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Exploring Return on Automation

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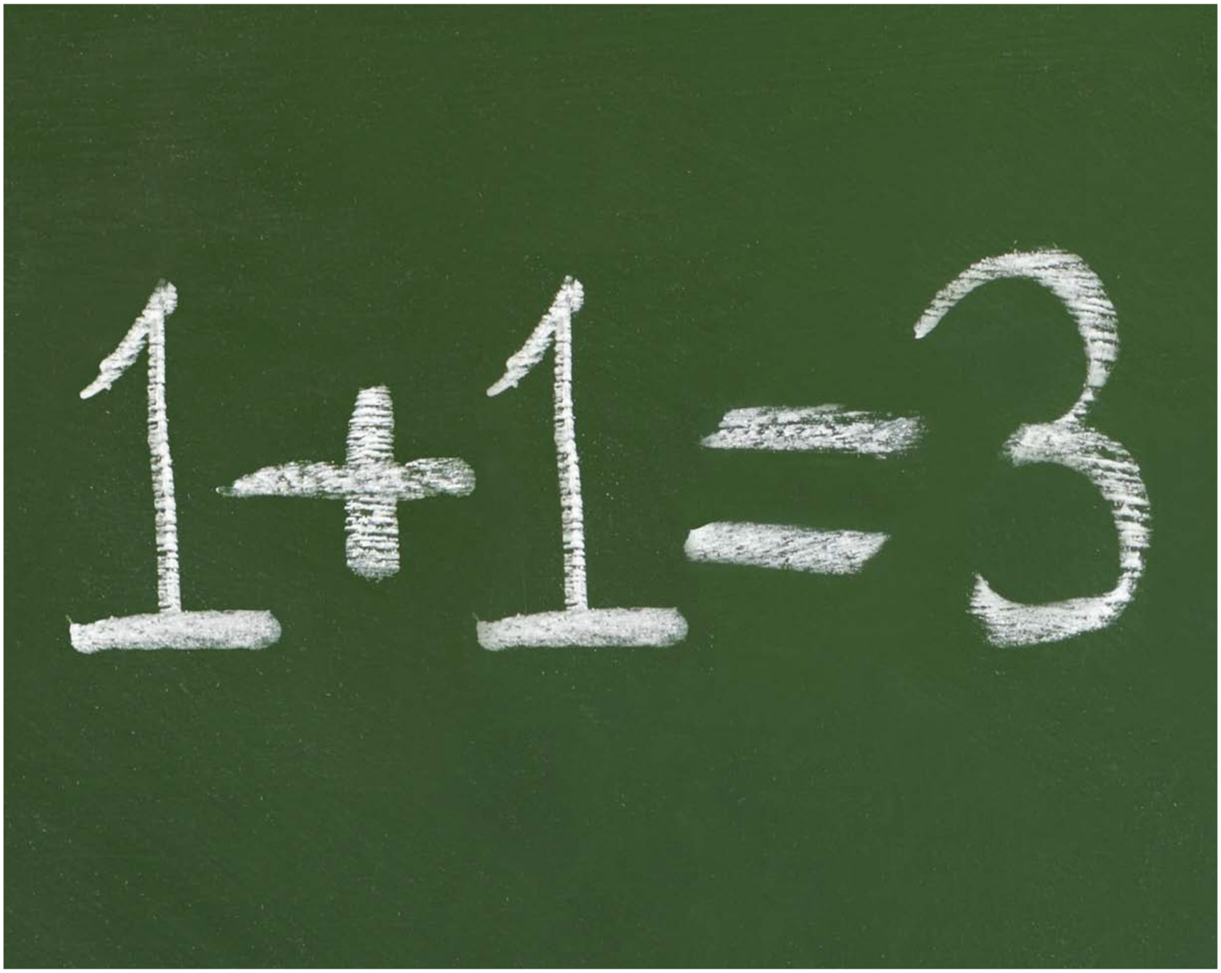

The equation for maintaining innovation after a successful M&A.

When one mortgage technology vendor acquires another, the questions start flying as soon as the merger is announced. If new product releases are promised, customers want to know how long until they can actually see them—and whether the acquiring vendor's fees will go up before users really start getting more bang for their buck.

"What are the perceived synergies in the merger?" asked Craig Focardi, senior research director for consumer lending at Boston-based TowerGroup.

By Scott Kersnar

"Are you trying to acquire a customer base you don't have? If the point is to acquire the software, is it written in the same source language as yours?"

Jordan Brown, CEO of Ponte Vedra Beach, Fla.-based Florida Marketwise Advisors, quickly rattled off five elements of a successful M&A: a solid financial metric, enabling product synergy, providing customer leverage (cross-selling and promotion), diversification of the income base and "people" (having a good cultural match).

"That last one is a make-or-break factor," he said. Brown's criteria track well with what Focardi and others said.

No one acquires another company without believing that targeted synergies actually will be realized. But Mark Herndon, president of Addison, Texas-based Parkwood Advisors said, "There are two kinds of acquirers, those who have screwed up, and those who will screw up. There is no easy cookie-cutter approach to doing M&A deals."

A Google search will take you to Herndon's widely admired 2005 slide deck "M&A Integration: Deal Killers and Best Practices."

That deck was used recently for deal analysis by a large financial services firm, he told *Mortgage Technology*.

1+1=3 is a formula often used to describe a synergy that produces benefits beyond the sum of its parts.

But Herndon found only a minority of acquirers achieving that enhanced level of success. Drawing on a variety of sources, he estimated that 70% of M&A deals fail to achieve anticipated synergies. Moreover, he found 50% of acquirers reported a drop-off in overall productivity in the first four to eight months and a mere 23% of acquisitions achieved their internal rate of return. In retrospect, C- was the average grade senior executives gave their completed acquisitions.

"Two things make folks fail to get synergy," said Jonathan Corr, chief strategy officer for Pleasanton, Calif.-based technology vendor Ellie Mae.

"One is that people don't first think strategically about why they're acquiring something. They just have this idea of acquiring revenue per se." The second instance, he said, "is when they become enamored with a deal or acquisition and buy it at the wrong time in terms of price. You've got to pay a price that doesn't create such dilution that you're not creating accretive value."

Even if you do have a good fit in terms of technology, strategic synergy and price, he observed, the deal can flop if there is poor tactical integration of the cultures and soft assets, as well as the technology and operations of acquirer and acquiree.

"Hanging on to whatever assets you saw upfront [in the acquisition] is very dependent on the people, the customer relationships, the partnerships," brought to the deal by the acquired company, Corr said.

Indeed, Herndon found that while clear communication, particularly with key personnel in the acquired company, was rated a top priority in one study, only 43% of respondents said they achieve it. As a result, Herndon found, 47% of acquired executives leave in the first year at the new firm and 75% leave in the first three years.

That type of brain drain can be particularly disastrous in mortgage technology mergers. It is a truism in this industry that in-depth mortgage technology expertise is rare.

Thus, when San Diego-based private equity firm TVC Capital recently reacquired technology firm Del Mar DataTrac from Fiserv, TVC managing principal Jeb Spencer brought back Rob Katz, who had previously served DMD as head of sales and marketing.

"You need a strong management team made up of people who are known and respected in the industry, to show that you offer software made by mortgage professionals for mortgage professionals," said Spencer. "Not many people can get to that level. Rob Katz is one who has."

"Not a lot of people know what it takes to actually move the ball forward in mortgage technology," agreed Don Covey, managing director of origination technology for Lender Processing Services. "Make sure you are acquiring that talent; technology without expertise doesn't get you very far."

TO GET IT DONE RIGHT, GET IT DONE FAST

Many say mergers succeed when managers demand that everyone focus all their attention on achieving the merger's strategic objectives quickly.

Successful mergers come when strong management and good planning have all employees hitting the ground running by the time the merger is announced, said Herndon.

Conversely, said Spencer, an early warning sign that things are not going well is a drop-off in sales. "The financials will tell you almost immediately whether the deal is working," he said. "If after 60 days you see a drop off in sales, you know something is off track. And you often see delays in product releases after an acquisition."

One reason that happens goes back to communication, he said. "You need to clearly communicate why this acquisition was done. Product delays show that your people are not feeling great about this merger."

Happy customers are the best proof of success. Mark Dallal, vice president for secondary marketing at Miami-based Kislak Lending Solutions, said his company was pleased that Ellie Mae acquired Mavent in December 2009, "because it adds efficiencies to our process flows and supports the data integrity of the compliance process. The fact that Mavent is integrated with Encompass at such a high level, now that they're a partner on the same team, meant that we ended up switching to Mavent from a competitor of Mavent purely because of the combined solution that's offered now."

Dallal said the metric his company used to confirm that they were benefiting from Ellie Mae's acquisition of Mavent was in a 50% reduction in calls that the vendor received for help with compliance issues.

He added further that while Kislack is happy with its current product-and-pricing engine, Optimal Blue, he is actively watching the performance of Ellie Mae's newly acquired PPE from Mortgage Pricing Systems—now rebranded as the Encompass Product and Pricing System—to see whether it delivers synergies that would justify switching PPEs.

"I would rather use any vendor Ellie Mae owns vs. an outside vendor because the integration is more complete," said Dallal.

A MERGER TO WATCH: CALYX BUYS LOAN-SCORE

An M&A deal everyone in the mortgage industry has been reading about is Calyx's acquisition of Loan-Score.

Small wonder. The first 200 entries in a recent Google search on Calyx were all devoted to that merger.

One reason the deal got so much media play is that San Jose, Calif.-based Calyx Software has been among the pre-eminent providers of mortgage point-of-sale software for years. Calyx Point boasts 70% market share among brokers, and the Loan-Score merger signals a major Calyx advance toward serving a broader range of players in the mortgage banking space, like community banks and credit unions.

"Looked at from the standpoint of business logic, Calyx's acquisition of Loan-Score is 100% dead on," said Covey.

Particularly with smaller vendors, acquisitions have a profound effect on the strategic focus of the company.

"If you have an LOS, adding a PPE and decisioning technology to your system is pretty straightforward," Covey continued.

However, if the strategic objective was to move deeper into the lender space, he said, "then some questions arise. If you think Loan-Score is going to drive because you are moving away from POS technology to a more robust lender-centric system, then Loan-Score might become the heart of your new loan origination software."

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FICS' suite of mortgage technology systems empowers organizations to **increase the number of loans originated and serviced per employee**, thereby cutting back expenses. Implementing technologically advanced mortgage software makes business intelligence more prevalent and useful providing organizations with **competitive advantages**. Lending and servicing managers are turning to FICS technology to help **streamline business processes** and manage their information more effectively. They are looking to **maximize profitability** in both good times and bad by **optimizing internal origination and servicing operations**.

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In any event, he said, "If Calyx and Loan-Score keep running separately, they will never achieve economies of scale. It does have to be a single solution in the long run." That last objective may already have been achieved; Calyx completed a tight integration with Loan-Score prior to the merger. But the market will determine how much that integration accomplished.

BEEFING UP TO HANDLE COMPLIANCE AND GAIN MARKET POWER

In the wake of a general collapse of the mortgage industry, some acquisitions obviously are motivated by fire sale prices rather than strategic objectives. But deliberately beefing up to help mortgage lenders and servicer cope with today's heavy compliance burden has been the strategic motive for more than one recent mortgage technology M&A deal.

The key determinations of acquisitions at Minneapolis-based Wolters Kluwer Financial Services is that they fall within the three categories of "regulatory compliance, workflow technology and actionable content," said Jason Marx, WKFS vice president and general manager for mortgage.

"Our acquisitions tend to follow that pattern," Marx said.

Another factor that Marx singled out was pursuing acquisitions in response to requests from the company's existing base of customers.

He cited Wolters Kluwer's 2009 acquisition of "substantially all" the assets of Austin, Texas-based flood determination specialist Stormwater Research Group. This addition to the WKFS settlement services business augmented the company's existing PCi flood determination offerings that serve some 1,500 banks.

As is typical with flood-services firms, Stormwater and PCi both employed trained map analysts to aid banks in determining whether a property required flood insurance. Both companies also helped lenders make sure flood insurance remains in place during the life of a loan. Given such overlaps, lender customers obviously benefit from having all their flood services handled by a single vendor.

The acquisition let Stormwater users get prompt flood determinations from the WKFS database, as well as PCi compliance analytics and settlement services.

"The Wolters Kluwer acquisition of Stormwater was a good change for us," said Troy Martin, a division manager for Austin-based second mortgage provider IBC First Equity, which already used WKFS doc management and HMDA reporting services. "Stormwater was a very hands-on, locally based company that gave us quick turnarounds. Those things stayed in place after they were acquired." And what Stormwater users got was a national presence. "If a local representative was not available when a problem came up, Martin said, "a rep somewhere else could help us out."

Global firms like WKFS have the advantage of having made their mistakes early on and applying those lessons to achieve staying power. And if they are service providers as well as holding companies, they have learned the value of integrating their acquisitions.

"The largest institutions are best positioned for integrated solutions to improve efficiency," said Focardi. "For mergers in a highly regulated world, a prerequisite for success is that the architectures match."

Jeff Lebowitz, president of Bend, Ore.-based MORTECH said recent studies show compliance as the leading motive for mortgage technology purchases in the current market. Seconding Focardi's observation that large institutions have the edge in creating efficiencies, Lebowitz has no trouble naming his pick as the leading technology provider in the mortgage space: LPS.

Like many, Lebowitz is more critical of LPS rival Fiserv and its notoriously brief ownership of Del Mar Database, which Fiserv bought in 2005 at the height of the mortgage bubble and sold in 2008 when the mortgage market was tanking. At time of purchase, owning DMD seemed like an obvious way to expand its footprint as a provider of back-office mortgage technology for small and medium-size mortgage lenders. But DMD became superfluous when Fiserv decided to concentrate on its core mission to provide bank technology.

While Fiserv is a latecomer in demanding integration among its business units, Covey said the history of LPS shows that integration is part of its DNA.

"Companies are driven by the need to grow and diversify," said Lebowitz. Particularly because there has been so much consolidation in the mortgage industry, he said, vendors need to beef up as well. "Smaller players have no pricing power with a big five bank," he said. "That's not a very good place to be in."

He said Calyx, Ellie Mae and all the other POS providers should merge into a single entity that could force and brokers and lenders operating in the originate-to-distribute space to deal with them.

"Companies are successful when they acquire a leadership position in their industry," Covey agreed. "They need size to do that, or they need a best-of-breed product or platform that gives them a leading position."

Or they may need all of the above. If, as widely rumored at press time, global consulting, technology and outsourcing firm Accenture is poised to complete a merger or strategic partnership with Bensalem, Pa.-based ISGN, the diversity of ISGN's outsourcing resources and mortgage technology holdings may have greater value to Accenture than any integrations ISGN has created between the various systems it has acquired.

ISGN's hefty bag of technology tools may be just the thing Accenture needs to create or enhance synergies for mortgage lending clients. MT