STRATEGIC MANEUVER

Fidelity is repositioning its technology approach by combining LPS and ServiceLink into the new Black Knight Financial Services.

BY TED CORNWELL

AS 2013 CAME TO A CLOSE AND THE CITY of Jacksonville, Fla. prepared to ring in the New Year with its traditional fireworks display high above the St. Johns River, another celebration was in the works a mile upstream.

The St. Johns flows north through Florida before it meets with the Atlantic Ocean at its mouth in Jacksonville. Fidelity National Financial's headquarters sits on the river's western bank, just south of where fireworks flew from a pair of barges flanking the Main Street Bridge that connects the city's Downtown Core and Southbank neighborhoods.

It was there, two days after the New Year's Eve festivities, that Fidelity, the nation's largest title insurance underwriter, announced that it completed its planned $2.9 billion acquisition of Lender Processing Services. The cash-and-stock deal, first announced in May 2013, is more of a reunion than a new alliance, as the two companies share a long history together.

Fidelity previously owned the mortgage servicing automation, analytics and lending technology that comprise LPS after it acquired Alltel Information Services in 2003. After also acquiring Certegy in 2006, it combined the two and spun them off into a separate entity called Fidelity National Information Services, or FIS.

But the mortgage technology assets struggled to find their place among the core banking systems, payments processing and other retail banking technologies that make up most of FIS. So in 2008, FIS spun off the mortgage technology into its own company, LPS.

Fidelity paid $2.9 billion in cash and stock to acquire LPS, combining it with its ServiceLink unit to form a new company, Black Knight Financial Services.

Its four underwriting units collectively issue more title insurance policies than any other title company, but Fidelity also owns restaurants through its American Blue Ribbon Holdings division, automotive parts manufacturer Remy and several other businesses unrelated to the title and mortgage technology sectors.

UNDER PRESSURE

With the refinance boom coming to an end and new mortgage regulations taking effect, the industry faces "increased cost pressure and margin compression," which will force lenders to look for technology that help them compete in the changing environment, Tom Sanzone, the new CEO of Black Knight Financial Services, said in an interview with *MT*.

Fidelity's new subsidiary actually consists of two legal entities: Black Knight, which focuses on technology, data and analytics; and ServiceLink, which focuses on transaction services like appraisal, title, closing, escrow, and flood insurance determinations, as well as default services and asset management.

There are a number of reasons for splitting the business into two entities, Sanzone said. For one, the technology side has a different business model from the transaction management side. On the technology side, business is usually done by way of long-term contracts averaging five to seven years. On the transaction side, there is more of a daily relationship with customers, who pay for services on a per-transaction basis.

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— **EJ Kite,** *CIO,* **WINGSPAN PORTFOLIO ADVISORS**

The crown jewel of the technology that Fidelity acquired with LPS is Mortgage Servicing Package, the system of record used for approximately 50% of all U.S. mortgages, as measured by dollar volume. The deal is also a strategic move that should enhance organic growth for Fidelity, and could open the door for future mortgage technology acquisitions in the future. Expense reductions were also a factor, and the company expects to attain $100 million in expense reductions by combining LPS and ServiceLink.

Even when LPS was out on its own as a standalone company, it was never too far away from FIS or Fidelity. All three companies are based in the same office park in Jacksonville's Brooklyn neighborhood. And while Fidelity's decision to buy back a company it had divested five years earlier came as a surprise to many, but its leaders have long been willing to make unconventional investment decisions.

"There is a move to get more efficient, and one of the ways to get more efficient is to purchase technology products that help run the business through third party vendors that have economies of scale across multiple clients," he said.

Sanzone said the combination of LPS technology and analytics with Fidelity's transaction platform creates opportunities to provide new and enhanced products and services that will help clients solve their business problems across every aspect of the lending process.

Another factor that may favor large, consolidated technology providers is the renewed focus on safety and security in the financial services industry, Sanzone said. Firms with large balance sheets face significant risks if they don't employ the proper analytics and technology to manage their operations. Black Knight is regularly audited and the vendor's size ensures that adequate resources can be devoted to providing clients with the security they need, Sanzone said.

Pairing the LPS technology assets with ServiceLink allows the new company to offer a complete lineup of products across the entire lending lifecycle. MSP remains Black Knight's "flagship product," Sanzone said, and it will retain its existing name and branding.

Black Knight will also continue to maintain its three loan origination systems: the enterprise-level Empower; PCLender, for midsize lenders; and LendingSpace, which is used by wholesale lenders. "It is a significant business for us and an area in which we think we can grow substantially over the next few years," Sanzone said.

To create Black Knight, Fidelity worked with private equity firm Thomas H. Lee and Partners, which serves as a minority stakeholder in each of the two subsidiaries, owning 35% of both Black Knight and ServiceLink. The Boston-based private equity firm will have board representation for both entities, Sanzone said.

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The acquisition has elicited a lot of buzz throughout the industry. E.J. Kite, chief information officer at Wingspan Portfolio Advisors, offers a blunt assessment about one potential motivation for the acquisition.

"Part of this has to be in some way shape or form an opportunity to smash CoreLogic," he said. "There's no doubt in my mind that there is some competition there between the gurus at both places."

The deal also has the potential to increase Fidelity's wallet share from big clients. By offering a full suite of products, Black Knight may be able to offer bundled services at pricing more attractive than a piecemeal approach with a variety of vendors.

"This could be an opportunity for them to pick up even more market share," Kite said. "I see this as an opportunity for Fidelity to build a really good end-to-end solution."

Craig Hughes, managing director of financial services consulting at CC Pace, said strategic goals drove the deal, rather than cost, noting that Fidelity bought LPS back for a price that's not far off from what LPS was worth when it first became a standalone company. "It's not like they sold high and bought low. It just made sense structurally," he said.

Fidelity's penchant for spinning units off and then repurchasing them reflects the philosophy of Fidelity's board, led by Chairman William P. Foley II, to take advantage of any opportunities that can provide value to shareholders.

"If something makes sense to them financially or structurally, to bring something back that they have spun off, then they'll do it," Hughes said. "Ultimately, I believe that Foley is a smart businessman and he doesn't do things that don't have strong value to shareholders, so there has got to be a strong financial piece to it."

Fidelity probably hopes the creation of a consolidated technology unit will spur organic growth, Hughes said, noting the loss of the LPS assets previously may have eliminated cross-selling potential.

But the deal does come with some risks, Hughes said. LPS ran into regulatory trouble in the wake of the financial crisis. In January 2013, LPS agreed to pay $127 million in a multistate settlement of claims that it forged documents that were used to foreclose on homeowners.

"I'm hoping this reorganization and change doesn't introduce structural problems into the organization," he said.

Mark Dangelo, president of MPD Organizations, who has written a book on post-merger and acquisition challenges, said in an e-mail interview the LPS acquisition is likely driven in part by a desire among lenders to seek larger service providers to "reduce vendor relationships and points of risk."

The more volume Fidelity retains from large lenders, the better its chances of maintaining or increasing margins on a per-loan basis, he adds. It also spreads the cost of research and development across more loans. But he expressed some skepticism about the benefits of these economies of scale going forward.

The low rate of household formation in recent years may portend a lower "new normal" for mortgage origination volume, rather than an aberration related to the Great Recession, he said. If origination volume does remain lower than in the past, that may undercut the financial assumptions made in any predeal targets for the combined entity's performance.

Dangelo also isn't convinced that the "bigger is better" model for mortgage technology providers will prove persuasive in the market. Historically, smaller firms often are better at "point-solution innovation" than larger ones, he said.

He doubts the Fidelity purchase of LPS and creation of a new technology and analytics company will have much impact on what offerings are available to lenders, at least in the near-term.

"There are a lot of 'Doubting Thomases' who think that this new iteration of the 'old family' assets have been just recast into a new brand and offering envelope — but remain essentially the same," he wrote.

Because of Black Knight's size, it has the potential to force smaller players to broaden product lines and enhance integration in response to its vast resources.

"As we have seen, those who can act upon their assets within a big or vast data world stand to benefit their clients the most — Black Knight has the potential, but execution and attention to detail in a post-deal M&A world is imperative," Dangelo said.

That could force smaller vendors and outsourcers to "form strategic or exclusive alliances, or joint ventures, to compete against the scale," of Black Knight.

Another risk for Black Knight is that a company whose core is the MSP servicing system that's known more for its consistency, audit capabilities and reliability more than its innovation, could prove too risk averse to compete with smaller, more nimble competitors, Dangelo said.

Time will tell whether Black Knight Financial Services can capitalize on its ability to touch virtually any part of the mortgage market. But the reunited Fidelity and LPS has the potential to change the dynamics of how lenders and servicers work with their technology and services partners. MT