative intermediary fees, credit card fees, ATM surcharges, mortgage servicing and refinancing fees, investment services (service fees from mutual funds and annuities), professional services, venture capital activity and fee income from securitized loans and securities lending. As Gramm-Leach-Bliley has come into effect, non-interest revenues – those from insurance, investments, merchant banking and other previously restricted lines of business – are becoming ever more significant.

The importance of non-interest income will go on growing as commercial banks continue to be squeezed by the increasing number of financing, investment and savings alternatives. For example, the proliferation of commercial paper and bonds has created an attractive alternative for business financing. Firms are borrowing proportionately less from banks and raising more debt via commercial paper (see Exhibit 8). Additionally, over the last twenty years the share of household assets made-up of bank deposits has shrunk significantly. In the last fifty years the growth of mutual funds – investment funds that pool shareholders’ money in order to purchase a diversified portfolio of securities – has substantially increased the competition for depositor savings (see Exhibit 9). At the time of the Investment Company Act of 1940 there were nearly 296,000 mutual fund accounts with assets totaling \$448 million. By 1999 the number of mutual fund shareholders in America had grown to 83 million with assets worth \$6.8 trillion⁵ (see Exhibit 10). Although banks remain as the primary deposit holder for consumers, the overall share of household assets maintained in banks has dropped significantly. According to the Federal Reserve System, bank deposits made up 12% of household financial assets in 1997 – down from 22% in 1980. In 1998, *The Wall Street Journal* reported, “While banks derive more of their profits from wealthier customers, only 20% of people with at least \$250,000 in assets for investment say a bank is their primary financial-services provider.”⁶

Emerging information technology and services has significantly affected the alignment of the banking industry. New technologies have enabled banks to streamline operations. Such information technology has allowed banks to refine credit/risk evaluation techniques, which will improve asset quality and increase profits. Similarly, new client/server technology is creating evermore efficient access to “critical information, optical systems, for paperless storage, integrated lending systems, on-line cross-selling tools and electronic delivery channels.”⁷ These developments have reduced the importance of geography while, conversely, increasing the significance of scale. Shortly after NationsBank purchased his bank for \$15.5 billion in 1997, Barnett Banks Chairman Charles Rice observed, “Banking is evolving from being oriented around geography to being oriented to lines of business. You need to provide services at the lowest possible cost, with technology driving change, and the advantage is going to the monoline companies and the larger organizations such as NationsBank.”⁸ In 1996, Coopers & Lybrand joined with the Economist Intelligence Unit to complete a study aimed at identifying the factors that are reshaping the retail banking industry. The authors concluded that rapidly developing technologies and evolving customer demographics are forcing banks to radically realign “their market focus, resources, structure and processes.” By 2005, the study concluded, nearly all customers will have ‘grown up’ with computers and demand anytime, anywhere, anyhow banking with premium, personalized services that consumers have come to expect from technology.⁹

The challenges presented by the industry-wide upheaval, coupled with the low interest rate environment, were not lost on Zions Bancorp. In order to survive, Zions would have to capture scale from which back-office efficiencies could be created and its portfolio of products, services and lending capability could be enlarged. An analyst with Credit Suisse First Boston stated, “You need to find new ways to generate earnings growth, and mergers are certainly one way to do it. This may be, in some cases, a last gasp to have a story which lasts more than a couple of years.”¹⁰ Without a successful acquisition, such regional banks might otherwise be under pressure to sell.

Zions Bancorp & First Security Corporation

Zions name belies its truly unique origin – although it is quite different, perhaps, than someone from outside the Intermountain West would imagine. Mormon pioneer leader Brigham Young founded Zions Bancorporation on July 10, 1873. Mormonism, formally entitled the Church of Jesus Christ of Latter-day Saints, was a newly organized religious movement that began in the eastern United States. Following widespread

persecution that culminated in the assassination of the Church's presiding leader Joseph Smith, Young led many of the Church's members in a westward migration to an geographic area that includes all of present-day Utah and parts of Idaho, Arizona, Nevada, and California. The Church's emphasis on proselyting led to a significant increase in members from the eastern United States, Canada and Europe. At that time, converts were encouraged to emigrate to the newly founded establishments in the West where the Church hoped to be free from persecution. Young soon recognized the importance of a formal financial institution in assisting the emigration of converts and their families west.

The Church maintained active involvement with the bank throughout the 87 years that it held majority stake. Former Zions presidents include Joseph F. Smith and Heber J. Grant who would later become presidents of the Church itself. The bank's financial strength enabled it to survive the panic of 1893 and the stock market crash of 1929. In February 1932, as the number of bank closings across the country multiplied rapidly, depositors initiated a significant run on the bank. Although tellers honored all withdrawal requests, waiting lines ran out the front door. After the run's second day, bank president Heber J. Grant posted a sign on the front door that read, in part:

[The Bank] is in a very strong, clean, liquid condition. It can pay off every depositor in full. Fear of its failure is not only without foundation, but positively foolish. There is no safer bank in the State or the Nation.

By the end of the week depositors had returned to re-deposit their money. Zions reported that by the end of the month total deposits exceeded withdrawals.¹¹

By 1960 the Church had decided to divest itself of its banking position. On April 22, 1960 the Church sold its majority position to Keystone Insurance and Investment Company. At that time the bank had total assets of nearly \$120 million. Keystone was a Utah-based consumer finance company headed by three businessmen that included Leland B. Flint, Roy W. Simmons and Judson S. Sayre. The name Keystone was changed to Zions Bancorporation in 1965, which was followed by an IPO in January 1966. When Roy Simmons' son, Harris, became president and CEO in 1990, Zions assets totaled \$4 billion.

It wouldn't take long for Harris Simmons to become a Wall Street favorite. Simmons adopted an aggressive growth strategy in an industry not often associated with successful mergers and acquisitions. Zions merged with or acquired twenty banks in a two-year span that began in July 1997. Zions also expanded its product and services offerings. In the same time span it acquired an insurance company, financial advisory firm and started a digital signature company. Zions revenues from municipal financial advisory services grew quickly. By 1999 Zions was the ninth largest municipal financial advisor in the US. In 1999 Zions acted as a financial advisor on 152 issues that totaled \$3.8 billion versus 106 issues totaling \$2.5 billion in 1998. In May of that year *FORTUNE* magazine recognized Zions as the best of 44 commercial banks in providing total return to investors. Based on its 10-year average compound total return to investors, a \$1,000 investment in Zions on December 31, 1988 would have been worth about \$29,300 ten years later. Zions five-year average return was two-times greater than that of the S&P 500 and 17.5 percentage points above the industry average (see Exhibit 11).¹²

Much of Zions success was attributable to its adept strategy and method of acquiring other banks. Zions sought out well-managed regional and community banks to acquire or merge with. In describing Zions' successful mergers and acquisition strategy he stated: "We try to assimilate into local communities, not make the customers conform to us." Often, it would keep the acquiree's name intact. Zions would then identify back office redundancies while significantly broadening the community banks' portfolio of products and services and their lending capabilities. Zions' strategy and performance was one that analysts grew to love. One analyst affirmed, "All the subsidiaries work for Zions because they recognize people are leery of constant name changing. They trade on a community bank feel and spirit, and that's not a fluke. Banks like Zions', and there are few as good, make money from locals. Alienating them with new names, procedures, merger-related changes is not in their best interest and they don't do it."¹³ Zions was proving very successful at achieving its goal of cutting expenses and improving its deposit mix.

But at the time when the banking industry was experiencing significant consolidation many wondered whether Zions could successfully compete as a relatively small, regional bank. The *Las Vegas Business Press* recorded: "When asked if the surge of growth from Zions' was a defense mechanism against a buy-out from a larger

bank, Simmons said becoming larger doesn't afford protection from being bought. Performance is the only meaningful defense against that sort of thing."¹⁴

As much as Zions looked toward its future performance, First Security pointed proudly to its notable history. First Security was also founded in Salt Lake City. The bank was started in 1928 by current CEO Spencer Eccles' uncles George and Marriner Eccles. First Security successfully navigated through the Great Depression and World War II and is today considered by many to have been the first multi-state bank-holding company. Marriner Eccles, First Security's first CEO, was later appointed by Franklin D. Roosevelt as the first chairman of the modern Federal Reserve Board. George Eccles succeeded his brother as CEO and served for 37 years. In just over seventy years, First Security had grown into a bank with over 10,000 employees, assets of \$22 billion and 324 branch offices spread across seven western states.

Recently, however, First Security had begun to stumble – initiating the likelihood of a takeover. Only a decade earlier Eccles had initiated talks with the Simmons Family about purchasing Zions. First Security had fallen nearly 30 percent from its high when Simmons first approached Eccles about a possible merger in the spring of 1999. Eccles was feeling the heat as evidenced by contentious Q&A session with shareholders at the bank's annual meeting in April.¹⁵ Although Eccles hated the thought of selling First Security, the bank's languishing stock price coupled with the industry trend toward consolidation made that reality unavoidable.

The Deal

Monday morning, June 7, 1999, financial papers the world over announced that the boards of Zions and First Security had approved the \$5.9 billion merger between the two banks. Pending regulatory and shareholder approval the combined bank would have assets of nearly \$40 billion with over 650 branches and 17,000 employees. The all-stock deal would be structured as a pooling of interests. In a formula approved by both boards, Zions' shareholders would receive one-for-one shares in the new company. Shareholders would receive 0.442 of a share for each old share of First Security – a 55% premium over Friday's closing price of $\$18\frac{3}{8}$ per share. On that day Zions' shares fell from $\$66\frac{3}{8}$ to $\$59\frac{19}{32}$ per share – down ten percent. First Security's shares traded up 31% – going from $\$18\frac{5}{8}$ to $\$24\frac{3}{8}$ per share. The mood on Wall Street was largely positive. Standard & Poor's equity analyst Tom Smith observed, "The effect on Zions' stock was a little more negative than I would have thought. But overall, I think there is a lot of optimism about the announcement."¹⁶

Simmons articulated the strategy behind the deal: "We decided to merge now because clearly it is a time when consolidation is going to continue to pick up pace, and it gives us the size to be able to continue to expand."¹⁷ The banks anticipated the deal would lead to a divestiture of some sixty branches with deposits totaling approximately \$1.5 billion. They also anticipated that the merger would enable the new bank to trim between 1,500 and 2,000 jobs from their combined work force. Such efficiencies would lead to annual pre-tax savings of about \$108 million.

The Zions-First Security deal underscored a shift in the momentum driving mergers within the banking industry. 1998 was marked by 'mergers of equals,' as the biggest firms attempted to create banks with nationwide market reach, such as BankAmerica with NationsBank and Citicorp with Travelers. Although 1999's "in-market" deals were clearly related to the behemoths of '98, they were marked by a decidedly different feel – inter-regional banks with the added scale and scope to compete with the national players (see Exhibit 12). The largest was Fleet Financial's acquisition of BankBoston, but also included AmSouth's (Birmingham, AL) purchase of First American (Nashville) and Firststar's (Cincinnati) merger with Mercantile (St. Louis).¹⁸ The *Wall Street Journal* reported that the new Utah-based bank, which would keep the First Security name, would be the second largest bank headquartered in the western United States and the fourth largest commercial bank in California (see Exhibit 13).

The deliberate effort by both companies to portray the deal as a "merger of equals" underscored the important sensitivities and politics involved with the acquisition. A banking industry analyst asserted, "They are trying to play this whole deal off as a merger, but Zions is really running the show." That analyst's assertion was one seconded across Wall Street "without question". However, Eccles continued to maintain that the deal was nothing less than a true merger of equals, "No way would we have considered going into this as a second-class citizen or as a junior partner just because at that particular juncture our stock price was not fully priced as we

thought it should be.”¹⁹ Acquisitions usually carried higher premiums for the acquired entity than a merger of equals, but they were also accompanied by more severe layoffs at the acquired entity.

Careful corporate spin aside, the deal best fit the definition of an acquisition. The first indicator was each respective CEO’s role after the merger. Although initially Simmons and Eccles would be co-CEOs the deal outlined Eccles’ intention to resign from that position in May 2002 and to step-down entirely – from the title of chairman – in 2004. “That alone,” observed an M&A attorney, “tells me that this is really an acquisition by Zions dressed up as a merger of equals.” The second indicator was the premium to be paid to First Security shareholders. Daniel Greenwood, a University of Utah law professor, stated, “Typically, the buyer pays the premium, so the analysts would see this as Zions buying First Security stockholders.” A third indicator was the significantly different multiples at which shares of Zions and First Security were trading. In March 1999, Zions was trading at a multiple of projected ’99 earnings twice that First Security (24 vs. 13). This enabled Zion’s shareholders to gain 49% ownership in the new company, although Zion’s profits only made up 40% of the combined profits as of March 31, 1999.²⁰

At the same time Greenwood observed, “There is a clear attempt to me to make this a merger of equals. They’ve done a lot of balancing to make it not clear which company is taking over the other.” Only months before Dale Gibbons, Zion’s chief financial officer, articulated the bank’s serious misgivings about deals structured as mergers of equals. On March 24, at the Bank and Financial Analyst Association’s annual symposium in New York, Gibbons stated: “With maybe a couple of exceptions, a merger of equals damages franchise value and tends to obscure. Companies that are independent, have valuable franchises, and have performed well are not willing to give up control of their companies.”²¹ Gibbons’ skepticism helps explain Zion’s approach to the First Security acquisition only ten weeks later.

Spencer Eccles’ First Security represented just such a bank – one with a proud history and very hesitant to cede control. At the time the *Salt Lake Tribune* reported that, “Eccles would be loath to sell First Security.” In January of 2000 Eccles asserted that: “Everybody is wrong who says that it’s (the merger) an acquisition, a takeover. It is not that. It never was that, never would have been that and it isn’t that now.” Without shareholder pressure Eccles probably would not have come to the table. The *Tribune* concluded: “The proposed merger with Zions was crafted in a way that neither bank is buying the other. Had it not been, Zions and First Security probably would not have struck a deal.”²²

Dale Gibbons’ earlier comments in New York indicated Zion’s recognition that eliminating the ambiguity after the deal – reflected by Simmons post-merger role – was worth almost any compromise on the front-end. Given these sensitivities Zions took a three-pronged approach to overcoming the potential obstacle that Eccles represented. First, the deal was portrayed as a merger of equals. At the deal’s announcement Simmons stated, “This merger is primarily the result of the vision of Spence Eccles, who had the foresight to recognize the potential for a second major banking organization in the western half of the US, headquartered in Salt Lake City.”²³ Additionally, Zions executives did not try to reign in Eccles as he fought the perception of the deal as an acquisition. Secondly, Eccles was afforded the prominent co-CEO role until 2002 when Salt Lake City would find itself on the world stage as it hosted the Winter Olympics. Even after 2002 Eccles would hold the title of Chairman until his retirement in 2004. Third, Eccles was awarded a liberal severance package. The deal ensured that while Eccles worked as co-CEO over the next three years he would receive an annual base salary and cash bonus equal to those awarded to Simmons. In 2002 Eccles would begin receiving retirement benefits valued at \$800,000 annually. Upon his retirement on his 70th birthday in 2004, Eccles would receive a \$1.5 million bonus while his retirement benefit would grow to \$1 million annually. It “might be a little high” observed one banking analyst of the benefits package when considering factors such as the company’s size and those awarded in other banking acquisitions. “But there are some political considerations that help explain that,” one analyst observed.²⁴ Fourth, the new bank took the First Security name. In truth, Simmons had been looking to trade in the Zion’s brand name for one that would create less confusion.

Eventually, it looked as though the Zion’s strategy had succeeded. When the deal was announced on June 6, 1999, Eccles pronounced that the merger between Zions and First Security would achieve his two goals – pleasing shareholders and “keeping First Security from falling into the hands of an out-of-state company.”²⁵ However, before the deal would face final approval by shareholders, management would encounter several obstacles and turning points. Ultimately, the success of the merger would largely turn on three pivotal events.

Stumbling Blocks

As Zions and First Security approached the New Year it seemed that the banks would cruise through the merger process. The banks had identified redundancies in a variety of back-office functions (accounting, administrative, and information technology) that would allow the combined bank to pare its 17,000-employee workforce by 10%. Although executives believed that over half of the reductions could come through attrition, the banks began giving their employees weeks, and sometimes even months, of notice for specific layoffs. Back office integration was moving along steadily. By December, the banks were only weeks away from having several branches united on the same computer platform.

In the same month the Justice Department finally provided conditional approval of the merger. The clearance was subject to the divestiture of some 68 branches in Utah and Idaho – about a 1/6th more than the banks had originally anticipated. The combined bank would clearly not be a sum of the parts (see Exhibit 13). A week later the U.S. Federal Reserve Board provided its approval of the deal. It appeared that the completion of the deal was only weeks away – pending final approval by the shareholders of the two banks.

Shortly before the holidays the Securities and Exchange Commission handed the deal its first significant blow. The SEC ruled that Zions had violated government policy that limits to 10% the amount of outstanding common stock that could be bought back after a pooling-of-interest merger. The SEC claimed that over the last three years Zions had repurchased more than 10% of its share while completing multiple transactions. John Heine, a spokesman for the SEC, stated that the ruling was consistent with the agency's interpretation of its staff accounting bulletin No. 96.²⁶ In an article for *American Banker*, an industry analyst observed, "This ruling is quite unusual. It seems that the SEC is applying new standards that are more strict than we have seen in this industry." Similarly, attorney Robert Tortoriello concluded, "This further evidences the great aversion that the SEC has to pooling transactions. What was a flashing yellow light a few months ago has now become a flashing red light."²⁷

As a consequence of the SEC ruling, Zions had to restate the earlier acquisitions as purchases, rather than poolings of interest. It added \$500 million of goodwill to Zions balance sheet that would be expensed by \$25 million a year for twenty years." Gibbons, Zion's CFO, expected that it would be February before the bank could restate its financials and produce an amended merger document. But at this point few felt the deal was in trouble – at worst delayed, not done. Lori Appelbaum, an analyst with Goldman Sachs, asserted, "Business trends are still strong and unaffected. This is an accounting issue, not a business issue. We will be moving toward purchase accounting anyway with the end of pooling accounting at the end of 2000." Joseph Morford observed, "This has been a true test of patience for management, but the merits of the deal are still there."

By March the deal was once again nearing completion when at least one of the banks was surprised again. On March 3rd First Security announced that its first quarter would fall far short of expectations. Specifically, First Security stated that rising interest rates and other factors would cause earnings to drop as much as 27% from the prior quarter. That day Zions' shares closed at \$37 – down 26% from the day's opening price of \$50 per share. A subsequent shareholder lawsuit would contend that First Security executives had realized as far back as October that rising interest rates coupled with the write-off of auto and consumer loans would significantly affect earnings.²⁸ Plaintiffs claimed that First Security management attempted to push disclosure of the troubles until after the merger in order to capture the large premium Zions tendered to complete the merger. The blow in early March would lead to a third pivotal event two weeks later.

The *Wall Street Journal* summarized the third surprise succinctly on its front page: "The board of Zions Bancorp. is legally committed to backing the company's merger with First Security Corp. There's only one hitch: Zion's investment banker at Goldman Sachs Group isn't, and that may imperil the deal." In mid-March Goldman Sachs withdrew its fairness opinion that it had submitted when the deal was announced in June. However, under the terms of the original merger agreement, Zion's board was obligated to proceed with the deal. Even in this merger marked by a nightmarish turn of events, the news was surprising and unusual. As companies decide to initiate a merger, they will enlist investment bankers to provide a "fairness opinion." The blessing by the investment bankers is meant to assist stockholders in determining whether to approve a proposed merger. While many argue that fairness opinions represent little more than a rubber stamp in support of management, investment banks maintain a certain interest in providing reliable analyses. The *Wall Street Journal*, noted:

The move by Goldman is highly unusual, but investment bankers may be under more pressure to walk away from poor deals. While investment banks are legally indemnified from lawsuits over fairness opinions, their reputations are very much on the line. Investment banks don't want to be tainted from blessing bad deals, and Goldman itself has come under some scrutiny for the fairness opinion it wrote for Mattel Inc.'s troubled purchase of Learning Co. for \$3.5 billion last year.²⁹

Zions would have to submit Goldman's revised opinion to shareholders before the final vote, which was scheduled for the end of March.

As the stumbling blocks mounted, tensions grew and the dynamics began to change. However, faced with the troubling earnings report, and Goldman's withdrawal of support, First Security's reaction was anything but timid. In a proxy filing with the SEC, First Security implicitly warned that lawsuits would follow any termination of the deal. "Zions is in breach of its obligations under the merger agreement to use reasonable best efforts to consummate the merger," Eccles asserted. In the event that the deal failed, Eccles warned that First Security was "prepared to pursue all options... to protect its interests and the interests of its stockholders."³⁰

The Dilemma

As the Oquirrhhs hid the setting sun, the sunlight reflection across the Great Salt Lake faded to a dim glow. The next morning, John Scott and the rest of Zion's directors would face shareholders for the last time before the final vote. The question remained: "Should the board recommend approval of the merger?" As Scott contemplated the quandary he summarized the fundamental considerations.

First, and perhaps foremost, the underlying industry dynamics that led to the deal had not changed. If anything, almost a year later the deal had become even more critical. There were several operational and financial issues. Most of the work to integrate back office functions had already been completed and was "ready at the flip of a switch". Both banks had encouraged attrition in order to pair the combined work force and eliminate back-office redundancies. As stand-alone entities each bank would walk away substantially weaker. Zions had already invested substantially in completing the deal. It had purchased First Security stock totaling 9.5 million shares (4.8% of outstanding shares) for much more than it was currently selling for. Zions and First Security had already entered into an agreement with BancWest Corp. to sell 68 branches (in order to get Justice Dept approval). Although agreement included an option that would allow Zions to unwind the deal, exercising the option would require a \$5 million fee payable to BancWest. Zions' share price was beginning to reflect the uncertainty (see Exhibit 14).

At the same time First Security continued to press for an approval. First Security shareholders had already approved the deal. Spence Eccles was forcefully asserting that Zion's Board is legally bound to support the deal with all of their power – his position backed by the transparent threat of an impending lawsuit. And if the merger failed it would leave both sides incredibly vulnerable. Even with the merger, many analysts believed that Zions had only bought itself a couple of years.³¹ One equity analyst noted: "There are no other regional banks in the Rocky Mountain region – they all have been acquired by somebody. If these two banks cannot come together, the odds are that they both will be acquired at some point."³² Financial ratings companies, like Moody's Investors Service, had already hinted that a failure could lead to a credit downgrade.³³ Should Zions try to re-negotiate the deal? Renegotiation at this point would prove difficult. Newspapers reported that Simmons and Eccles barely communicated with each other. The two hadn't spoken directly in weeks. One market analyst stated, "There still may be a fair chance these two companies can come together under renegotiated terms. Unfortunately, after all that has happened, I'm not sure if they will be able to." Another worried, "It seems like they have gone so far down the road they cannot afford to renegotiate."

Exhibit 1
Zions Bancorporation: Balance Sheet

	1999	1998
Assets		
Cash Due from Banks	898,300	922,654
Money Market Investments:		
Interest-bearing deposits	17,371	30,484
Federal funds sold	85,898	246,946
Security resell agreements	421,900	382,275
Investment Securities:		
Held to Maturity	3,330,444	2,850,756
Available for sale	778,930	954,057
Trading	327,845	191,855
Loans:		
Loans held for sale	204,800	232,253
Loans, leases, other receivables	12,648,325	11,037,292
Less Unearned income and fees	62,480	50,059
Less Allowance for loan losses	204,114	212,557
Net Loans:	12,586,531	11,006,929
Premises and equipment, net	287,448	249,896
Goodwill and core deposit intangibles	666,219	663,060
Other real estate owned	8,939	5,270
Other assets	871,075	544,895
Total assets:	<u>20,280,900</u>	<u>18,049,077</u>
Liabilities and Shareholder's Equity		
Deposits:		
Noninterest-bearing	3,276,097	3,394,884
Savings and money market	7,660,786	6,544,607
Time: Under \$100,000	1,836,645	2,439,696
Time: Over \$100,000	1,078,631	1,637,479
Foreign	209,780	204,244
	<u>14,061,939</u>	<u>14,220,910</u>
Securities sold, not yet purchased	237,020	29,702
Federal funds purchased	825,997	337,283
Security repurchase agreements	1,366,653	992,671
Accrued liabilities	247,406	321,258
Commercial paper	238,660	49,219
FHLB advances and other borrowings:	1,150,667	157,546
Long-term debt	453,471	453,735
Total Liabilities	<u>18,581,813</u>	<u>16,562,324</u>
Minority Interest	39,249	34,670
Common stock	888,231	796,519
Accumulated other comprehensive loss	(4,158)	(3,407)
Retained earnings	775,765	659,519
Total Shareholder's equity	<u>1,659,838</u>	<u>1,452,631</u>
Total liabilities and equity	<u>20,280,900</u>	<u>18,049,625</u>
Shares Outstanding:	85,593,000	78,636,000

Exhibit 2
Zions Bancorporation: Income Statement

	Years ended December 31,		
	1999	1998	1997
Interest income:			
Interest and fees on loans	1,001,741	694,338	423,456
Interest on loans held for sale	12,194	14,256	11,874
Lease financing	13,293	12,630	13,190
Interest on money market investments	67,234	92,248	88,267
Interest on securities	264,876	219,377	180,206
Total interest income	1,359,338	1,032,849	716,993
Interest expense:			
Interest on savings and money market deposits	247,729	173,833	125,124
Interest on time and foreign deposits	166,749	143,313	69,260
Interest on borrowed funds	203,371	141,761	153,005
Total interest expense:	617,849	458,907	347,389
Net interest income:	741,489	573,942	369,604
Provision for loan losses	17,956	14,034	5,930
Net interest income after provision for loan losses	723,533	559,908	363,674
Noninterest income:			
Service charges on deposit accounts	76,756	61,131	44,682
Other service charges, commissions, and fees	66,098	57,027	40,861
Trust income	15,762	10,969	8,075
Investment securities gain (loss), net	(2,970)	4,055	888
Underwriting and trading income	11,551	9,239	5,716
Loan sales and servicing income	40,516	50,365	38,734
Other	58,832	17,411	9,354
Total noninterest income:	266,545	210,197	148,310
Noninterest expense:			
Salaries and employee benefits	346,710	261,531	164,938
Occupancy, net	49,393	33,387	17,970
Furniture and equipment	45,477	38,256	24,500
Other real estate expense (income)	(66)	656	301
Office expense	57,482	51,892	31,140
FDIC premiums	2,152	1,528	708
Merger expense	27,691	38,128	815
Amortization of goodwill and core deposit intangibles	36,008	31,641	7,069
Amortization of mortgage servicing assets	911	5,484	2,152
Other	115,809	94,197	63,321
Total noninterest expense:	681,567	556,700	312,914
Income before taxes and minority interest	308,511	213,405	199,070
Income taxes	109,498	69,632	67,667
Net income before minority interest	199,013	143,773	131,403
Minority interest	4,949	420	0
Net income	194,064	143,353	131,403

Exhibit 3
First Security Bank: Balance Sheet

	December 31,	
	1999	1998
Assets:		
Cash and due from banks	926,148	1,026,335
Federal funds sold and securities purchased under release agreements	167,949	230,210
Total cash and cash equivalents	1,094,097	1,256,545
Interest bearing deposits in other banks	2,902	605
Trading account securities	22,650	329,109
Available for sale securities	5,528,269	4,764,127
Loans held for sale	772,696	2,391,508
Loans	13,631,398	11,448,559
Premises and equipment, net	429,422	378,032
Accrued income receivable	119,895	113,399
Other real estate	8,055	3,617
Other assets	822,821	594,220
Intangible assets	560,722	409,367
Total assets:	22,992,927	21,689,088
Liabilities and stockholders' equity		
Deposits:		
Noninterest-bearing	2,272,811	2,752,009
Interest-bearing	10,937,605	9,906,565
Total deposits	13,210,416	12,658,574
Federal funds purchased and securities sold under repo agreements	3,697,346	3,747,084
U.S. Treasury demand notes	34,993	25,081
Other short-term borrowings	1,055,026	493,424
Accrued income taxes	349,986	333,881
Accrued interest payable	57,844	58,778
Other liabilities	231,661	167,213
Long-term debt:		
Guaranteed preferred beneficial interests	150,000	150,000
Other	2,435,755	2,459,558
Total liabilities:	21,223,027	20,093,593
Stockholders' equity:		
Preferred stock	451	484
Common stock	247,058	238,760
Paid-in surplus	296,822	181,906
Retained earnings	1,398,619	1,233,264
Accumulated other comprehensive income	(131,652)	30,377
Common treasury stock	(41,398)	(89,296)
Total stockholders' equity	1,769,900	1,595,495
Total liabilities and stockholders' equity	22,992,927	21,689,088
Shares Outstanding:	195,971,000	186,712,000

Exhibit 4
First Security Bank: Income Statement

	For the years ended December 31,		
	1999	1998	1997
Interest income:			
Interest and fees on loans	1,193,016	1,111,417	954,992
Federal funds sold and securities purchased under resale agreements	15,912	5,538	4,249
Interest-bearing deposits in other banks	408	177	69
Trading account securities	11,470	9,173	12,686
Available for sale securities	364,429	294,355	241,382
Total interest income:	1,585,235	1,420,660	1,213,378
Interest expense:			
Deposits	409,087	403,886	352,656
Short-term borrowings	234,548	204,902	163,096
Long-term debt	155,153	108,173	71,687
Total interest expense:	798,788	716,961	587,439
Net interest income:	786,447	703,699	625,939
Provision for loan losses:	59,447	71,923	63,386
Net interest income after provision for loan losses:	727,000	631,776	562,553
Noninterest income:			
Service charges on deposit accounts	88,334	90,755	90,835
Other service charges, collections, commissions, and fees	66,491	53,934	40,539
Asset sale and securitization gains	47,375	47,619	17,515
Bankcard servicing fees and third-party processing fees	4,875	31,247	34,295
Insurance commissions and fees	19,957	16,966	16,975
Securities commissions and fees	77,947	17,863	14,934
Mortgage banking and loan servicing activities	216,268	215,538	117,859
Loan servicing rights and amortization	(51,907)	(41,495)	(16,146)
Trust (fiduciary) commissions and fees	34,365	29,474	26,195
Trading account securities gains (losses)	8,633	994	1,446
Available for sale securities gains (losses)	13,426	8,075	3,150
Other	7,211	3,420	9,560
Total noninterest income:	532,975	474,390	357,157
Noninterest expenses:			
Salaries and employee benefits	475,575	386,715	304,903
Amortization of intangibles	19,119	11,666	7,537
Armored and messenger	7,868	6,658	6,065
Bankcard interbank interchange and fees	16,824	32,147	34,130
Computer service and software expense	27,060	17,037	12,000
Credit, appraisal, and repossession	31,122	27,931	17,176
Fees	16,407	14,645	11,589
Furniture and equipment	71,052	58,181	46,263
Office	179,418	168,108	149,241
Total noninterest expense:	844,445	723,088	588,904
Income before provision for income taxes:	415,530	383,078	330,806
Provision for income taxes:	142,188	135,398	115,532
Net income	273,342	247,680	215,274

Exhibit 5. Number of commercial banks and share of assets at the largest 100 banks, 1970–99³⁴

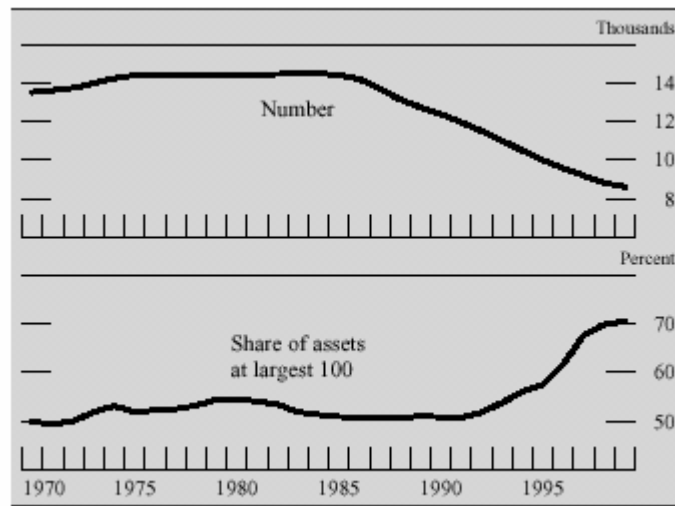


Exhibit 6. Non-interest income and its components as a share of total revenue, 1985–99³⁵

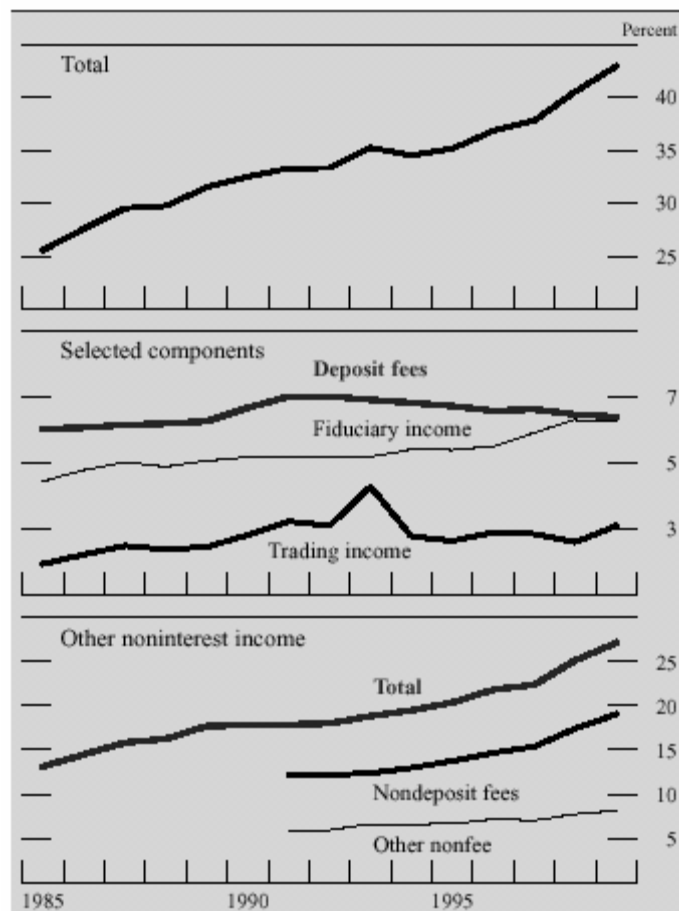


Exhibit 7. Off-balance-sheet securities lent, 1989–99

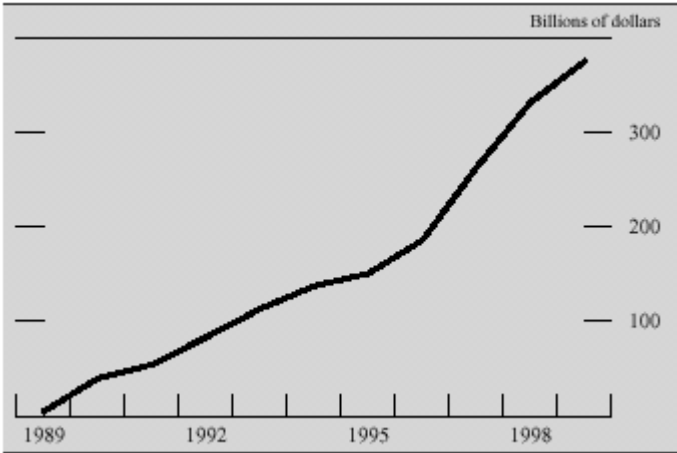
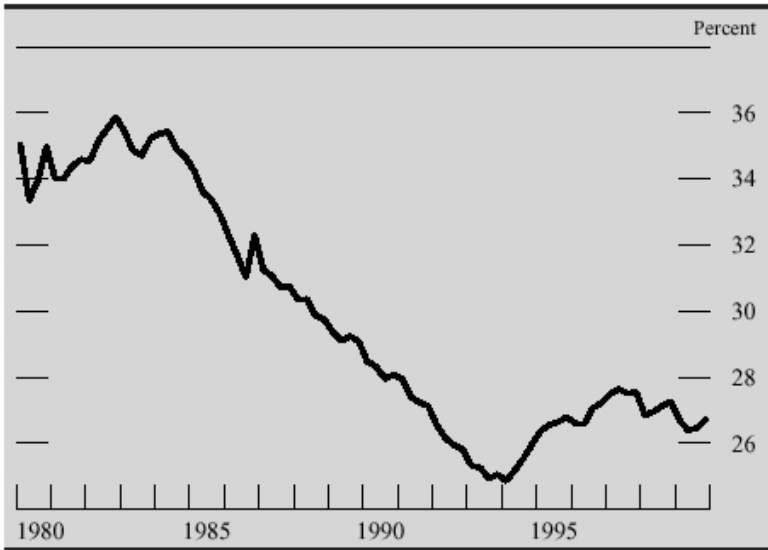
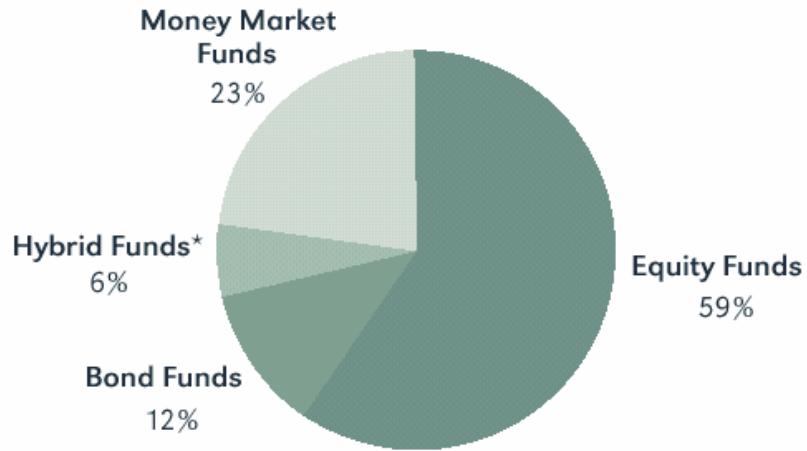


Exhibit 8. Bank loans as a share of total non-mortgage credit market debt, non-financial businesses, 1980–99³⁶



SOURCE. Federal Reserve Board, Statistical Release Z.1, “Flow of Funds Accounts of the United States,” table L. 101.

Exhibit 9. Assets of mutual funds (\$ billions), 1940–99³⁷



*Hybrid funds include balanced, asset allocation, and other similar funds.

Exhibit 10. Mutual fund assets (\$ billions)³⁸

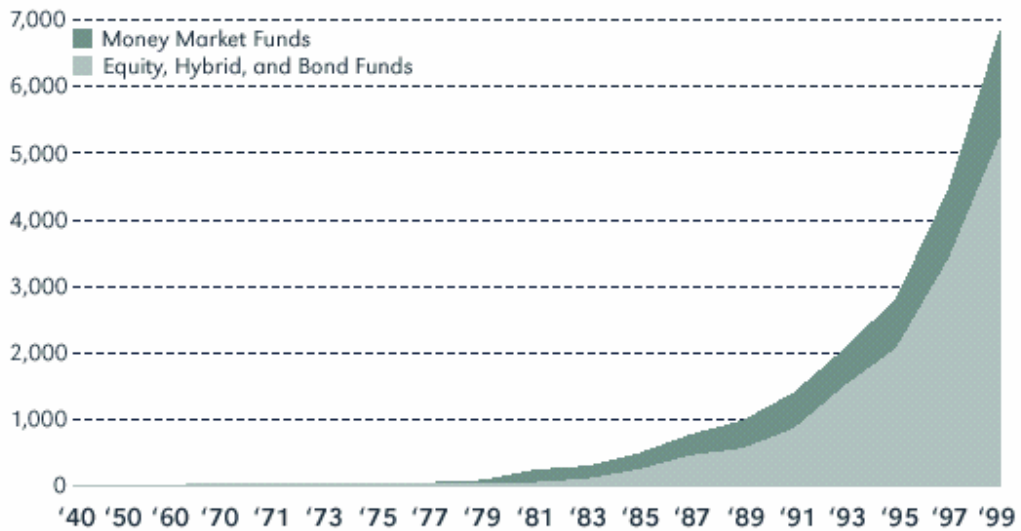


Exhibit 11. Zions Bancorp stock performance in the four years preceding the deal

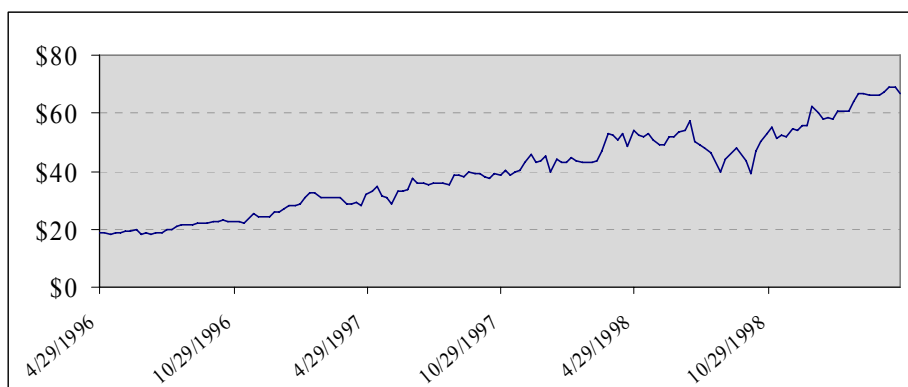


Exhibit 12. Large regional bank deals announced in the first six months of 1999.³⁹

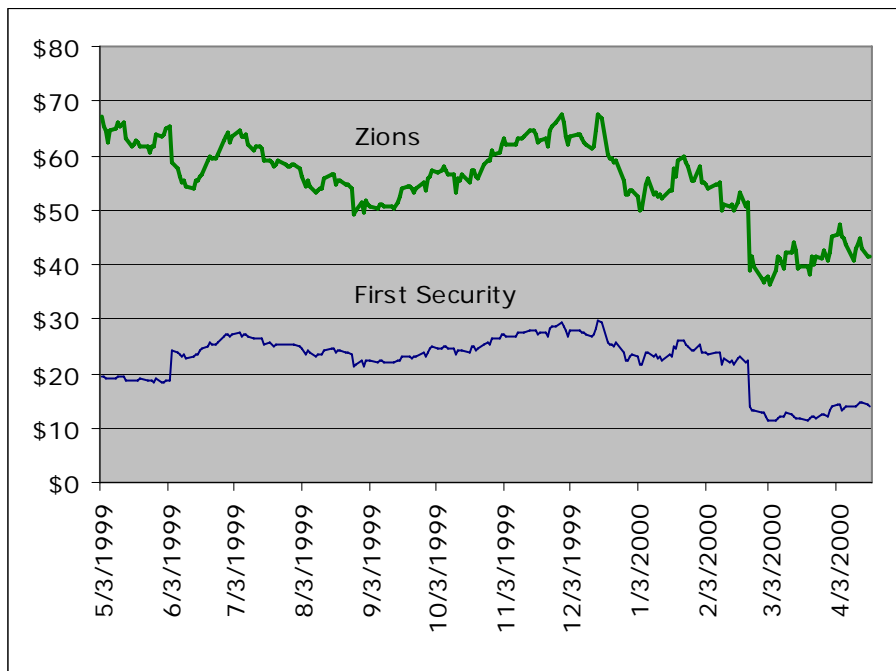
Bank	Size
Fleet Financial, Boston	\$16.0b
BankBoston, Boston	
Firststar, Milwaukee	\$9.9b
Mercantile Bancorp, St. Louis	
Zions Bancorp, Salt Lake City	\$5.9b
First Security, Salt Lake City	
AmSouth Bancorp, Birmingham	\$5.5b
First American, Nashville	
Charter One Financial, Cleveland	\$1.2b
St. Paul Bancorp, Chicago	

Source: WSJ Research

Exhibit 13. Combined Entity, June 8, 1999⁴⁰.

	Zions	+	1st Security	=	New1st Security
Employees	7,000		10,000		15,300
Branches	330		324		586
States	8		7		8
Assets	\$17.5b		\$22b		\$39b
Market Share					
				UT	49%
				ID	32%
				NV	18%
				NM	11%

Exhibit 14. Zions Bancorp and First Security stock performance during the deal



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- ¹ “Zion’s Shareholders Give Merger Thumbs-down,” Laura Mandaro, American Banker. New York: April 3, 2000. Vol. 165, Issue 64, Page 4.
- ² “Profits and balance sheet developments at U.S. commercial banks in 1999,” Bassett, William F. et al. 2000. Federal Reserve Bulletin. June 2000: Washington, DC, pg. 377.
- ³ Bassett et al 377.
- ⁴ Bassett et al 379.
- ⁵ Mutual fund industry report 2000 – background – what is a mutual fund, page 1.
- ⁶ “Going Outside – We’re Here to Help,” Karen Hube, The Wall Street Journal. November 30, 1998.
- ⁷ “Financial industry predictions for 1998,” Credit World, St. Louis: March/April 1998.
- ⁸ “Era May Be Ending for Big Local Banks,” Saul Hansell, New York Times, New York: September 2, 1997.
- ⁹ “Research forecasts banking upheavals,” Financial Technology International Bulletin, London: April 1996.
- ¹⁰ “Wave of US bank mergers continues,” John Authers, Financial Times, June 8, 1999.
- ¹¹ <http://www.zionsbancorporation.com/history.html>.
- ¹² “Zion’s goes on a big buying spree,” Sharon Gerrie, Las Vegas Business Press, May 31, 1999.
- ¹³ Gerrie, Las Vegas Business Press, May 31, 1999.
- ¹⁴ Ibid.
- ¹⁵ “Zions–First Security deal designed as a merger of equals... sort of,” Guy Boulton and Lesley Mitchell, The Salt Lake Tribune, January 2, 2000.
- ¹⁶ “First Security stock up; Zions’ takes hit,” Lesley Mitchell, The Salt Lake Tribune, June 8, 1999.
- ¹⁷ “First Security and Zions Bancorp agree to merge in \$5.9 billion all-stock deal,” Paul Beckett, Wall Street Journal, New York: June 7, 1999.
- ¹⁸ Authers, Financial Times, June 8, 1999.
- ¹⁹ “Zions–First Security deal designed as a merger of equals... sort of,” Guy Boulton and Lesley Mitchell, The Salt Lake Tribune, January 2, 2000.
- ²⁰ Boulton and Mitchell, The Salt Lake Tribune, January 2, 2000.
- ²¹ “Mergers of equals gets cold shoulder from Zions, Fifth Third, Firststar Execs,” Tania Padgett, American Banker, March 24, 1999.
- ²² Boulton and Mitchell, The Salt Lake Tribune, January 2, 2000.
- ²³ “Western US banks to merge,” William Lewis, Financial Times, London, June 7, 1999.
- ²⁴ “Zions cleared to buy First Security,” Lesley Mitchell, The Salt Lake Tribune, December 14, 1999.
- ²⁵ “Merger in Utah would unite two strains of in-state banking,” Olaf de Senerpont Domis, American Banker, New York, June 8, 1999.
- ²⁶ “SEC stock buyback ruling disappoints Utah deal partners,” Tania Padgett, American Banker, New York: December 28, 1999.
- ²⁷ “Tania Padgett, American Banker, December 28, 1999.
- ²⁸ “Shareholder sues First Security over bank merger,” Lesley Mitchell, The Salt Lake Tribune, October 4, 2000.
- ²⁹ “Deals & deal makers: Zions-First Security deal is dealt a blow as banker Goldman withdraws blessing,” Steven Lipin, Wall Street Journal, New York: March 14, 2000.
- ³⁰ “In brief: 1st Security fires salvo at Zions,” American Banker, New York: March 16, 2000.
- ³¹ John Authers, Financial Times, June 8, 1999.
- ³² “Bank merger: Great deal of trouble,” Lesley Mitchell, The Salt Lake Tribune, March 31, 2000.
- ³³ “Banks face credit downgrading,” Lesley Mitchell, The Salt Lake Tribune, April 5, 2000.
- ³⁴ “Profits and balance sheet developments at U.S. commercial banks in 1999,” Bassett, William F. et al. 2000. Federal Reserve Bulletin. June 2000: Washington, DC, pg. 368.
- ³⁵ Bassett et al. 379.
- ³⁶ “Profits and balance sheet developments at U.S. commercial banks in 1999,” Bassett, William F. et al. 2000. Federal Reserve Bulletin. June 2000: Washington, DC, pg. 377.
- ³⁷ Source: Investment Company Institute
- ³⁸ Source: ICI
- ³⁹ “Is the bank next door merger material?” Paul Beckett, Wall Street Journal, New York: June 9, 1999.
- ⁴⁰ “First Security stock up; Zions takes hit,” Lesley Mitchell, The Salt Lake Tribune, June 8, 1999.