The Carnage Will Be Horrific

About a year ago I discussed in this column the battle for the industry's Portal. There were over a dozen companies listed that were competing to carry the industry's e-commerce traffic (mostly order services like Credit reports, Title, Flood Certificates and Appraisals). As then predicted, it appears that just a couple of companies will end up surviving. Recently, several companies have thrown in the towl in this space including GE's NetOriginate, OpenClose and several smaller companies. In the world of Venture Capital, it's called "playing the odds". The hope is that though some will fail, the survivors will payoff so significantly they'll more than make up for the failures. Still, any prudent startup investments require a full review of the marketplace and the competition. Perhaps this was just another demonstration of the excesses of the dot-com boom.

Once again we are facing another situation where the carnage will be horrific. Once again, far too many companies are chasing far too little opportunity. The startup market facing this inequality is building web-based solutions for larger lenders. These systems typically have product and pricing engines that allow mortgage brokers and consumers to become prequalified and to take an application. Some of the companies will handle other aspects such as rate locking and more robust functionality for wholesalers. For those that concentrate on wholesaler solutions, they might handle product guidelines and the ability to return conditions back to the originator. A few of these also offer vendor management solutions. Below is a list of 14 companies and their web site.

Dexma, Inc.	www.dexma.com	Claims to have 35% of the top 25 lenders as clients.
Dorado Corp.	www.dorado.com	Also offers vendor management solutions.
eCloser	www.ecloser.com	Startup just beginning to market their products in this space.
GHR Systems	www.ghrsystems.com	Perhaps the oldest product/pricing engine with dozens of clients. Claims half of the top 20 as clients.
IMX	www.imx.com	Primarily an exchange system but recently entered this market with a private label version for wholesalers.
LendingTree	www.lendingtree.com	Primarily a consumer web site but recently

		entered this market with their Lend-X offering
LION	www.lioninc.com	Started as a broker solution but now offers LoanCAT for this market.
Loan Trader, Inc.	www.loantrader.com	Started as a loan exchange and recently introduced to this market LTMS for wholesalers
mortgagebot.com	www.bot2b.com	Offers complete solution for retail lenders – not wholesale.
nCommand	ww.ncommand.com	Currently for sale. Emphasizes vendor management for lenders.
OpenClose Technologies	www.openclose.com	Now only concentrating on this market after closing it's multi-lender marketplace system.
Sollen Technologies	www.sollen.com	Startup in this market now marketing their products.
Ultraprise Corp.	www.ultraprise.com	Recently entered this market after starting a loan exchange system.
Xpede	www.xpede.com	Startup where FirstUnion is their first client.

There are about 150 large retail lenders and wholesalers in the market that might purchase these types of systems. The largest of these have developed their own solutions like Countrywide, Wells Fargo and Flagstar. Companies that build their own solutions would be removed from the prospect list - they probably account for 25% in terms of number of companies but more importantly, probably 80% of the loan volume. In this marketplace, 25% of these companies handle about 80% of the volume. Because many of these technology vendors earn their revenue on each loan sent through their system, the real market opportunity is fairly small.

Most of these firms rely on these per loan fees and when asked, many are targeting the $50-$75 range per loan. Historically, lenders have never spent this much per loan on automating their systems. While these solutions have real benefits for a lender, the costs may not be justifiable and sustainable in a highly competitive marketplace. Today, mortgage originators like mortgage brokers spend less than $10 per loan for their solutions. While lenders may be willing to spend more, many are balking at fees as high as $75 that provides no significant marketing advantage.

Many of these companies are just now coming to market so there hasn't been a lot of competitive pressure. This is rapidly changing though and soon, every company will be chasing a fairly small marketplace. This will make landing the lucrative deals very challenging and pricing pressures will mount. For lenders, having so much to choose from will seem to be a blessing. However, this field is so fragmented with no clear winner, it becomes a challenge to steer clear of the numerous eventual losers. Imagine investing huge amounts of money and staff time only to find out the vendor is going out of business. Out of the 14 companies listed above, I predict 4 or less will survive over the next two years. Several will be gone within 1 year as funding is becoming increasingly difficult. Many of these are in a make or break situation where the money in the bank is all they have left. They still talk of burn rates rather than profitability targets.

We should see the few winners begin to emerge in the next six months. Look for those with a real client list that continues to expand. Also, look for the companies able to land large upfront setup fees. Lenders must be weary of those offering deals to good to be true. It could be the vendor's last attempt to get some clients in order to impress their investors in the hopes of another funding round.

In my 20 years in mortgage technology this is probably the most out of balance market space I've seen. While some will survive, most won't. In total, I estimate some $350 million has been invested. I'd be surprised if 5 years from now this market space had revenues that exceed $25 million. Truly, it's going to be tough for some of these firms… and their clients.