

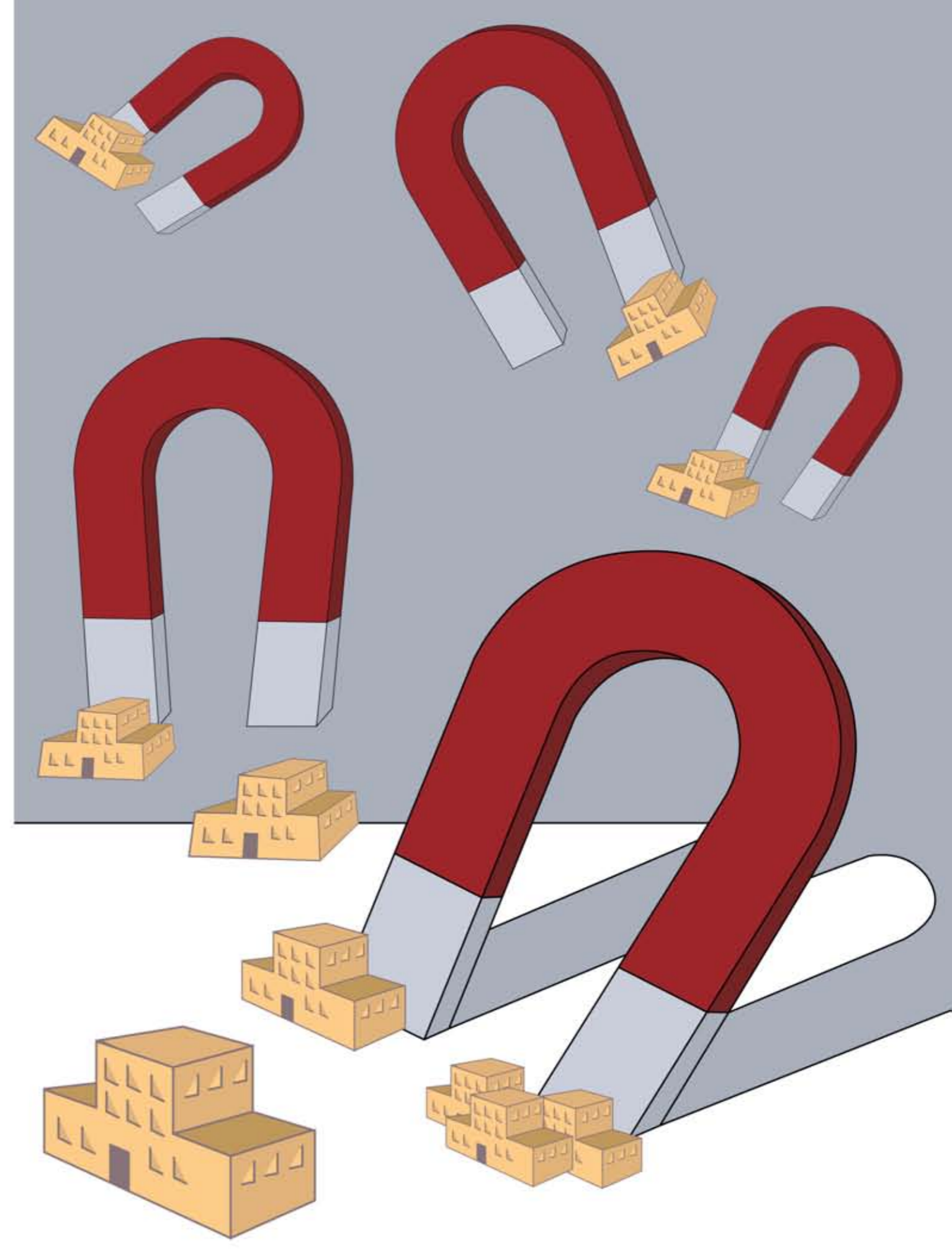
THE TECHNOLOGY PICKUP

Booming M&A activity is drawing investment to mortgage vendors.

Like the industry it seeks to serve, the mortgage technology sector lost its luster when the housing market took its turn for the worse. Companies that had been courting investment and acquisition partners suddenly found themselves out in the cold and many firms did not weather the storm.

But interest is picking up for those that have hung around and survived the bottoming of the housing market. Investment partners and those looking for merger and acquisition opportunities are being drawn to mortgage technology, as many see the current climate as an opportunity to get in on the ground floor of an industry primed for a revival.

By Austin Kilgore



The market for vendor acquisitions peaked around the same time as the housing market. Since the decline, the return of investor interest has come in waves, focusing on specific types of technology providers.

In 2009, vendors that provided technology to the default industry were a popular target for investment and acquisition. In addition, there was considerable consolidation in the origination technology space, with many point-of-sale and loan origination system providers merging or going out of business. 2010 was marked by opportunistic investors, typically venture capitalists and private equity firms, taking gambles on technology vendors they could acquire for a low price and hold onto until the market turned around.

"In 2009, you had some people looking at fire sales—some venture capital guys and some private money saying if we can find a company that spent millions and millions on technology solutions, and we can buy them for pennies on the dollar to get the technology and wait out the storm, then maybe it's a good buy," said Scott Cooley.

"A company that maybe in 2005 or 2006 would have sold for \$20 million, would have sold for \$3 million, or even less," he added.

Cooley's career in mortgage technology spans decades. Currently, he's a consultant who advises lenders and vendors on technology implementation and mergers and acquisitions through his Silicon Valley-based company, Cooley Consulting.



"There are a lot of opportunities for companies with good technology to consolidate their products and go to market with a more holistic offering."

Michael Detwiler, CEO,
Mortgage Cadence

Looking to 2011, industry experts and those actively involved in investment deals believe the renewed interest in technology vendors will continue to blossom across all sectors of the mortgage space. But the attributes of a vendor that attract one type of investor are negatives that repel others.

The type and background of those investors is also varied. While the traditional mortgage technology acquirers—large, publicly traded firms like Lender Processing Services, First American Financial, Fiserv and Wolters Kluwer, among others—will continue to practice a calculated and tempered acquisition strategy, while new sources of investment dollars not previously involved in the space are also making a play for vendors.

In August, the private equity firm Monitor Clipper Partners made a multimillion-dollar investment in technology provider Mortgage Cadence. With those funds, the Denver-based company intends to acquire vendors and technology that complement its existing offerings, which include a LOS, document preparation, loss mitigation and compliance software—a strategy that CEO Michael Detwiler said has already begun to take root.

There were a number of deals industrywide in 2010 and the momentum will continue to grow in 2011, he told *Mortgage Technology*, adding he began fielding calls from prospective sellers soon after the investment deal closed.

"The investment from Monitor Clipper gives us the opportunity to get much more aggressive from an acquisition perspective," Detwiler said.

Even with all the money in the world, a company set on acquiring other vendors can't be successful without a method and strategy, which begins with the opening conversation between the potential buyer and seller.

"I'm usually pretty direct. I don't say, 'Hey, can I buy you?' But I will say that I think there are a lot of opportunities for companies with good technology to consolidate their products and go to market with a more holistic offering," Detwiler said. "If you go in and can become a one-stop shop; you get a master services agreement in place and it's easy to just add in additional products and services."

"That rings true with a lot of companies because they've faced the barriers of getting business they know their technology can service, but they only have one little thing or they're not financially viable enough," he continued.

"If you have a conversation like that and start to appeal to things that you know they struggle with and face, and then you ask them if there's an opportunity for future investment, and then it goes from there."

For vendors, there are a variety of benefits to acquiring competing or complementary vendors and technology.

When one firm acquires a niche provider, it adds the technology and the knowledge base of its developers to the organization. It also gives the buyer access to the seller's clients to target sales and marketing efforts.

Acquiring vendors is a more regimented process at large public firms. Potential deals come to LPS in a number of ways, explained Don Covey, the managing director of origination technology at the Jacksonville, Fla.-based company. One way is when vendors approach LPS with a proposal.

"When we get approached by a company, it's because they've been able to take their organization to the limit that they've gotten it to and they can sustain a good revenue stream going forward," Covey explained.

"But they know they need to move to the next level," he said. "To do that, they need a capital investment."

"When we talk to a company about an acquisition, it is so they could marry in and leverage the whole infrastructure of LPS," Covey continued. "They want to participate in the deal going forward. It's a move to grow their pride and joy within our organization."

Other times, LPS needs to fill a void in its offerings and pursues an existing vendor. In other cases, a vendor hires a consultant or investment banker to prepare the company and solicit it for sale to the broader investment space.

No matter how the prospective acquisition comes to LPS, the company always evaluates how the deal would fit in its existing products and services and its in-house M&A department spearheads executive review and approval even before LPS reaches out to a potential partner to make an offer.

The established process at vendors like LPS ensures proper due diligence to satisfy their boards of directors, shareholders and other Wall Street participants that keep an keen eye on the firms.

But it can also impair the large public companies from moving quickly on a potential deal or to take a gamble on an upstart. It's also the byproduct of a different goal in acquiring vendors. Covey said LPS looks for established companies, rather than investing in a new entity the way venture capitalists do.

"You've got to have a certain track record generally three to five years' worth, to be able to put yourself out in the market," Covey said. "Unfortunately based on the market conditions, many people's balance sheets in that period don't look very good because the technology segment was a tough market."

How an acquisition fits into a buyer's operation differentiates how investors evaluate vendors for an investment.

"The venture capitalist space will assess and evaluate deals differently than LPS will, on both the positive and negative side," Covey said. "We will give value on synergy, but we'll take away value for organizations based on market conditions."

"A venture capitalist can look at it purely as a valuation, not taking into consideration the impact on the bottom line of the acquiring company or market conditions," he said.

On the other side of public money M&A is the opportunity to take on shareholders with an initial public offering. In May, Pleasanton, Calif.-based Ellie Mae, which provides LOS and related technology, filed its intent to go public with the Securities and Exchange Commission, with the assistance of lead underwriter Goldman Sachs.

As of publication, the IPO has not happened, but on Dec. 17, Ellie filed its second updated form S-1, a step required during any protracted IPO process. Ellie's position in the LOS space, combined with its seemingly stalled IPO, has led to speculation on the offering's status.

Ellie Mae declined *Mortgage Technology's* request for comment, citing its statutory "quiet period" that limits company statements during the pending offering.

In 2009, the company posted a \$1.7 million profit off revenue of nearly \$58 million, according to Ellie's SEC filings.

Some industry observers, like Detwiler, don't believe Ellie Mae is in the right place for an IPO.

"I don't wish anybody ill will; I hope they're successful," he said. "But is it the best thing for the company now, is it the best timing? I don't think so."

"I don't believe that they will have an IPO," Cooley said. "If they did, it would be great for the industry. It would provide credibility to our industry and would provide a big influx of capital into Ellie Mae."

Longtime mortgage industry spectators no doubt associate Cooley's name with Contour Software, the LOS and technology firm he started in 1982.

Cooley sold Contour to First American in 1998 and joined the company to run the Contour business as a division within the mega-firm.

Less than three years later, he facilitated First American's sale of Contour to Ellie Mae, and briefly served as its chief strategy officer until 2002.

Cooley believes Ellie Mae's ownership group and CEO Sig Anderman have set their sights too high for the value of Ellie Mae, given the current depressed values for vendors.

"I expect that when [Anderman] becomes reasonable with his pricing and a little bit more accepting of market dynamics, he'll be able to sell the company," Cooley added.

If Ellie does eventually go public, Cooley believes it will be on a smaller scale than current plans. "It's not going to be with a top-name underwriter," he said. "I don't think Goldman Sachs will ever take them public."

Cooley's not the only one to postulate that Ellie Mae's IPO won't happen. Some have speculated initiating the IPO process is a strategy to generate interest in Ellie Mae from a private suitor.

Ellie Mae officials declined to respond to the industry buzz and Cooley's comments, citing company policy and the ongoing quiet period.

But Jordan Brown, CEO and founder of mortgage technology consultancy Marketwise Advisors in Jacksonville, Fla., doesn't put too much weight in that theory. He believes the delayed IPO is a function of Ellie Mae leadership biding its time until officials feel they can maximize Ellie's prospects on the New York Stock Exchange.



"I don't believe that [Ellie Mae] will have an IPO."

Scott Cooley, owner, Cooley Consulting

"That's an awfully expensive and involved process to go through if that's their strategic goal," said Brown. "They're in very solid hands with Goldman Sachs and I'm sure they'll shepherd them to a successful conclusion."

Going public is a way to make investors not currently in the space part of the mortgage technology sector, but aside from Ellie Mae, there aren't any other vendors that have initiated IPOs.

Detwiler said he has no plans to take Mortgage Cadence public and doesn't believe many of his competitors and colleagues have IPO aspirations anytime in the immediate future.

"It used to be the dream to go public, but I'm not so sure that's the dream anymore," he said. "I think people would rather be a private company that's very profitable and not be subject to the regulations around a public company."

But investors not currently in the mortgage technology industry are positioning themselves to enter the space through other investment strategies.

"I would expect in the deal queue out there that there will be some significant deals coming in the first quarter of 2011 that will open the eyes for nontraditional mortgage technology vendors to play a new role in the industry," Brown said.

Detwiler, a recent beneficiary of such an investment, agrees that more investment is coming. So much so that there's more available capital than viable investment opportunities.

"There are hundreds of private equity firms trying to make investments," Detwiler said. "There are billions and billions of dollars sitting on the sidelines wanting to invest in companies like Mortgage Cadence."

"The people investing in mortgage technology believe the space is depressed right now," he continued.

"They believe that mortgage is a big part of the fuel of the U.S. economy and if they have any experience in the mortgage space, they believe they're getting in on the ground floor."

The pace of acquisitions has already picked up. LOS provider Calyx announced its acquisition of product and pricing engine Loan-Score Decisioning System on Dec. 22.

In the first week of the new year, Ellie Mae followed suit, acquiring PPE vendor Mortgage Pricing Systems.

Private equity firm TPG Capital completed its acquisition of MacDonald, Dettwiler and Associates' property information business, an \$850 million deal announced in November for MDA Lending Solutions and Marshall & Swift.

"Deals like this serve as confirmation for others considering similar acquisitions," said John Guzzo, managing director at New York City-based investment bank Berkery Noyes. "The companies that offer validation, verification and/or valuation solutions are in high demand."

There's more certainty about mortgage technology's future and a belief the space is close to bottom, if not already there. Values are depressed, but aren't worsening.

"The smart money is going to be looking at buying in the next six to 12 months," Cooley said. [MT](#)

Notable Mortgage Technology M&A/Investments

2011 Target

MDA Lending Solutions/Marshall & Swift
Mortgage Pricing Systems

2010 Target

MortgageDashboard
Inmatrix Technology Pty.
Techs Loanstar
Strategic Analytics
Abacus Accounting Services
Equifax Enabling Technologies
Dexma
SymSure Limited
Perceptive Software
Mortgage Cadence
Commerce Velocity
Aklero Process Solutions
Lender Support Systems Inc.
Corvisa
DocuSign
Loan-Score Decisioning Systems

2009 Target

BasePoint Analytics
Mavent
Fiserv Loan Fulfillment Solutions
Stormwater Research Group
Oakwood Financial Technologies
Rapid Reporting Verification Co.
Digital Risk
Netupdate from Most Home Corp.
Lydian Data Services

Acquirer

TPG Capital
Ellie Mae

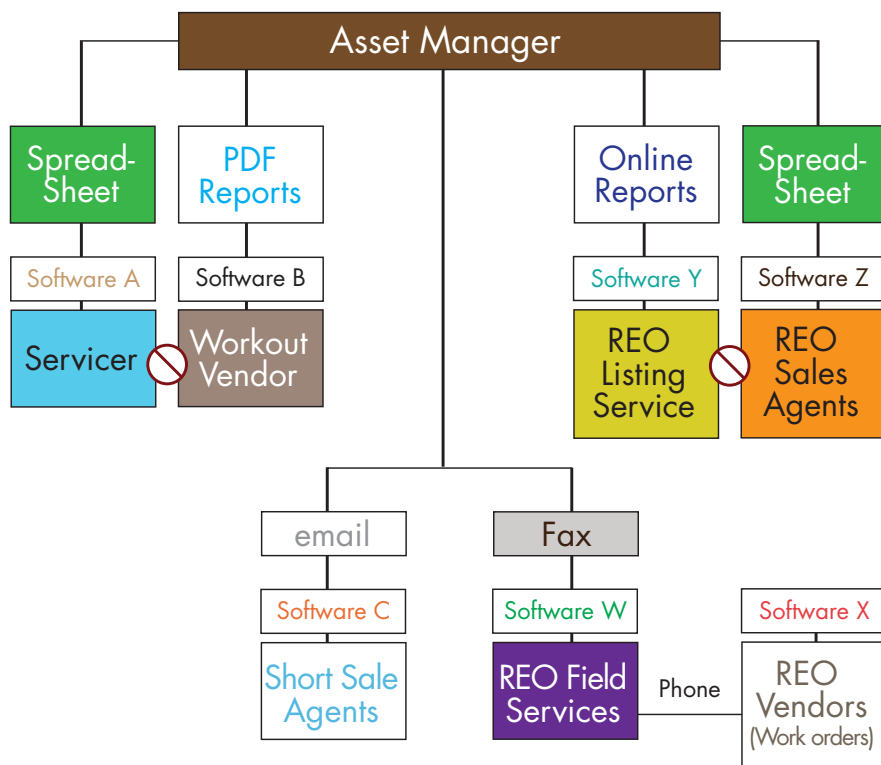
Acquirer

Catalizador Private Equity Fund
SunGard Data Systems
ZZUSA
Interthinx
Mortgage Banking Solutions
CRIF Corporation
Prime Alliance Solutions
CaseWare IDEA
Lexmark International
Monitor Clipper Partners
Fidelity National Financial
Hall Underwriting & Consulting
Emphasys Software
StreetLinks National Appraisal Services
Scale Venture Partners
Calyx Software

Acquirer

First American CoreLogic
Ellie Mae
ISGN
Wolters Kluwer Financial Services
Paladyne Systems
Equifax
Century Capital Management
Mortgagebot
Headstrong Corporation

PROCESS INEFFICIENCIES



Servicing Side

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Borrowers are more likely to positively respond to a short sale offer after a modification attempt is made. With a definitive outreach plan, time-to-money considerations are greatly accelerated for the investor, as a clear course of action is executed.

Red Rock's distressed asset workout program utilizes extensive net present value and waterfall algorithms that are customized to individual investor- or program-level specifications, allowing for highly targeted workout programs. This benefits investors, while also giving borrowers immediate feedback on the likelihood that a workout can be achieved or if other options should be pursued for a dignified exit.

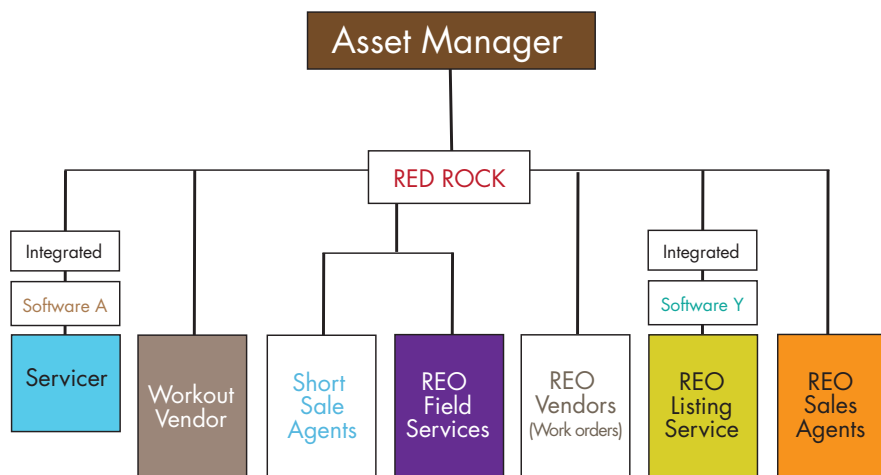
Total Debt Matters

Although it is widely accepted that the servicers have failed to implement modifications on any scale that will perform well for stakeholders, when our field service agents make contact with the borrower, in addition to examining the mortgage workout options, the borrower is also exposed to an extensive "Soft Chapter 13" debt settlement—a debt relief program that attacks the major sources of debt competing for the cash flow meant to service mortgage debt; namely credit card debt, personal lines of credit, business debt and unpaid tax debt.

Although the servicers do not address the total debt picture for each borrower, Red Rock's borrower debt relief model has yielded greater secured loan performance by incorporating the total debt service approach.

Red Rock uses an affiliate, Debt Relief IQ, for a practical and economical (no enrollment or upfront fees) approach to settle debt. The company provides a unique approach to settling unsecured debt that puts the control in the hands of consumers with a workflow portal that guides them to resolution.

SOLUTION: SINGLE SYSTEM OF RECORD



The top chart shows how an asset manager must manually consolidate data, a process susceptible to human error and loss of data integrity. With the single system of record technology shown in the bottom chart, all participants access the same automated system.

In many cases, an unsecured debt settlement is necessary for borrowers to meet HAMP debt-to-income requirements. If a consumer can reduce unsecured debt payments, that extra money can be used to pay the mortgage.

Unsettled, unsecured debts that end up as judgments or wage garnishments jeopardize the borrower's abil-

ity to sustain payments, even after a successful loan modification is accomplished. All the time and resources the servicer dedicates to execute a modification can be unwound if the servicer ignores the competing debt. [MT](#)

Richard Kaye is CEO of Irvine, Calif.-based Red Rock Servicing.