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Participant: Willy Walker - CEO
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Interviewer

Okay. So we're going to get started here with and I won’t take any of Willy's time. Willy Walker is the CEO of Walker & Dunlop. He'll tell you about the business plan and also Claire Harvey is in the audience, she's head of investor relations. Thanks for coming. Willy.

Willy Walker

Thanks. Thanks Will. I will jump into these slides if anyone has questions during this, I'm seriously happy for you to interrupt me and stop me and I'll focus on it that time or we can get to it in Q&A.

The mission statement of Walker & Dunlop is to be the premier commercial real estate finance company in the United States. You just, if you were in here, previously heard from what I believe to be the premier commercial real estate services company in the United States. I would think that if there's a company that has that, if you will the scripture today is Wells Fargo. So I guess you could say that it's our goal and ambition to displace Wells Fargo as being the premier commercial real estate finance company in the United States.

It's a huge market. It's about $3.1 trillion of loans outstanding in the commercial real estate space. And of that $3.1 trillion about a $1.9 trillion refinances over the next five years. No matter where interest rates go, that $1.9 trillion has to be redone in the next five years. So there’s sort of a fourth market that is coming our way and it's a highly fragmented market. I'll show you some lead tables in a moment about who plays and who we compete with.

On the W&D side, as far as the initiatives, we've grown dramatically over the past couple of years. And I think we've developed a brand and the distribution network and the underwriting capabilities to compete with the biggest and the best. And we are in the process right now of diversifying our business from being a very significant player in the multi-family finance space out into other commercial real estate asset classes.

As you can see from these graphs, we've grown pretty dramatically over the past couple of years. And I would say that being in the financial services space over the last five years and having numbers like those is quite an accomplishment. You can see growing revenues, origination volumes at about 30 percent on a compound annual growth rate revenues have grown a little bit greater than that. You can see in our pre-tax on the right hand side growing those revenues in 37 percent over the last five years at a compound annual growth rate. And then on the bottom left is our servicing portfolio which has grown dramatically and I'll show you some numbers on our servicing portfolio in a moment.

If you look at our development five years ago, we set out a plan to grow the company 5X in five years. So that was 5X revenue, it's 5X pre-tax and 5X net income. I set that goal for the company in November of 2007 when we turn 75 years old as a company. And I did not, at that time, foresee the financial crisis that was coming up in 2008 nor did I foresee our ability to go out and acquire companies in the downturn. We acquired Column Financial from Credit Suisse in 2009. We went public in 2010 really just on the other side of the financial crisis when mortgage bank was more of a four letter word than anything else. And then we acquired CW Capital last year if we hadn't been a public company by going public in 2010 we would have never had the ability to acquire CW from Fortress last year.

The added scale that we've gotten from the CW transaction has been fantastic. And I'll show you how that's played into our league tables. Total loan originations you can see on the far right hand side we've grown total loan originations from $2.1 billion in 2007 up to $7.1 billion last year. And you can see down below how we've grown in the league table. So as an overall lender, five years ago we were number 40 in the country. We finished 2012 as the 10th largest commercial real estate lender and I'll show you in a second who we compete within that arena.

On the Fannie Mae side five years ago, we were the 10th largest Fannie Mae DUS lender in the country, today we're number one. And we're taking advantage of that scale on that market position every day. On the Freddie Mac side, we weren't even an originator for Freddie Mac five years ago. And as you can see from the numbers, we've moved up dramatically in the Freddie Mac lead tables from being non-existent to being number five at the end of last year or number two year to date. And so I just saw the CFO of CBRE he was walking out and CBRE is the largest originator for Freddie Mac in their seller/servicer program. And as I said, we're nipping on his heels in the number two position.

And then on HUD, you can see we weren't even in the HUD origination business four years ago. We started at HUD and we've grown dramatically in the HUD space to being the sixth largest HUD originator in the country today. If you look at who we compete with, pretty much all the financial services institutions on the overall mortgage originations in the commercial space are household names other than us, we sort of like that. It gives us a real focus in our space and clearly those other financial services companies have a lot of other things on their plate other than just growing and wanting to be the premier commercial real estate lender in the country.

On the Fannie Mae side, you can see we jumped over Wells Fargo last year to become the largest Fannie Mae DUS lender in the country, very, very pleased with that. And on the Freddie Mac side as I said, CBRE is number one in that market year to date, we're two and we finished last year as the fifth largest, Freddie Mac seller/servicer. So not exactly easy from a competitive landscape and the companies that we compete with on a daily basis. But as you can see from our growth over the past five years, we have not only grown very successfully but we are gaining market share.

If you look at the overall market and the components in the overall market on the $3 billion number that I talked about as far as the total commercial real estate debt outstanding, on the left hand side it's multi-family, it's about $850 billion of multi-family outstanding. To size of those markets as far as the annual refinancing opportunity, it's about 10 percent of the market roles every year. You can see on the right hand side it varies year by year. You could see we're coming into a bulge here as it relates to refinancing volumes in 2015, 2016 and 2017. A lot of that has to do with the CMBS origination boom back in 2005, 2006 and 2007. On this graph, you can see the dark blue at the bottom that's CMBS Refinancings that are coming up. So it's a huge amount sitting in CMBS pools.

The green in there is Fannie Mae and Freddie Mac. And you can see their consistent participation in the markets and the amount that they have coming up for refinancing. And then the light blue in there is life insurance companies. Life insurance companies provided about $50 billion of capital for commercial real estate space last year. And of that, they provided about $10 billion to multi-family.

If you look at our distribution network and how we have grown, we've got offices now, we got 20 offices across the country. We're in pretty much every major MSA, maybe Denver is one of the few that we are not in at this point. And we have source loans traditionally from both direct originators. We have 66 originators in offices across the country that are out meeting with borrowers every single day. And then we have 24 correspondents who are local mortgage banks that feed us loans.

On the right hand side of the slide, you can see how the percentage of direct originations versus the percentage of broker to correspondent originations had fluctuated over time. The one thing to point out is if you look at 2007, you can see direct originations ballooning. The reason there is that there was absolutely no, if you will, fidelity in the channel. Brokers are taking deals wherever they can get them done. Wall Street was on fire and so a lot of deals flow in other places, which meant that we did a lot of direct originations back then. Then when the agencies really the only lenders out there in the multi-family space, it got back to sort of a 50/50 mix. As we have acquired CW and added a significant number of direct originators, our direct originations of the percentage of our originations will continue to grow.

If you look at our origination volumes on a quarterly basis, you can see ‘11, ‘12 and ‘13. Q1 is always the slowest quarter of the year. You can see that we did 13 percent of our originations in ‘11 first quarter, 9 percent in 2012. Our Q1 origination this year of $1.73 billion was up significantly over 2012 by 158 percent. So significant growth, let me dive in to that for two seconds as it relates to the overall market. The commercial real estate financing market grew 9 percent year on year on the first quarter. Companies like HFF who some of you made it in the presentation on HFF earlier, their originations year on year were down 4 percent in the first quarter.

Fannie Mae grew their originations in the first quarter year on year 15 percent, Freddie Mac grown 23 percent, Walker & Dunlop and CW so organic growth, grew 48 percent year on year. So we are not only growing much quicker than the market but we're gaining share in our core markets. And so 48 percent organic growth year on year with Walker & Dunlop and CW with Fannie Mae and Freddie Mac, shows you why we've moved up so much in the league tables. And so we are stealing share from the HFFs of the world and Berkadias of the world and the others.

On the right hand side, you can see the mix of our business. This is frustrated investors somewhat and so I want to take two seconds here as it relates to mix. We make different margins on our different executions. Our most profitable executions is HUD and we originate along with HUD, we're going to make a point origination fee. We will make a trade premium for selling the Ginnie Mae which can be up to three or four hundred bases points on the sale of the Ginnie Mae security. And then we booked a servicing fee, we were taking however long the loan is pre-payment protected for. We're taking half a year off of that and we discount that back to the present value.

So HUD is our richest origination, behind that is Fannie Mae. Similar economics, the point origination fee, some trade premium but not trade premium is even close to what you get on HUD deals. But then on the servicing side with Fannie Mae, we take risk on the loans we originate for Fannie Mae. And so in our servicing fee, we get paid for our risk. So when we are discounting back nine and a half years of pre-payment protected payments, we are booking servicing fees of somewhere between 30 and 50 bases points. On Freddie Mac, it's the same economics but the servicing fees are 6 to 8 bases points.

And then if it's not with one of the GSEs, if you're just originating a loan and brokering it off, you're not booking any MSR. You might make a small amount of servicing so to use the comparison in HFF's business, they don't book MSRs other than on their Freddie Mac business. But they don't have a Fannie Mae franchise and therefore they're not booking really rich MSRs. I'll get to in a second our servicing portfolio which will show you how valuable those MSRs have been to Walker & Dunlop and will continue to be going forward.

So our Q1 highlights if you will, you can see $1.7 of originations we've given guidance for Q2 of $2.3 to $3 billion. We've reiterated our annual guidance of $10 to $12 billion of originations. You can see revenues grew a 101 percent year over year in Q1. And you can see where we have taken games from mortgage banking activities came down just a little bit. That's really driven off to the mix. So I just talked about the various executions, quarter by quarter we might do more with the HUD and less with the Freddie Mac. First quarter had a lot of Freddie and not a lot of HUD. So because of the mix in business in the first quarter, you will have lower gains on mortgage banking activities. That does not mean that the HUD business is dead for the year and it does not mean that the 508 percent growth that we got year on year with Freddie Mac is going to be sustainable if you will.

We're trying to grow in all of our different origination groups. But we really don't know quarter to quarter what that distribution will be. And so some investors is out there and said, well last quarter margins were here in this quarter they're there, and that kind of frustrates me because I love to see them be very, very consistent. If you're going to be an investor in Walker & Dunlop, I would strongly encourage you to look at us on an annual basis. And the distribution of execution, the Fannie, Freddie, HUD and other should be generally speaking the same over the year. So if you're building a model and trying to back in to what percentage of our business will be Fannie, Freddie, HUD or other, you can look at past years. And then the only thing I'd say there is we're trying to grow dramatically and with Freddie Mac for instance, we've grown tremendously year on year with Freddie Mac.

As it relates to adjusted income $8.5 million or 25 cents per diluted share, 46 percent over Q1 of 2012, it's a really nice EPS growth. There were some talk on Q1 as it relates the margin. We did 28 percent operating margin in Q1 of '12 and we did 20 percent adjusted operating margin in Q1 of '13. So a lot of people said to me, hey, you know, where in the economy scare, you acquired CW capital and have margins coming down. We did our largest origination volume in Q4 of 2012. We did $2.9 billion of origination in Q4. And I've asked, many people are asking about what do you like me to do, go layoff a quarter of our origination staff and underwriters because we know that Q1 is our slowest quarter of the year, of course not.

So Q1 slow $1.73 billion of originations with an install base of underwriters and asset managers and closers to do $2 to $3 billion on a quarterly basis. So margins are going come down Q1, they will always come down Q1. And they will start to rise throughout the years our origination volumes continue to grow. There's nothing atypical about our Q1 overall origination volume as well as our Q1 margin. And then finally on the servicing fees of $21 million so we're right now looking at sort of $80 to $90 million run rate as far as servicing revenue this year and the servicing portfolio is just about $37 billion of which 88 percent of that is pre-payment protected.

A very significant difference of any were investors in single family mortgage companies. There's no pre-payment protection on single family mortgages, 88 percent of our portfolios is pre-payment protected. So who wants to refinance their loan they write us a check for the future servicing fees that they are due to us. So a huge difference, if you're on the single family space, you don't know whether that loan is going to payoff in year five, year six or year seven. And ours, we know that if they payoff in year six, they write us a check for the next four years of servicing income.

So let me see whether there's anything on this slide that I want to dive into any deeper than what I just said. You can see the growth pretty much across the board on everything. I already explained to you why the operating margin was down year on year. You can see where we are in adjusted net income, so it's important. Weighted average servicing fee is at 24 bases points. And the average life of the portfolio was now 10.2 years.

Gain on sale margin, the blue is the origination related fees so that’s the origination fee and the premium on trade and the security. The green is the MSR. So the gain is attributed on the mortgage servicing right. So as you can see, those have bopped around a little bit of the green, so you can see it kind of spiking and coming down and going back up. Again, it really depends on the mix, if we do a ton of Fannie Mae in the quarter, you’re going to get MSRs spiking up. You have less Fannie Mae, it’s going to come down a little bit. Similarly, if you do a lot of HUD originations on the quarter, the origination fees will go up because of the trade premiums we make off of our HUD business. But overall you can see down below on the average, total gain on sale margin in Q1 of ’13 was 248 bases points. The three-year historic average is 265 bases points for us. So lots of people have asked us since CMBS is back are servicing fees or origination fee is coming down. We have not seen margin compression so far at all. And we lost some deals, sure we lost some deals, not many to CMBS. Life insurance companies we’ve lost deals to. But as it relates to our servicing fees so far, we’re not seeing the margin compression. Lots of people back up to 2007 to try and do a comparison of what it was like when there was $230 billion of capital provided in the market in 2007 from CMBS. Average servicing fees for us in 2007 were in the 20 to 30 bases range. So significant compression when you have that much capital coming from CMBS. We do not right now see $230 billion coming from CMBS any time soon. CMBS did $50 billion last year, should do $60 to $70 billion this year.

Servicing portfolio, I love this slide, I'm sorry if it's too busy for you but it's got a lot of data in it. So you can see along the bottom, the average life of the portfolio that I just talked about is up now at 10.2 years. The reason it's over 10 years when the majority of the loans we do at Fannie and Freddie are 10 years as HUD. So HUD maturity is being 30- and 40-year maturities. We've got a pretty significant HUD portfolio that pushes it over 10 years of average duration. You can see the yellow line that goes up there as our servicing income on a quarterly basis that comes off of the servicing portfolio, you can see all of three years ago we were making $7.2 million on a quarterly basis off of our servicing portfolio. Today, it's over $20 million on a quarterly basis. The aggregate servicing portfolio is at just under $37 billion and then the different colors are what component of the servicing portfolio, that executions of Fannie is in the dark blue or purple, the light blue is Freddie Mac, the green is HUD and the gray is other.

So as you can see we've built up a pretty significant asset base here as it relates to our servicing portfolio. And then this shows you the value of the portfolio today and how far out it is pre-payment protective. So on the top part it shows that 89 percent of the portfolio today is pre-payment protected and you can see that tailing off as maturities come into the portfolio. On the bottom you can see that's basically the same colors as we had previously on what the maturities are in the portfolio, what the composition of the portfolio is. And then on the bottom is kind of the punch line. So the total contractual servicing revenues of the portfolio today are $680 million. So if all those loans stayed in and didn't go bust on a $680 million, the amortized book value of the MSR is $316 million and the estimated fair value is $351 million. So we get a third party to come in and value the portfolio on an annual basis. The most recent valuation was 351, we're carrying it on our books at 316. That's just our math on how we take the present value of the future servicing strip, bring it back and put it on our books.

Credit has been a really strong component of what's made Walker & Dunlop as successful as we've been and allowed us to weather the downturn extremely well. We have almost 5000 loans in our servicing portfolio today, with the UPV of just under $37 billion and we do not have a single loan today, not a single loan that is 60 days delinquent, not one. And as you can see the 60-day delinquencies peaked in Q2 of 2010 at 162 bases points, come down dramatically over the next year and you can see right now we've got no delinquencies in the portfolio, but more important to this slide it's not that the delinquencies got up to 162 bases points, but looking at the bottom which is our net write offs which is the yellow graph that goes along the bottom. Basically we had no charge offs, very, very limited losses in our portfolio. This is just on the $17 billion that we have with Fannie Mae because that's the only execution we were taking risk. So of the $37 billion portfolio, $17 billion is Fannie Mae, on the $17 billion we take the first loss position on all those loans for the first 5 percent and then we share losses with Fannie Mae back to 20 percent.

So proprietary capital initiatives, we are raising capital today to both meet investor needs in the multi-family space as well as broaden our originations in the other asset classes. We've got a bridge loan program where we have term sheets from two large institutional investors of $190 million each. We'll put in $20 million of our own capital at $400 million of equity. We'll lever that up and have lending capabilities of $1.2 billion in our bridge loan program. May investors today are buying B class assets, going and investing in them, putting tenant improvements and then wanting to put on permanent financing. So we'll do the bridge and then we'll do permanent on the backend. CMBS loan origination platform, Tim Koltermann who ran the CMBS platform at Bear Stearns is doing Walker & Dunlop. We are launching that platform right now with a large private equity firm, we will have a minority interest in that. What investors will look out there is it will enhance our overall origination number, we'll capture deal flow, we'll make relatively small amounts of money as being a minority equity investor in the platform and then we'll make servicing fees in the backend.

Commercial mortgage REIT, we continue to explore with our bankers, our commercial mortgage REIT and creating that type of financing vehicle. And then a separate account, there is a lot of life insurance capital that is chasing deals, that compete with us every single day and so we are in the process of raising a separate account of either pension fund or life insurance company money to go compete with that money source. If we win 20 to 25 percent of the deals we go after, we have access to $40 to $50 billion a year of deal flow. So creating a new source of funding to compete effectively with the agencies, life insurance companies and CMBS, we leave that to very good use of time and effort.

So what this all do? It's onward to 80, we did the drive to 75 which is from 70 to 75 now we're doing onward to 80. We've catapulted ourselves, we've created a really, really big brand, we're competing with the biggest out there and we have access to huge amount of deal flow. We have an underwriting track record that is as good as anybody's and we are raising institutional capital to be able to broaden what we do from not just the multi-family market where we have a great market presence but out in to other types of commercial real estate asset classes.

And that is it. Any questions?

Interviewer

All right. I'll start off. So if you were to take a stab, I think you're going to take the 5^{th} on this but where the GSEs are, where Fannie and Freddie are in a year in terms of are they going to cut back more, is there enough liquidity this year, is this a stable platform as it is, where do you think they'll be, what's going to happen?

Willy Walker

Well the GSE debate is something that takes up a lot of time for people like you who asks me questions like that all the time, right off the bag. We try not to spend too much time focusing on reading the tea leaves and are trying to scale our business as rapidly as we possibly can. The GSEs with the 10 percent reduction that FHFA came out with in their annual score card, Fannie will still be able to put $30 billion in the multi-family this year and Freddie will put 26. So that's $56 billion coming from Fannie and Freddie. They will still be the dominant providers of capital to the multi-family space and last year $103 billion went to multi-family. So if another $100 billion goes to it this year, they'll have a 56 percent market share. So given our competitive positioning with them, we feel very, very good as it relates to business in 2013. If FHFA came out again and cut another 10 percent next year, they still got $50 billion to put towards it. Whether Mel Watt gets confirmed as the new director of FHFA is anyone's guess. I would say that I've been somewhat contrarian since the nomination came out because I think that the Obama administration is going to really put their shoulder into it and I think the President's address on Saturday where he talked about the housing markets and spent about 30 seconds on the housing markets and then spent about 4 minutes talking Mel Watt, tells you something about his desire to have Mel Watt confirmed as the FHFA director, who knows whether we can get him through Congress. And then the final thing is the amount of money that Fannie and Freddie have just returned to the treasury. The debate has not, I mean, anybody that's out there talking about winding down the agencies are shouting into the wind right now. Period. And Jeb Hensarling is one of them who's the chairman of the House Financial Services Committee. There's a lot of talk right now about whether you can get anything done on GSE reform because they're providing treasury with so much money right now. So the GSE debate, we went public on December 15, 2010, a month and a week after the Republican Congress was elected with a mandate to take down Fannie and Freddie. So people who invested at that time in us, A, thank you but B, the debate has changed dramatically as it relates to Walker's GSE exposure from when we went public in 2010 to what we are today.

Interviewer

I guess we're out of time, but there will be a breakout upstairs. Thanks, Willy.

Willy Walker

Great. Thank you all very much.