

foreclosure legal outsourcing mergers and acquisitions (M&A) summary

Summary of the foreclosure / creditors' rights law firm M&A market provided by 7 Mile Advisors – leading advisors to outsourced services and technology companies on executing M&A transactions

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7 mile advisors overview

7 Mile Advisors is an investment banking and corporate advisory firm. Please [contact us](#) to discuss these topics in more depth and to understand how an engagement with us to pursue an M&A strategy or other board-level initiatives could accomplish the objectives of unlocking and increasing enterprise value.

Our services are custom-tailored to our client's needs:

mergers & acquisitions

- sellside – company sale and divestiture
- buyside – growth through targeted acquisitions
- discrete, managed process

private capital

- growth – expansion & acquisition capital
- recapitalization – partial shareholder liquidity
- debt – leveraged shareholder dividends / refinance

valuation services

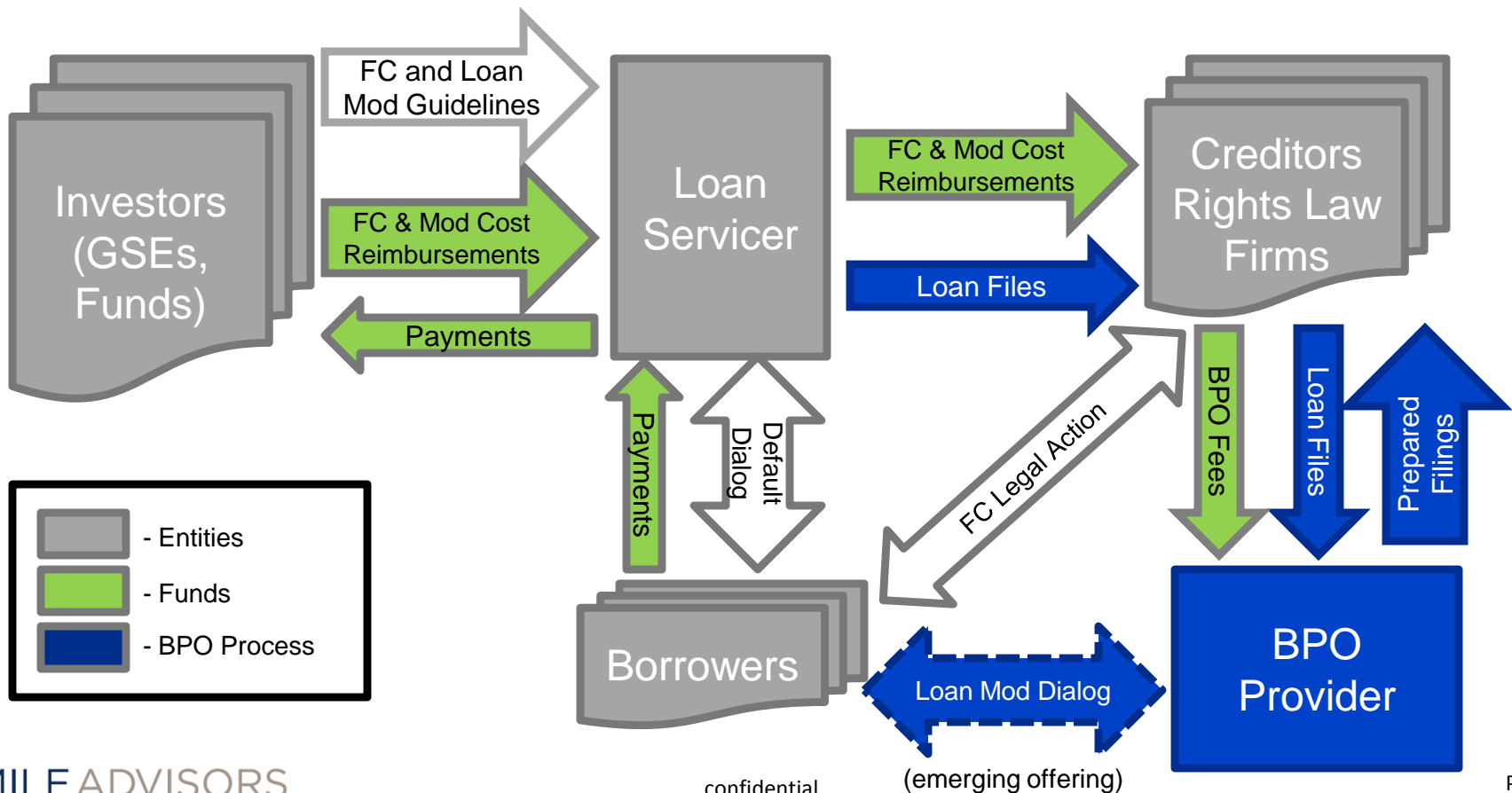
- fairness opinions
- ESOP's / regulatory requirements
- estate planning
- benchmarking

Our principals' recent transaction history reflects a deep focus on outsourced services and technology companies:

Year	Target	Buyer	Type	Industry
2008	NuTech Solutions	Netezza	Sale	Services
2008	Freeorders PLM unit	Lawson Software	Sale	Software
2008	eBAS	Emtec	Sale	Services
2008	Aveeva	Emtec	Sale	Services
2007	Saratoga Systems	CDC Corp	Sell	Software
2007	E-Tech Solutions	Perficient	Buy	Services
2007	Tier1 Innovation	Perficient	Buy	Services
2007	MyITGroup	VIP	Sell	Services
2007	CHPD	Capital H	Sell	Services
2007	Creative Digital	Lbi	Sale	Services
2007	Blue Hammock	Collabera	Buy	Services
2006	DCSS (EGG Division)	Perficient	Sale / Divestiture	Services
2006	Strata Group	Ariston Global	Sale	Software
2006	QA Labs	US Technology Resources	Sale	Services
2006	xPAN	Accenture	Sale	Services
2006	Advantium	Accenture	Sale	Services
2005	eBuilt	US Technology Resources	Sale	Services

This analysis of the foreclosure legal business process outsourcing (BPO) market is intended to summarize the potential market, relevant recent M&A transactions and essential economic terms for a foreclosure (FC) legal BPO operation.

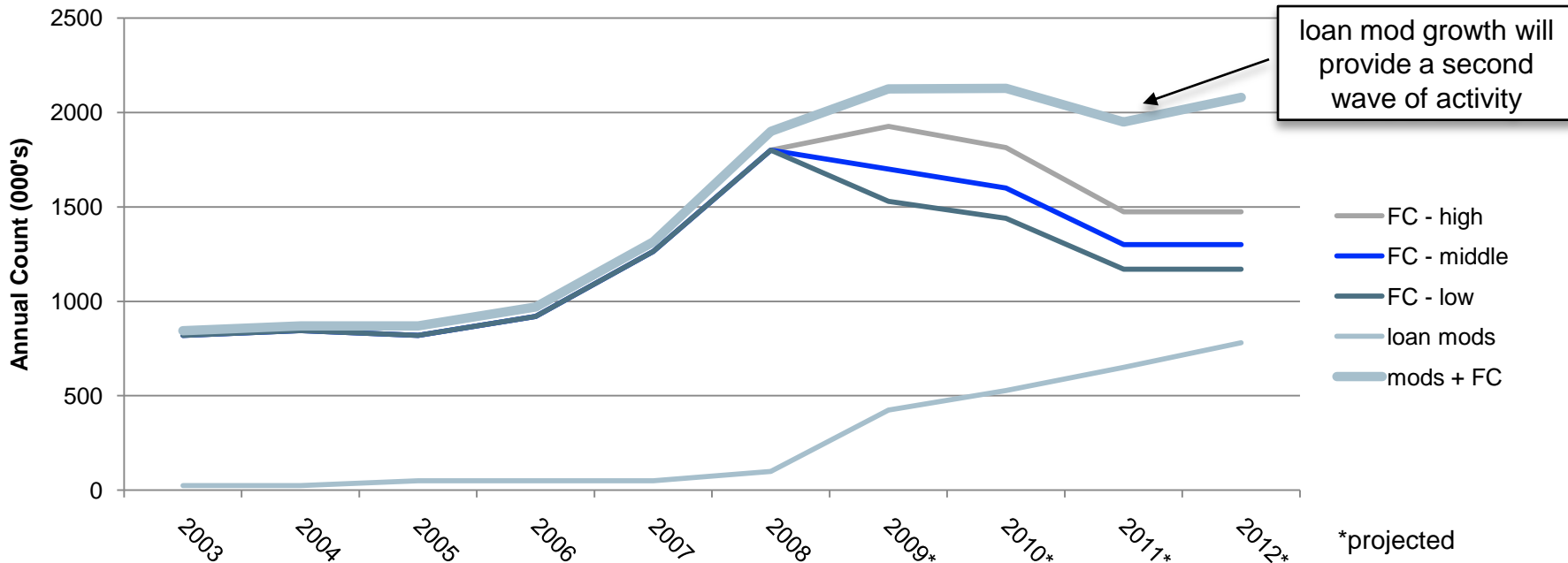
A typical BPO operation in this space will provide all non-legal services to a law firm or a trustee firm who serves mortgage loan servicers. Sometimes referred to as “creditor rights” firms, these firms are responsible for filing foreclosure and bankruptcy actions on behalf of mortgage loan servicers and their clients, the investors who own U.S. residential mortgages. The largest U.S. residential mortgage investors are the Government Sponsored Entities (GSEs) Fannie Mae and Freddie Mac.



historic and future foreclosure volume

The size and scope of U.S. residential mortgage foreclosure (FC) activity has been making headlines recently. It's instructive to view the recent growth and predicted future trends to understand the actual size of the potential market of foreclosure transactions to be handled by a BPO operation. The largest predicted impact to foreclosure volume in 2009 and beyond is loan modifications by investors in lieu of foreclosure. A foreclosure BPO operation should be prepared to handle both foreclosure transactions and loan modification (mods) transactions so the focus is on the "mods + FC" statistics. The following historic summary and projections were built using data obtained from The Mortgage Bankers Association and Credit Suisse.

2009 and beyond represent high / middle / low projections based on factors such as the severity of the recession, real estate price trends and unemployment levels. The base estimate is for 8.1m total foreclosures during 2009-2012 with a projected peak in the 2008-2009 time period. **Loan mods will be increasing as foreclosures become a higher loss to investors due to poor real estate markets. New Government programs, the proposed ability of bankruptcy judges to modify loans and investors' interests in minimizing losses will drive a rapid growth in loan mods.**



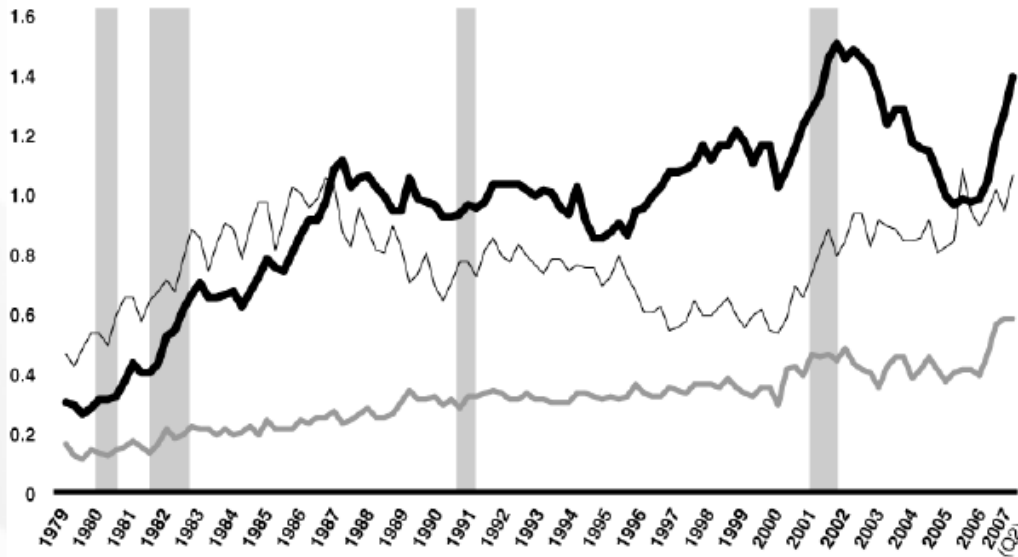
long term history of foreclosures

The following analysis performed in Q3 2007 by the US Government Accountability Office (GAO) for the House of Representatives shows the long term trends in defaults, foreclosure inventory and foreclosure starts as a percentage of all mortgages outstanding. "Foreclosure starts" represent new foreclosure transactions for a BPO operation to handle and is the most relevant statistic to focus on. The percentage of all mortgages outstanding going into foreclosure has been on a **long term upwards trend regardless of economic conditions**.

- Default and foreclosure rates for home mortgages have varied over time and have increased during both recessionary and nonrecessionary periods.

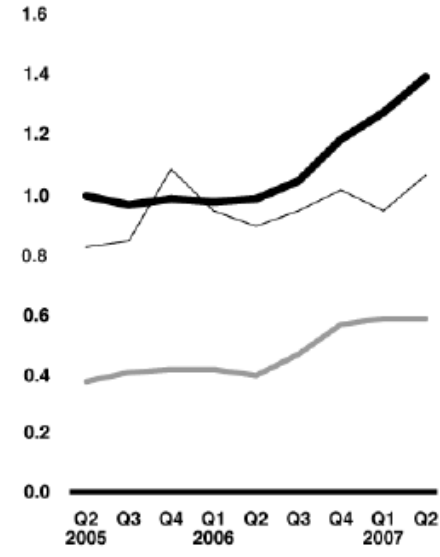
Q1 1979 – Q2 2007

Percentage



Q2 2005 – Q2 2007

Percentage



— Default — Foreclosure starts — Foreclosure inventory — Periods of economic recession

Source: GAO analysis of MBA data, National Bureau of Economic Research.

One of the largest recent acquisitions of a foreclosure BPO operation was closed in September, 2008 by Dolan Media (NYSE: DM). Dolan acquired National Default Exchange (NDEx), the back office carve out of the foreclosure law firm known as Barrett Daffin Frappier Turner & Engel in Texas. Technically APC, a majority owned sub of Dolan, acquired NDEx. This deal included a 25 year exclusive contract with Barrett.

Consideration Paid: \$167.5m cash plus a 6.1% interest in APC which was valued at \$11.6m by Dolan for a total upfront consideration of \$179.1m, plus an earnout of up to \$13m for a maximum possible purchase price of \$192.1m.

Target Financials: Dolan disclosed a \$28m EBITDA target over the next twelve months following the close that will trigger the maximum earnout payment. Assuming Dolan was building in a 25% EBITDA growth plan, one could assume NDEx was producing **\$22m in EBITDA** for the twelve months leading up to the acquisition. That would be an **estimated LTM EBITDA multiple of approximately 8.5x with over 90% of the consideration paid at closing**. This type of valuation will likely not be seen in the current market which has recently gotten more attractive for sellers but not to this level.

The table below describes the new ownership structure of APC which shows the ownership handed out to past sellers as well as NDEx's past owners:

Shareholder	Ownership %
Dolan	84.7
APC Investments, LLC (Trott & Trott)	7.6
Feiwell & Hannoy, PC	1.7
NDEx Sellers	6.1

past M&A transactions and recent market trends

The Barret / APC transaction was one of the last of the “mega deals” in this sector. M&A market activity cooled off in Q4 2008 and Q1 2009 as various state legislated foreclosure moratoria, federal loan modification (HAMP) plans and a Fannie Mae foreclosure moratorium were put in effect which gave investors and service providers concern over their future revenue projections. Since Q1 2009, most of the effects of these efforts have been measured and the results have been to delay inevitable foreclosures with a consistently growing wave of loan modifications beginning to emerge.

The net effect on foreclosure law firms for H2 2009 and beyond is a “bulge” of cases which were postponed in Q4 2008 and Q1 2009. The M&A market has reemerged as investors become more confident in the longevity of the fundamental drivers of foreclosure (unemployment, declining real estate values and lack of subprime credit) going forward.

Buyer	Seller	Period
Several Pending	Several Pending	Q3-Q4 2009
Dolan Media / APC	Barrett Daffin Frappier Turner & Engel	Q3 2008
Great Hill Partners / Prommis (pka MR Default)	Cal-Western Reconveyance	Q4 2007
FTV Capital / CMS	Castle Meinhold & Stawiarski	Q4 2007
Great Hill Partners / MR Default	McCalla Raymer	Q2 2007
Dolan Media / APC	Trott & Trott	Q2 2006

As foreclosure BPO firms and private equity groups acquire a law firm's back office or add a new law firm as a BPO client, they should consider that firm's market share and future case volume. Since only a lawyer can own a law firm in the U.S., and only a law firm can provide foreclosure services in "judicial" states, the BPO is dependant on the law firm to continue to source foreclosure cases for future revenue.

The largest investors in the U.S., the GSEs, mandate that their servicers use multiple law firms in any one state to avoid the risk of dependency on one provider. This prevents any one law firm from owning 100% of any state. However several law firms have established a large percentage of a particular state's volume. They have also focused their attention on the states with the highest foreclosure volume.

7 Mile has access to proprietary research which shows the following trends among foreclosure law firms:

- 21 law firms in the US estimated to have handled 50% of all foreclosure volume in 2008
- The top ranked firm by volume was estimated to have handled 107,420 cases in 2008
- Firms ranked 2 through 5 were estimated at 80,000, 40,500, 40,000 and 37,000 cases in 2008 respectively.

The revenue model for a foreclosure BPO operation is a fixed fee per case. The GSEs set forth a fixed fee schedule that they use to determine how much to reimburse foreclosure firms to handle a foreclosure case. In some arrangements there are milestone payments based on the progress of a case through the system, but the bulk of the fees are paid at the completion of a foreclosure. This fixed fee schedule from the GSEs has been historically used by most other investors to determine the amount they will reimburse for a foreclosure. Key facts about BPO economics in this space:

- When a BPO provider outsources a law firm's non-legal foreclosure process (usually prep work, transfer of data, QA and submission to an attorney for signature), they typically receive 90+% of the fees paid to the firm. The current estimate for an average fee paid in 2008 is \$1,000. This varies by jurisdiction and is subject to change by the GSEs and investors. The average fee is expected to go slightly higher as timelines are stretched by real estate markets and overwhelmed courts.
- The typical gross margins for a foreclosure BPO provider is 50% with EBITDA margins ranging from 15 to 25%. The use of offshore labor, technology and scale are the main drivers of enhanced margin.
- The GSEs and other investors measure the effectiveness of a foreclosure law firm based on the success rate of closing out foreclosures and their average time to close a case once it's been submitted. These same metrics are passed down to the BPO providers and drive SLA's and other contract terms.
- A typical BPO acquisition of a law firm's back office will involve a long term (10-25 years) contract with exclusivity to "lock in" future file volume. This typically drives significantly high percentages of acquisition consideration to be paid at closing. Equity and long term incentives are also used to try to incent the law firm partners to continue to try to grow volume and revenues in the future.
- The foreclosure process frequently encounters a borrower who has filed for bankruptcy. The same law firm typically also files a bankruptcy request on behalf of the investor to release the mortgage from bankruptcy protection and allow the foreclosure to proceed. The process, margins and economics are typically very similar to foreclosure work.
- As foreclosures become more costly to investors due to poor real estate markets, loan modifications will be requested for delinquent borrowers. These loan modification processes involve borrower outreach, financial data preparation and communication with the servicer to confirm eligibility. The fees and margins for this service should be similar to foreclosures, if not better, as no law firm is required in between the BPO provider and the loan servicer.

The foreclosure BPO provider's customer base is complex. Mortgages are serviced typically by banks who have loan servicing divisions. The bank may also be an investor in the mortgage or they can be a third party servicer working on behalf of another investor. The foreclosure decision and any decision to offer a loan modification comes from the investor.

A BPO provider must sign up a law firm as their direct client. The law firm must in turn sign up servicers as clients. The servicer must in turn sign up investors as clients. Investors' criteria are passed down to the law firms and their BPO providers. The GSEs are the largest investors and have become dominant in terms of pricing, policies and procedures. They have a "counsel of record" review and audit procedure that must be successfully completed before a law firm can handle a foreclosure on their behalf. With the recent changes to the mortgage investor landscape, the GSEs' seizure and subsequent backing by the US Federal Government and the total lack of private party mortgage investors due to the halt of securitizations, the GSEs are more dominant than ever and seem to have no competition in the near future.

This consolidation of investors has also been accompanied by a consolidation of servicers. Countrywide was one of the largest mortgage servicers, followed closely by Bank of America. Their merger forms the largest loan servicer player. Wells Fargo and Wachovia were also both large servicers by themselves. Their merger forms one of the largest in the US. JP Morgan Chase and Citigroup are also top servicers. These players combined service over half of all residential mortgages.

The foreclosure law firms (and the BPO providers behind them) that serve these players will see their case volumes continue to rise. Firms that can scale up their volume and continue to meet and exceed SLAs for time and success rate will earn more cases. Ill equipped firms will lose out and be left behind. It's critical that any BPO provider choose the right law firms and have the right strategy to become a top player in order to thrive in the future.

7 Mile Advisors has extensive experience in BPO and tech-enabled services mergers and acquisitions. Our recent work in the foreclosure law firm outsourcing space has identified strong M&A opportunities that should be pursued. We have access to proprietary deals as well as those in the market, understand the factors that drive value and know how to generate the transactions that should be closed.

We anticipate continued opportunities for new players to enter this space and existing players to grow through acquisitions. The ultimate consolidation of mortgage loan servicer clients and investors will likely drive consolidation of the BPO providers and vendors. Those providers and vendors who survive by closing the right deals should enjoy strong revenue and profit growth for the foreseeable future.

We seek engagements with law firms, vendors and private equity investors who are interested in pursuing an M&A strategy. Whether selling a law firm's back office, selling a vendor's business or sourcing acquisition targets for an investor / acquiring company – we are well prepared to guide a client through the market and achieve the shared objectives of increasing and unlocking enterprise value.

We encourage interested parties to [contact us](#) to learn more.

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