

Mortgage Banking

COMPLIANCE



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*Jumping Through **New Hoops***

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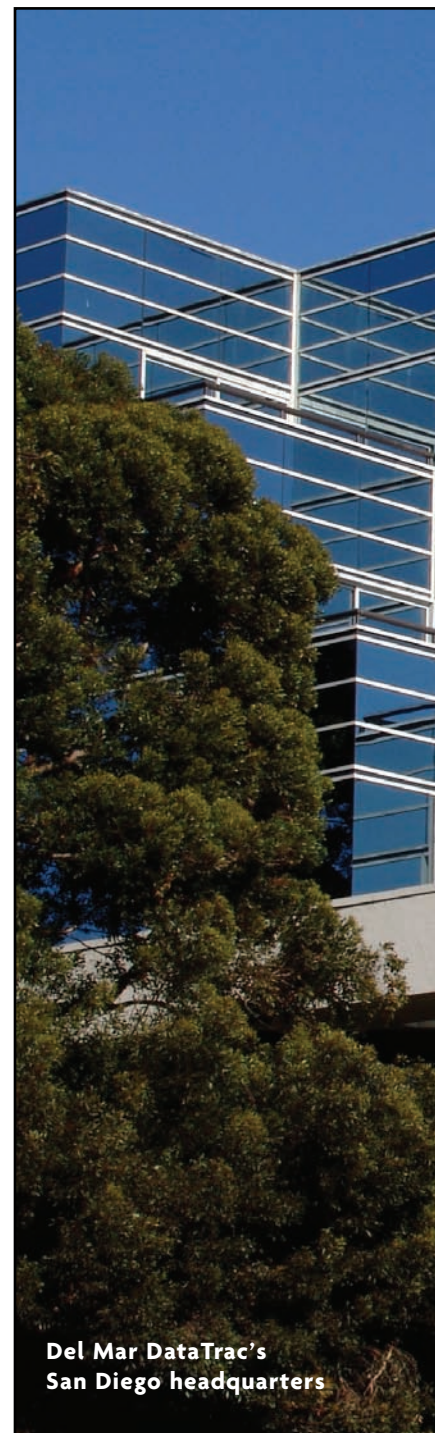
In the history of technology companies and financial backers, Del Mar DataTrac Inc. (DMD), San Diego, boasts one of the more unusual stories. The mortgage banking technology firm has been acquired by the same private-equity firm not once, but twice, in less than a decade. ■ TVC Capital LLC, also based in San Diego, first acquired DMD from company founder Tom Brown in 2001 when the private-equity firm was known as Titan Investment Partners. In 2005, Titan sold DMD to Fiserv Inc., Brookfield, Wisconsin. ■ However, the acquisition didn't work out as planned and Titan, now known as

This small mortgage banking technology company is staging a comeback after an acquisition that didn't quite work out.

TVC, jumped at the chance to buy it back—which it did in 2008.

■ The *modus operandi* of private-equity firms is to find a small, undervalued company, buy it and invest capital to boost market share and expertise, and then

sell it at a nice return on investment to a larger corporate entity. The small undervalued gem disappears into the maw of the bigger enterprise, and the equity firm moves on to its next deal. ■ In the case of DMD, Jeb Spencer, co-founder and managing partner of TVC, had been closely following the fate of the technology company it sold for two reasons—one emotional and the other remunerative. DMD was the first company Spencer was involved with after joining the old Titan Investment; plus, after the then-chief executive officer (CEO) left DMD, Spencer stepped in as chief executive officer for an 18-month stint. ■ On the financial side, when DMD was sold to Fiserv, there was an “earn-out” component to the deal, which meant the seller got X amount of cash upfront and X dollars over the course of the next three years as certain baseline goals were met.



Del Mar DataTrac's
San Diego headquarters

Mar DataTrac

BY STEVE BERGSMAN



PHOTOGRAPH BY NICK PARKS

"I had made frequent inquiries over the two years we didn't own DMD," says Spencer. "I got particularly interested when I heard there was a mass exodus of management. So, I knew there were issues and I was not surprised after I read a Fiserv press release which said it was taking a look at non-strategic assets and considering selling them."

Despite the emotional tug of the company, it's really not in a private-equity firm's interest to go back to the well on an individual company. But Spencer, who knew DMD intimately, couldn't resist what he saw as a bargain coming his way.



Rob Katz (left), DMD's president, and Jeb Spencer (right), DMD's chairman, have taken the company back to a focus on growth.

"Fiserv and TVC agreed to not disclose the price paid for the business in 2005, nor what was paid in 2008," says Spencer. "We sold the business at the peak of the mortgage industry bubble and bought the business back during the mortgage industry meltdown. One can assume we paid less than we would have been expected to pay."

What Spencer got back was a dispirited, somewhat eviscerated company—but it was still a gem, with what many in the mortgage industry regard as producing a killer product. Its flagship system, DataTrac®, manages workflow—or as the company likes to say, it helps clients maintain control over their pipeline.

"For the small to medium-sized mortgage banker, DMD's system is unbeatable," notes Kevin Parra, president and CEO of Plaza Home Mortgage Inc., San Diego. "I haven't spoken with anybody who felt there was a better system. DataTrac is an easy-to-use workflow-management product, and robust enough to manage a company our size [\$5 billion to \$6 billion estimated 2009 annual origination volume]."

Plaza Home Mortgage, a nationwide wholesale lender that has bucked the dismal economic trend, expects to do more business in 2009 than 2008, says Parra. But at the beginning, Plaza Home Mortgage funded its first loan in April 2001 and even then it was working with DMD.

Things that go right; things that go wrong

When Rob Katz was chief information officer at a San Ramone, California-based company called Monument Mortgage, he adopted the DataTrac system for his company. "I was not necessarily the happiest customer," he laughs. "There were things about the product I thought could be better. I made a lot of phone calls asking for requests. In fact, I spent a good amount of time looking for an alternative solution for our lending shop."

He never did find one—perhaps because he never got the chance. A new chief executive took over at Monument Mortgage and Katz saw that the new CEO was an old-fashioned, paper-loan kind of guy and that Monument would go in a new direction.

"I remember thinking, 'I am the head of technology for a lender that no longer wants to use technology,'" says Katz.

He didn't have a lot of time to mull over his fate, because the next day he received a call from Stuart Clifton, who told him he was chief executive officer of DMD and part of the group that had just bought the company in 2001. The conversation went something like this, Katz remembers: "I just bought the company away from Tom Brown, who says you're not the happiest client but you have some interesting ideas."

By the end of their talk, Katz decided to jump ship and become executive vice president of DMD, responsible for sales, marketing and business development.

Clifton only stayed at DMD for about a year, being replaced by Spencer, who became president and CEO before giving up the president's title to John Walsh in 2003. Spencer, a hands-on investor, now carries the title of chairman at DMD.

Although the company went through three presidents from 2001 to 2005, Spencer remained as CEO and Katz as executive vice president.

"Tom Brown had founded a moderately successful company, and we got to turn it into a real company," says Katz, now president. "We got a real office, starting hiring more engineers and support personnel. Over the next four years, we had explosive growth."

When Katz joined the company, revenue was about \$2 million and clients totaled 80, he says. By 2005, when DMD was sold to Fiserv, it could count almost 400 customers and \$12 million in revenue.

"Word got out that this little San Diego company appeared to have 16 percent to 20 percent of U.S. mortgage loan volume passing through this system called DataTrac," Spencer adds. "At the time in 2005, that represented about \$600 billion of volume. And we had that flow because we had almost 400 small to medium-sized mortgage bankers as customers."

This was, of course, why private-equity folks had invested in DMD and in 2005, seeing that prevailing omens were propitious, it was offered for sale.

"We were very happy with the way things turned out, because it became like an auction," says Spencer. "Two of the four largest financial services software companies were interested in buying."

When you want to sell something, you cannot just have one bidder—you need at least two. We had two, and each badly wanted the asset. Fiserv was the winner.”

As employees, the thing Katz and others liked about Fiserv was that not only was it a successful technology company in the banking space, but it was known as a company that leaves its acquisitions alone to keep doing whatever it was they had been doing successfully prior to acquisition.

About a year into the new ownership, Fiserv got a new CEO who looked around at his company’s 127 separately run businesses and concluded this is no way to run a Fortune 500 company. Consolidation started immediately.

None of this was helpful to the old DMD, because it was so tiny. It was still an under-\$20-million-in-revenue operation, and that was small potatoes compared with other Fiserv units that were garnering that much revenue weekly. DMD engineers and product managers got pulled into work on other Fiserv programs, products weren’t getting updated as quickly and clients were dropping out. Katz and others left the firm.

In reality, DMD was always a bit of a square peg in a round hole at Fiserv, which was all about the banking sector, whereas DMD was strictly a mortgage banking product.

“The story that was related to me,” says Katz, “was that Fiserv had three choices: shut down DMD and take the writeoff; put it up for sale and get the best price; or do right by the company and see if TVC might be interested, as DMD had thrived under its leadership in the past.”

The last option must have gone smoothly, Katz says, “because I got a phone call asking me if I would be willing to come in as president and fix what had gone wrong. I always loved this company, and to get a chance to come back and put it all together again was exciting for me. I rejoined on the day TVC closed [on the purchase]—Jan. 24, 2008.”

A swift turnaround

Katz figures that at its height under Fiserv, DMD earned revenues of \$18.5 million. When it was reacquired in 2008, Katz, without being specific, says, “revenues were not close to that. They were down.”

In addition, the staff was demoralized. “There had been no staff meeting for the people in San Diego for over six months, because they all reported to different people all over the place,” says Katz.

Probably the biggest problem Katz faced as the new president was the issue of maintenance fees. DMD software is licensed, and every year the clients have the option of paying a maintenance fee, which means they get unlimited support and updates to the software. During the Fiserv years, there were no releases or updates and support was lacking, so many clients stopped paying the maintenance fees.

“That was one goal we set out to do—win the customers back,” says Katz. “We wanted to give them the confidence of paying us money again so they could get updates and support.”

Over the course of 12 months, 30 clients came back, Katz reports.

Back in 2003, Sue Sroka, a veteran of two decades in the mortgage banking industry, joined DMD. She stayed with the company through the Fiserv ownership years and now holds the title of vice president of client services.

“Prior to Fiserv taking us over, we were in a growth mode, so at that stage of the life cycle of the company, we were adding products quickly,” she recalls. “We not only had a lot of new customers, but it was a challenge also to keep up with all the new products.”

Sroka then added a consulting service to the company’s repertoire because clients not only needed to know how to use the software, but they wanted to streamline workflow as well.

“When Fiserv took over, the product wasn’t changing as greatly, but the client base was expanding because the market was still hot. We ended up doing more consulting,” she says. “When Fiserv sold us again, we ramped up in the other direction—training—because DMD was again adding new features.”

While in negotiations with Fiserv to buy back DMD, Spencer kept track of what he called the “implode-o-meter,” to see who wasn’t surviving the mortgage meltdown. He figures at peak, the company had 400 clients and about one-fourth had gone away.

“In my estimation, 300 of our customers survived,” he says. “It speaks to the cost efficiencies of this product, because it was unbelievable that 300 customers survived through what the mortgage industry went through.”

Arguably, a bigger testament to DMD is that in economically troubled 2008, as an independent firm, it enticed back 30 old customers and added 26 new ones.

One long-time customer of DMD not only survived but is doing better than ever. Castle & Cook Mortgage LLC (C&C Mortgage), Salt Lake City, opened for business in 2005 right in the heart of the boom; but unlike the industry, which has gone from boom to bust, C&C Mortgage continues to roll.

“2008 was our best year ever,” says Matthew Pineda, C&C Mortgage’s president. “And we surpassed last year’s entire earnings in the first two months of 2009.”

The secret to C&C Mortgage’s success is that it is absolutely and truly 100 percent paperless, and it got there by using DMD technology, says Pineda.

“I fell in love with the DMD system; thought it was wonderful,” says Pineda. “DataTrac and WebTrac® are very efficient systems, making life easier for everybody who uses them the right way. WebTrac is the tool you need to communicate with corporate operations without having to rely on e-mails, faxes and phone calls. Communications creates delays, but if you network your originators to the back office and train the staff to use both systems, it speeds up your turn times.”

With DMD’s systems, you can go from underwriting to closing with a click of the mouse, Pineda says. “We went from closing 2,000 loans a year to closing 4,000 loans a year [from 2007 to 2008], and didn’t hire a single new person,” he says.

Product efficiency

Most of DMD’s client base consists of mortgage bankers that sell

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their loans on the secondary market, observes Sroka, “so the unique thing about our product line is that we built in all of those things that all mortgage lenders have to deal with such as regulatory requirements and compliance. In addition, our product is flexible enough that it allows clients to tailor it to their own business model.”

DMD’s flagship product, which has been used by as many as 450 different clients, remains DataTrac. The pipeline-management technology centralizes data across a mortgage banker’s entire operations—underwriting, secondary marketing, documents, funding, shipping, accounting, interim servicing and insuring.

WebTrac was created next, and is basically an Internet-based interface. “Files don’t ever come through e-mail,” explains Pineda, an enthusiastic advocate.

“The files are uploaded in real-time at the branch level and transmitted electronically—it doesn’t matter if they are 10 pages or 169 pages, or originated in Hawaii or California. My underwriters see files as quickly as you can snap your finger. They don’t have to wait for that attachment to open. That’s the difference between scanning a document and sending them over an e-mail versus utilizing software that enables you to be completely paperless,” he says.

DMD’s most popular innovation has been DocumentTrac™, which is basically a virtual file cabinet that is readily available in real-time to the entire organization. “DocumentTrac is the software piece that enables companies to go paperless,” explains Pineda. “Many companies say they are paperless because they will scan documents and e-mail them over. E-mailing and [using] Adobe® [Systems] attachments doesn’t make you paperless; if anything, it is harder than just [overnighting] hard copy. I don’t think there is anything else out there like DocumentTrac,” Pineda says.

Optimal Blue LLC, a Plano, Texas-based company that pioneered a pricing and secondary marketing automation platform, works almost the same corner of the market as DMD. Because the two systems don’t overlap, Optimal Blue and DMD work closely together with new customers. In fact, the companies have begun to integrate their systems.

“We both serve the same customer—the mortgage banker, not the big aggregators,” says Larry Huff, co-CEO of Optimal Blue. “People love our systems and for the longest time, lenders used them separately and would have to rekey information between the two. By more and more elegantly integrating the two systems, we have reduced the inconvenience,” he says.

Huff, for one, is happy to see DMD out of the bosom of Fiserv. “DMD changed their business model a couple of times,” he says. “When Tom Brown founded the company, it was an open platform. When DMD sold to Fiserv, the bigger firm changed the mentality, claiming to be an open system—but in reality, [it] would only work with one or two select partners. Now that DMD has been sold back to the private-equity firm, they have re-engaged that open-platform mentality.”

When DMD was part of Fiserv, the idea of the latter was to take all of Fiserv’s add-on products and pack them onto DMD’s loan origination system. “We got so focused on developing add-ons for Fiserv, that DataTrac didn’t get a whole lot of attention for almost two years,” says Gregg Holsapple, DMD’s vice president of product and technology. “So the vision for 2008 when

we came back under TVC Capital was to take all of our energy and effort and put it back into the core product.”

As a customer-management tool, clients can go on the DataTrac Web site, log in, and review product issues and searches. If they are so inclined, the clients can recognize a technology issue has surfaced and support change as a requester. Holsapple’s team then reviews the requests, which can mean addressing a defect.

“After two years at Fiserv, you could imagine the number of requests we had,” says Holsapple. “So the first thing we did was take the top slice and knock those out. A few months later we took on the next batch.”

DataTrac did two significant releases in 2008. The first introduced 140 enhancement requests and the second introduced 120. “Those are staggering numbers,” says Katz. “In the old days, we would do a release addressing 12 to 15 responses from clients.”

DMD’s first release in 2009 dealt with about 100 enhancements and, says Katz, “we now have in our core product support for FHA [Federal Housing Administration] loans, which we never had in the past.”

Rampant optimism redux

“When TVC Capital bought DMD again, the idea was to dump all profits back into the product,” Spencer says. “Now our product-development team is up to 15 people. When we bought DMD, it was one [person].”

DMD began 2009 with two very solid months. “We had a great January, and February was good,” says Katz, who would like to see revenue and the client base grow 20 percent this year. “A year from now, when we are looking back at 2009, I would like to report we got another 300 enhancements into the product and that we were profitable. We still reinvest a lot, but we want profit this year as well.”

What management is trying to do in 2009 is stabilize the company, Spencer adds. “We want to find the right cost structure, figure out how many sales reps we need for the market and then dump every dollar back into product development,” he says.

The near-term goal, Spencer notes, is to grow the company to \$25 million in revenue and a 15 percent EBITA (earnings before deduction of interest, tax and amortization expense) by the year 2011. At that level, TVC Capital would probably put DMD back into play, says Spencer.

“What we hope is that at the \$25 million mark, the next acquirer will believe it could better serve the DMD customers under its umbrella than as a stand-alone,” says Spencer. “That was the theory with Fiserv. We believed that all their peripheral services could help our customers. Apparently, it didn’t work out that way, which was because they were so focused on the large end of the market and we were focused on the small to medium-sized end.”

Spencer would like to try to avoid a reoccurrence of the Fiserv experience with the next deal. “I’m hopeful it won’t occur again,” he says. “The big goal is to fulfill the dream of the employees—that if they create value in this company, they will be rewarded.” **MBt**

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