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Walker & Dunlop, Inc. *(WD)*

Q4 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Walker & Dunlop's Fourth Quarter 2012 Earnings Conference Call and Webcast. Hosting the call today from Walker & Dunlop is Willy Walker, Chief Executive Officer. He is joined by Debbie Wilson, Chief Financial Officer; and Claire Harvey, Vice President of Investor Relations.

Today's call is being recorded and will be available for replay beginning at 11 AM Eastern. The dial-in number for the replay is 1-800-677-7320.

At this time, all participants have been placed in a listen-only mode and the floor will be open for your questions following the presentation. [Operator Instructions] It is now my pleasure to turn the floor over to Claire Harvey. Please go ahead.

Claire Harvey
Vice President-Investor Relations, Walker & Dunlop, Inc.

Thank you, Zach. Good morning, everyone, and thank you for joining the Walker & Dunlop fourth quarter and full year 2012 earnings call. Joining me this morning are Willy Walker, our Chairman, President and Chief Executive Officer; and Debbie Wilson, our Executive Vice President, Chief Financial Officer and Treasurer. This call is being webcast live on our website and a recording will be available later this morning. Both our earnings press release and website provide details on accessing the archived call.

This morning, we posted our earnings release and presentation to the Investor Relations section of our website, www.walkerdunlop.com.

During her remarks this morning, Debbie will be referring to slides in the posted presentation, so participants who are interested in following along should pull those up and have them available.

We may reference certain non-GAAP financial metrics such as adjusted net income, adjusted earnings per diluted share, adjusted operating margin, adjusted income from operations, and adjusted total expenses during the course of this call. Please refer to the earnings release and presentation for reconciliation of the GAAP and non-GAAP financial metrics and related explanation.

Investors are urged to carefully read the forward-looking statements language in our earnings release. Statements made on this call which are not historical facts may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, including statements regarding future financial operating results, involve risks, uncertainties, and contingencies, many of which are beyond the control of Walker & Dunlop, and which may cause actual results to differ materially from the anticipated results.

Walker & Dunlop is under no obligation to update or alter our forward-looking statements whether as a result of new information, future events, or otherwise. We expressly disclaim any obligation to do so. More detailed information about risk factors can be found in our reports on file with SEC. Willy?

Willy Walker

Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

Thank you, Claire, and good morning to everyone joining us on a very snowy morning in Washington DC. I'm extremely pleased to be reporting such strong quarterly and annual results to our shareholders. Five years ago, when Walker & Dunlop turned 70 years old we set a goal to grow revenues, income from operations, and net income 5x in five years.

Walker & Dunlop's 2007 numbers were $50 million in revenues, $16 million in income from operations, and $10 million in net income. As our 2012 earnings show, we grew revenues 5.1x to $257 million, adjusted income from operations 4.9x to $80 million, and adjusted net income 4.8x to $48 million.

Growing a real estate finance company 5x in the past five years is an incredible accomplishment, particularly if you look at many of our peer companies that had just recently returned to the size and scale they had prior to the financial crisis. But what is equally as important and likely more exciting to our investors is where our dramatic growth positions us today as the economy recovers and a tremendous amount of commercial real estate debt comes up for refinancing.

Walker & Dunlop's new scale is not only reflected in our financial performance but also in our industry rankings and market position. In 2007 we originated $1.2 billion of loans for Fannie Mae and we're the 10th largest DUS lender. Today, we are the largest DUS lender in the country and originated $4.2 billion of loans with Fannie Mae in 2012.

In 2007 we were not a licensed lender with Freddie Mac and HUD, so originations with them were zero. In 2012 we were the fifth-largest Freddie Mac seller/servicer in the country, originating $2.6 billion worth of loans and we will likely be a top five lender with HUD when the rankings come out, having originated $1.3 billion for them in 2012.

We originated $849 million of loans with conduits and life insurance companies in 2007 and increased that to $1.4 billion of loans for these executions in 2012 and added two new origination teams to this platform. In 2007, we had one office with 90 employees; today, we have 21 offices with 430 employees.

Finally, in 2007, our servicing portfolio totaled $6.1 billion and provided $12.3 million in annual servicing fees. As of December 31, 2012, our servicing portfolio totaled $35.2 billion, and at its current size will produce nearly $80 million in servicing fees on an annual basis.

In summary, we have created one of the fastest-growing, most highly profitable mortgage origination and servicing platforms in the United States. With our nation's economy on the mend, commercial real estate attracting capital once again, and a massive commercial mortgage refinancing wave just around the corner, Walker & Dunlop is extremely well positioned to continue growing and delivering strong returns to our shareholders.

If we focus for a moment on 2012, loan originations grew 76% over 2011, while revenues were up 69%. Our servicing portfolio more than doubled to $35.2 billion and the weighted average servicing fee increased 9% to 24 basis points. This produced an adjusted operating margin of 31% and an adjusted net income of $48.4 million or $1.87 per diluted share, up $0.27 over 2011.

As fantastic as these results are, it represents only a fraction of what the combined company is capable of, given we only had CWCapital inside of Walker & Dunlop for the final four months of the year. As our Q4 results show, we grew originations, revenues and servicing fees well over 100% quarter-on-quarter.

This growth was accomplished while integrating the two companies, making sure the combination of our two cultures kept us true to who we are, and while making sure every client of Walker & Dunlop and CWCapital felt like they were working with the same company they knew and trusted. That is no small feat, and a massive accomplishment for our team.

While the CW acquisition was immediately accretive to earnings and brought with it huge economic and market positioning benefits, we still have work to do to realize efficiencies and economies of scale. In 2011, Walker & Dunlop originated 304 loans with an average loan size of $13 million. In 2012, we originated 515 loans with a similar average deal size. To deal with this increase in aggregate volume, we asked our staff to work tirelessly, but in the same manner as before. The opportunity and challenge in 2013 is to look at what we do and figure out how we can do things smarter and more efficiently.

When talking about economies of scale, people usually think only about cost savings. For a company that has grown as rapidly as Walker & Dunlop, scale also means new revenue opportunities. When Walker & Dunlop was simply one of 25 Fannie Mae DUS Lenders, attracting a new client who had a preexisting relationship with Fannie Mae through another lender was very difficult.

But when people learned that Walker & Dunlop was number one with Fannie Mae in 2012, they are keen to understand what we do differently and why we are so good. When a mortgage broker at one of our competitor firms loses their third deal to Walker & Dunlop due to our market expertise and reputation, they enquire about potentially working for us. And when large investment institutions see how well Credit Suisse and Fortress, along with our other shareholders have done with their investments in Walker & Dunlop, they call us to see if we can potentially put their money to work.

All of these opportunities for new sources of revenue come from the significant scale we have added to our enterprise over the past five years. Yet as we have grown, we have maintained a corporate culture at Walker & Dunlop that is unique and paramount to our success. We were ranked as the seventh-best small and medium-sized company to work for in the United States in 2012 by the Best Place to Work Institute (sic) [Great Place to Work Institute] (09:21), published in Fortune Magazine.

We began our integration work the day we announced the acquisition of CWCapital and worked tirelessly to maintain the best of both firms, thoroughly integrating our operations and merging our workforce in a collaborative and productive manner.

Our 2013 budgeting process was seamless, mostly due to having worked so hard on integration and planning at the very beginning of the acquisition process.

Finally, we have been able to maintain the vast majority of CWCapital employees through the acquisition and integration process due to the teamwork, culture and growth opportunities that exist at Walker & Dunlop today.

I'd like to turn the call over to Debbie for her to dive into our financial results in further detail. I will then come back and finish the call, discussing our strategy and where we go from here. Debbie?

Deborah A. Wilson

Chief Financial Officer, Treasurer and Executive Vice President, Walker & Dunlop, Inc.

Thank you. As Willy highlighted, 2012 was transformative for Walker & Dunlop. The combination of the 20%-plus organic origination growth and the acquisition of the CWCapital catapulted the company to a new level. I'm thrilled we effectively integrated CWCapital, exercised operational discipline, managed our financial metrics and posted record results while we more than doubled our size.

The fourth quarter is frequently the busiest quarter of the year, and 2012 was no exception. People throughout the company worked incredibly hard to manage and integrate the business, and I'm very proud of the employees at Walker & Dunlop. I'll focus my remarks today on the performance drivers for the fourth quarter and the year; the CWCapital acquisition and its impact on the company's performance; point out some changes we're seeing in our financial metrics, and finish with a look at the balance sheet and the value of our MSRs.

The bottom line is, it was a record quarter, a fabulous year, and the company is poised for continued growth, diversification, and profitability in 2013 and beyond. As we mentioned in our Q3 call, the CWCapital transaction generates both short-term and long-term changes to our financial statements.

We are disclosing both GAAP and adjusted financial information because we believe the adjusted financial information provides meaningful data to benchmark our performance between periods. Slides 21 and 22 reconcile the GAAP and adjusted financial metrics. You may want to have these slides available as I speak to the quarter and the full year.

Adjusted net income for the fourth quarter was $18.4 million or $0.54 per diluted share, a 67% increase from $11 million in Q4 of last year. GAAP net income was $11.5 million or $0.34 per diluted share, a 5% increase over the fourth quarter of 2011.

In our first full quarter as a combined company, we originated $2.9 billion of loans, a 123% increase over Q4 of 2011 and the largest quarterly originations in the company's history. The legacy Walker & Dunlop originators contributed $1.6 billion of the quarter's originations, up 28% over last year.

We had significant growth in each execution, including a 365% increase in HUD originations. The origination-related revenues increased 140% in the fourth quarter of 2012, a full 17 percentage points more than the growth in volumes. The average gain on sale margin increased 273 basis points and reflected the increase in HUD originations. I'll refer back to the outsized growth of the production-related revenues shortly.

Servicing fees for the fourth quarter were $19.7 million, a 117% increase over last year fueled by both the increase in organic originations and the acquisition of CWCapital. On an annualized basis, that's nearly $80 million in servicing fees. Reflecting back to the fourth quarter of 2010 when we went public, our servicing portfolio was less than $15 billion. It carried a weighted average servicing fee of 20 basis points and provided less than $30 million of annual servicing fees. In just two years, we've grown the portfolio by over $20 billion, increased the weighted average servicing fee by four basis points and generated revenues 192% greater than 2010 on an annualized basis. This is remarkable growth for such a stable and meaningful revenue stream.

The growth in the servicing portfolio provides more than just increased servicing fees. It also provides opportunities to earn ancillary revenues such as interest income from escrows, assumption fees, and prepayment penalties. In total, ancillary revenues from our servicing portfolio were approximately $3.3 million in the fourth quarter, a $2.1 million or 172% increase over Q4 of 2011. Q4 demonstrated the value of the combined franchise and produced our first quarter with over $100 million in revenues, an increase of 122% over Q4 of 2011.

Now, let's turn to expenses. We are seeing a change in the mix of expenses, and you may want to slide – refer to slide 14 of the presentation as I talk through this section. Q4 total expenses were $86.2 million, a 190% increase over Q4 of 2011. Adjusted expenses were $74.9 million in the fourth quarter, a 153% increase over the fourth quarter of last year. The major drivers of this growth were amortization and personnel expense. I'll speak to them separately and discuss any long term implications.

Q4 2012 personnel expense was $47.9 million, a 170% increase over Q4 of 2011. There are several drivers to the higher personnel expense: One, increased commissions due to higher origination volumes and higher average origination-related fees; two, increased expenses from investments and personnel through signing and retention bonuses; three, severance expense related to the CWCapital acquisition; and four, additional personnel expenses as we retain the entire CWCapital servicing staff through the end of the year after we converted the servicing portfolio to the W&D outsourced model.

Personnel expenses, excluding $1.2 million of severance expenses related to the CWCapital acquisition were 44% of revenues in the fourth quarter compared to 37% in Q4 of 2011. Amortization expense, excluding the $7.8 million of amortization of the CWCapital pipeline increased 142% to $15.1 million in the fourth quarter.

The amortization associated with MSRs outstrip the growth of servicing fees by 25 percentage points, primarily because of the significant amount of new MSRs booked in 2012. Similar to a mortgage that pays more interest in the early years, MSRs are amortized more heavily in the first few years of their lives. The amortization of MSRs was 79% of servicing fees in the fourth quarter.

The fourth quarter of 2012 generated an adjusted operating margin of 29% and was affected by the levels of amortization and personnel expense. Going forward, we expect adjusted margins in the low 30s.

Now let's turn to our 2012 full-year results. They were spectacular. In 2012, we surpassed a number of records; origination volumes, revenues, adjusted net income, and adjusted earnings per share. Adjusted net income was $48.4 million, or $1.87 per diluted share. GAAP net income was $33.8 million, or $1.31 per diluted share.

Please turn to slide 8. Adjusted income from operations was $79.7 million and grew at a 37% compound annual growth rate over the last five years. In 2012, we originated $7.1 billion of loans, a 76% increase over 2011. As the graph on slide 8 also shows, total originations have grown at a compound annual growth rate of 28% over the past five years.

Clearly, the acquisition of CWCapital played a significant role in the financial success of 2012. However, on a standalone basis, Walker & Dunlop legacy producers originated $4.8 billion of loans, a 20% increase over 2011. The $7.1 billion of originations included four months of CWCapital activity since the acquisition. Walker & Dunlop and CWCapital together originated $9.5 billion of loans in 2012.

Total revenues were $256.8 million, and as slide 8 shows have grown at a compound annual growth rate of 39% over the past five years. 2012 origination-related fees were $93.9 million, up 94% on the year. Origination-related fees grew faster than volumes, as the average origination fee grew to 132 basis points in 2012, up from 120 basis points in 2011.

HUD originations contribute most of the increase in the average fee as there is currently a very strong appetite for this execution in the market.

Servicing fees grew to $52.2 million, a 55% increase year-over-year. It's important to note that the 2012 servicing fees include only four months of fees from the CWCapital portfolio.

Again, as slide 8 shows, servicing fees have grown at a compound annual growth rate of 33% over the last five years and we expect more than $90 million of servicing fees in 2013. In addition, the servicing portfolio provides some significant ancillary benefits, in particular interest on escrows, which grew 101% to $3 million in 2012.

In December 2012, our average escrow balance was $1 billion, up from $358 million a year ago. It's particularly hard to generate any significant revenues from these balances due to the current interest rate environment. However, if short-term interest rates rise, the escrow balances can provide significant revenues in the future.

Let's turn to expenses. Total expenses were $201 million, up 110% from the prior year driven by amortization and personnel expense. Adjusted total expenses were $177.1 million, up 85% over 2011. Personnel expense was $109 million, up 113% over last year due to, one, increased commissions due to higher origination volumes and higher average origination related fees; two, increased expenses from investments in personnel through signing and retention bonuses; and three, severance expenses related to the CWCapital acquisition.

Personnel expense, excluding the $2.2 million of severance cost related to the acquisition were 42% of revenues in 2012 compared to 34% of revenues in 2011. It is important to keep this statistic in context. Approximately 59% of our personnel expenses are variable and driven primarily by origination-related revenues. So, as origination-related revenues grew faster than servicing fees and other revenues, the ratio of personnel expenses to total revenues increased. In 2013, we expect personnel expense to be in the low 40s as a percentage of revenue.

Amortization expense, excluding the amortization of CWCapital pipeline was $38.7 million in 2012, a 72% increase over 2011 and primarily due to significant amount of MSRs added in 2012. The amortization of MSRs was 76% of servicing fees in 2012, and we expect MSR amortization to remain in the low to mid-70s as a percent of servicing fees in 2013.

The credit quality within our portfolio remained strong. 60-day-plus delinquencies were 15 basis points of our at-risk portfolio at December 31, 2012. Our provision decreased to $3.1 million or 2 basis points at the at-risk portfolio. The net write-offs of $6.5 million from settlements with Fannie Mae decreased our allowance for loan losses to 12 basis points of the at-risk portfolio at December 31, 2012.

We are extremely pleased with the credit performance of the CWCapital portfolio. It is clear that the leadership of CWCapital believes in a strong credit culture very much like Walker & Dunlop.

We finished 2012 with an adjusted operating margin of 31% and within our expected range. It's not often that a company can start, complete, and integrate a large acquisition, make investments in people that return benefits immediately and maintain the economics of the business, all in the same year. However, we did just that in 2012. Given the size of the combined company, we expect the adjusted operating margin to continue in the low 30s in 2013.

I'd like to briefly touch on the CWCapital acquisition. We incurred $23.9 million of expenses associated with the acquisition. Approximately $15.2 million or 63% of these expenses were non-cash and related to the amortization of the pipeline intangible asset acquired from CWCapital. We are pleased that the actual expenses incurred were less than the initial estimates provided on the September 13 call.

Slides 19 and 20 of the presentation provide the transaction-related expenses by category. At December 31, 2012, the remaining pipeline intangible asset totaled $3.5 million or 19% of the amount initially capitalized and we expect to amortize the remaining balance throughout 2013.

As with most acquisitions, purchase price adjustments are made during the 12 months following the acquisition. Please – excuse me, please refer to slide 18. During the fourth quarter, we increased goodwill by approximately $6.3 million, the vast majority of which related to a $5.9 million decrease in the estimated fair value of the MSRs acquired. The adjusted – the adjustment to the MSR is related to the refinement of useful life estimates for a group of loans that are expected to prepay within the first year following the acquisition.

The remaining adjustments reflect true ups of certain compensation-related liabilities and the initial settlement of net working capital with CWFinancial Services. We expect there may be some additional adjustments to the purchase price as we finalize the net working capital adjustment over the coming months, but none of them are expected to be significant.

I'd like to touch briefly on the servicing portfolio. Please see slide 17. We recognize the complexity of servicing portfolios, their revenue streams, and their associated mortgage servicing rights. Therefore, it never hurts for us to spend a few minutes and revisit the key components of the servicing portfolio and its value to the company.

During our origination process, we not only generate fees, we also create MSRs that throw off significant revenues and cash for the next 9 to 10 years. The value of the cash flows is based on the size of the portfolio, the servicing fees, the life, any prepayments and defaults, and other revenue opportunities. At December 31, 2012, our servicing portfolio was the ninth-largest commercial multifamily servicing portfolio in the nation, a total $35.2 billion with a weighted average servicing fee of 24 basis points and a weighted average remaining life of 10.3 years. The associated MSRs were valued using 12% to 15% discount rates.

Slide 17 of the presentation illustrates the $680 million of contractual servicing fees that will be generated from the portfolio, assuming no prepayments and defaults. You can see that during the first six years, no less than 87% of the annual servicing fees are prepayment protected such that we share in the prepayment penalty in the event of an early payoff.

Given the size, life, prepayment protection and historically low default rates of the portfolio, the servicing fees represent a revenue stream that comprises 20% to 25% of our revenues, and when netted against amortization and servicing-related costs looks like a GSE HUD security, yielding 12% to 15%.

Our year-end net cash position remained strong with about $50 million in free cash. In addition, we have very little debt as evidenced by our 0.23 debt-to-equity ratio at December 31. The combination of our free cash, our low leverage, and our publicly-traded stock gives us significant flexibility to make strategic investments in the business as we grow our proprietary lending initiatives. The company is financially strong and poised for growth in 2013 and beyond.

As I reflect over the past five years, it's been incredible to see the transformation of Walker & Dunlop. We have demonstrated our ability to execute. We have bought and successfully integrated two businesses, both of which doubled our size. We went public in late 2010, and all of our key metrics grew at a compound annual growth rate of between 28% and 39%. I am so proud to have been part of this incredible period at Walker & Dunlop and I look forward to watching the company's continued success.

And with that, I'll turn it back to Willy.

Willy Walker

Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

Thank you, Debbie. I'd like to pause for a moment before discussing our ongoing strategy to thank Debbie for a fantastic work at Walker & Dunlop over the past five years. Debbie has been one of my closest partners in growing Walker & Dunlop, including acquiring two businesses and taking Walker & Dunlop public. Any CEO and CFO who have gone through the IPO process together share a bond that they will carry forever.

As we announced on Monday, Steve Theobald will be joining Walker & Dunlop on April 1 as our new chief financial officer. We are very excited to have someone with Steve's background and leadership skills joining us. But for today, our thanks are to Debbie for a job well done. You have been a great member of our team and we will miss you.

I want to take a moment to talk about GSE reform before discussing Walker & Dunlop's ongoing strategy. The Federal Housing Finance Agency, Fannie and Freddie's regulator came out with its 2013 scorecard yesterday. This scorecard calls for several initiatives which Fannie and Freddie will be graded upon, including a joint back office operation, and shrinking their multifamily commitments by 10%.

As it relates to the joint back office operations, if it ends up making Fannie and Freddie more efficient, that is net positive for the agencies and the consumer. With regard to the decrease in multifamily origination volumes, I'll make a broad regulatory comment and then put some context around what this means to Walker & Dunlop and our industry.

On the regulatory front, it is very surprising that FHFA would focus on decreasing multifamily origination volumes by 10%, to "bring more private capital" to the multifamily mortgage origination market. Fannie Mae and Freddie Mac's multifamily finance businesses have huge private capital participation. With Fannie Mae requiring private lenders to take the first loss position on all loans originated in the DUS program, and Freddie Mac selling securities for only the AAA tranche, is backed with a Freddie guarantee.

Fannie and Freddie's multifamily businesses are literally poster children for successful public-private partnerships. And the fact that FHFA has decided to create a scorecard objective focused on trying to attract private capital to the multifamily finance space is misguided at best.

With that said, from a practical standpoint, the FHFA scorecard will have little impact on Walker & Dunlop's business. We have every intention of remaining one of the very largest Fannie Mae DUS Lenders in the country and moving up the rankings with both Freddie Mac and HUD in 2013.

We will continue to add fantastic originators to our platform whenever possible and we will sell our scale and expertise at every opportunity. To put the 10% reduction in context, Fannie Mae did $33.8 billion of multifamily financing in 2012. So, subtracting 10% from that number equals $30.5 billion. $30.5 billion would be the fourth-highest annual origination volume in the history of the Fannie Mae DUS program and would be equal to Fannie's originations at – in 2007 at the height of the last economic cycle.

Freddie Mac grew 2012 originations over 40% from 2011. So a 10% reduction in Freddie's volumes will still produce the third-highest annual volume in the history of the Seller/Servicer program at over $25 billion. So Fannie and Freddie can originate over $55 billion of multifamily mortgages in 2013, by far the largest source of capital to the multifamily market.

So as misguided as this scorecard initiative is, it will have very little impact on Walker & Dunlop's ability to meet its annual origination guidance and continue being one of the largest providers of capital to the multifamily market in 2013 and beyond.

As I said earlier, in 2007 we established a goal of growing Walker & Dunlop 5x in five years, and we did it. In 2010 we told investors that we have the profitability and growth potential to be a public company, and have subsequently watched our market capitalization more than triple over 26 months.

In 2011, we told investors that we raised capital on our IPO to acquire businesses that would be accretive to earnings and enhance our market position. And we did just that in acquiring CWCapital.

And we told investors at the beginning of 2012 that we plan to be a top-five lender with Fannie Mae, Freddie Mac, and HUD, and finished 2012 as the number one Fannie Mae DUS lender, up from number three; the number five Freddie Mac Seller/Servicer, up from number nine, and will likely be a top-five HUD lender when the next rankings are released later this year.

I could not be more pleased with our track record of establishing ambitious goals and reaching them time and again. So where do we go from here and what should Walker & Dunlop's investors expect from us going forward?

We have established origination guidance of $10 billion to $12 billion for 2013 and are establishing Q1 2013 origination guidance of $1.9 billion to $2.4 billion. The midpoint of that range is over three times what we originated in the first quarter of 2011.

One of the goals we established in 2012 was to build out a national brokerage platform to gain access to non-multifamily commercial real estate financing opportunities. We successfully added two teams in Florida and Wisconsin in 2012, and we are focused on completing our national footprint in 2013 with the addition of teams in the Western United States.

Our final strategic initiative is to raise proprietary capital in the form of CMBS, investment funds, and/or in mortgage REIT to feed – and to feed that capital into our scaled origination platform. There are plenty of brokerage firms that have access to deal flow, but few have the underwriting expertise to raise proprietary capital and underwrite loans.

Similarly, there are plenty of mortgage REITs and CMBS origination companies that have very skilled underwriters and credit expertise, but few have a proprietary distribution network as large and talented as Walker & Dunlop's.

We believe our origination platform and credit track record position us very well to raise and deploy capital to meet the significant demand for capital – for commercial real estate financing that is coming over the next five years. These various initiatives have distinct start-up costs. If we are successful on some combination of these endeavors, we estimated it would cost us between $5 million and $15 million on a net basis in 2013.

After all the growth Walker & Dunlop has experienced, we know that every strategic move is a stepping stone for the next endeavor. When we execute on our 2013 strategy, we will greatly enhance our access to deal flow and create a proprietary capital solution that can be used to meet our client's needs. These proprietary sources of capital would generate returns and asset management fees that will grow Walker & Dunlop's long term stable revenue streams.

Today, 20% of Walker & Dunlop's revenues come from servicing fees that are stable and largely prepayment protected. As we continue to grow our servicing portfolio through loan originations, we will add asset management fees from the funds we raise to increase the percentage of revenues from long-term stable revenue streams to a goal of 50% of revenues by 2017.

If we are successful at accomplishing this strategic goal, investors will be rewarded by holding stock in an enterprise that is significantly larger, significantly more diversified, and extremely stable from a revenue standpoint due to the growth in servicing and asset management fees.

I'd like to close our prepared remarks by thanking every member of the Walker & Dunlop team for all we accomplished in 2012. Our financial results, market position, and industry awards as one of the fastest-growing and best places to work speak for themselves. They reflect what happens inside of Walker & Dunlop every day, where 430 highly talented professionals work together to exceed our customers' needs and build the premier commercial real estate finance company in the United States. It is an honor to be CEO of this company, and before I finish my prepared remarks, I'd just like to thank Debbie Wilson once again for all her contributions to Walker & Dunlop's success over the past five years.

With that, I'll turn the call over to the operator for any questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Our first question comes from Bose George with KBW. Please go ahead.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Hey, all. Good morning and congratulations on a great year.

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

Thanks, Bose.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.
Q

I had a couple of questions. One, first just on the gain on sale margin trends, we've seen a pretty good pickup in CMBS so far this year. Was wondering is there much of an appetite in that market for multifamily, and is there any impact there on margins you're seeing in your business??

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

Plenty of appetite, Bose. CMBS has gotten to be able to price competitively on some transactions. But it has not, as you can see – I mean CMBS was coming back significantly in 2012 particularly at the end. It's gotten out of the blocks very quickly in 2013 from an origination volume standpoint. But as you can see from the gain on sale margins, CMBS has not impact those to-date and there is a heck of a lot of other asset classes that they can lend on where they don't have to produce their spreads to be able to compete on multifamily.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay, great. That makes sense. And then actually going back to the comments you made on FHFA earlier, just wanted to clarify, do you see that 10% as a one-time adjustment or is it something they kind of periodically revisit?

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

So, the scorecard is an annual process. And if you looked at what their 2012 scorecard laid out for multifamily, it was to do an analysis of whether Fannie and Freddie's multifamily businesses could stand on their own. Fannie and Freddie did that analysis, submitted it to FHFA, and then they came out with this as their 2013 objective.

So to be honest with you, it's hard to tell. This is something that FHFA just decided to go do. To put it in context, Bose, the single-family – one of the objectives in the scorecard for 2013 is that Fannie and Freddie and the single-family business do $30 billion in public-private partnerships, so attracting private capital to their origination business.

And as you well know, the single-family origination business is a multitrillion dollar business. And so they are trying to attract private capital to a very, very small percentage of their single-family business, whereas they are trying to reduce multifamily by 10% in a business that is predominantly private capital today.

And so, as I said in my prepared remarks, the objective doesn't seem to make a whole lot of sense as it relates to Fannie, Freddie reform. But FHFA obviously has the scorecard, can put it out there on an annual basis. And to be perfectly blunt about it, there is no – I have no idea what they will do in 2014 as far as the scorecard is concerned.

I'd make one final point which is just the real issue is Fannie, Freddie reform on Capitol Hill. And there, we have seen nothing that tells us that Congress is going to come together. There is such a different point of view between Fannie and Freddie and the role they play, where the Democrats think that Fannie and Freddie doing 90% of single-family financings is perfectly fine, and the Republicans thinking that Fannie and Freddie shouldn't even exist. That that chasm between the two sides is so wide that it's hard to see them coming together to figuring out what they might do as a more comprehensive approach to Fannie, Freddie reform.

Bose George Q
Analyst, Keefe, Bruyette & Woods, Inc.

Okay, great. Thanks a lot.

Operator: Your next question from Brandon Dobell with William Blair. Please go ahead.

Brandon B. Dobell Q
Analyst, William Blair & Co. LLC

Thanks. Good morning.

Deborah A. Wilson A
Chief Financial Officer, Treasurer and Executive Vice President, Walker & Dunlop, Inc.

Good morning.

Brandon B. Dobell Q
Analyst, William Blair & Co. LLC

Just, Willie, want to focus on, first, on your comments about the $5 million to $15 million in kind of, I guess let's call it, net extra expenses if you're successful on the things you got planned for 2013. I want to make sure I understand kind of what that means either from a P&L perspective, or would that just be from hiring people or the cost it would take to put some of these teams in place. Want to make sure I understand how you're positioning them.

Willy Walker A
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

Brandon, the different initiatives all have different startup costs as far as from an operating standpoint, and then also capital that will be required from us to get them up and going. The most expensive would be the mortgage REIT and getting that up and going and raising the capital into the mortgage REIT...

Brandon B. Dobell Q
Analyst, William Blair & Co. LLC

Okay.

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

...because of the underwriting expenses and the banking expenses, if we're successful at doing so.

The second, if you will, most expensive, is the fund business just from finders' fees on raising the amount of capital that we plan to raise in our funding – in our fund business. And then the – if you will, the cheapest in the group is the CMBS strategy of hiring the people to get the CMBS group up and going; originators, underwriters, credit people. And the idea there is that we would pool somewhere between $100 million and $200 million of mortgages and then contribute them to other securitizations that are being managed by larger – well, the issuers of the securities.

And so, we have got in all three instances; significant work done in heading down all three of those. And as I said in the prepared remarks, it'd be great if we can accomplish all three, which would be at the high end of the cost range that we gave. But if we're not successful on all three, the cost of starting up one or two of them will be somewhere in the midpoint between the $5 million and $15 million of startup expenses.

Brandon B. Dobell
Analyst, William Blair & Co. LLC
Q

Okay. And then I guess in a related way, your comments around getting the business to kind of 50% of revenues from more recurring sources in the next four or five years. Obviously, there is some assumptions in there about what a fund management business or a mortgage REIT would be contributing to that revenue stream. Any more color on kind of what size you've contemplated that it would take to get you to that kind of percentage revenue breakdown, looking out five years?

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

A really good question. As you can imagine, we've modeled it out, Brandon...

Brandon B. Dobell
Analyst, William Blair & Co. LLC
Q

Right.

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

...but without getting over our skis, if you will as far as guidance. As you can – you can run the numbers on it and realize that they need to become multi-billion dollar businesses.

Brandon B. Dobell
Analyst, William Blair & Co. LLC
Q

Yes.

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.
A

...to be able to provide us with the asset management fees and the servicing fees to be able to get those numbers to where we'd like them to go. So, the real issue is that we plan on continuing to scale our agency business because it's a fantastic business and we see Fannie, Freddie and HUD remaining the dominant providers of capital in that space.

And at the same time, we see huge opportunity in both other asset classes, as well as in multifamily on deals that don't size for the agencies or for HUD. And so as we build up proprietary capital, we will feed it into both our multifamily originations, as well as our non-multifamily originations due to the growth of our non-multifamily origination platform.

Brandon B. Dobell Q
Analyst, William Blair & Co. LLC

Okay. And then the final one for me, as you think about human capital additions on the origination side this year, in the context of scale on that business, should we expect a handful of additions? I know it's tough to find people and it's tough to predict how many you get. But it sounds like part of that scale comment you made was more people as opposed to just more productivity. So, should we expect you guys to be as aggressive as you've been in the past couple of years on finding people to put in the platform?

Willy Walker A
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

Yes, I think that's – yes.

Brandon B. Dobell Q
Analyst, William Blair & Co. LLC

Okay.

Willy Walker A
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

Very, very, very, very quickly, very much so. As I said in my remarks, I think that the scale of our platform, our market position – I mean, the difference in where we are today versus where we were just five years ago, as it relates to why someone would want to come work at Walker & Dunlop, is dramatically different. And the platform and our scale today are big selling points. And so as a result of it, our ability to attract talent is far greater today than it's ever been before.

And we have ambitious goals to continue to grow our originations, both in the multifamily specific space as well as in the non-multifamily space. And whether that comes through just hiring or acquiring businesses, Brandon, we may end up just going and acquiring platforms, and we may end up hiring individuals as we've done in the past.

Brandon B. Dobell Q
Analyst, William Blair & Co. LLC

Okay. And then I guess one final one. Numbers question. Doesn't sound like there was anything in the quarter like you had last quarter around a shorter duration deal that changed the origination fee structure or – and kind of moved those relative numbers around. But I want to make sure that I didn't miss anything, Debbie, in your prepared remarks about kind of mix of business, I guess, this quarter.

Deborah A. Wilson A
Chief Financial Officer, Treasurer and Executive Vice President, Walker & Dunlop, Inc.

No, Brandon, there were some with longer durations and some with shorter durations. But on average, the answer is no.

Brandon B. Dobell
Analyst, William Blair & Co. LLC

Q

Okay, great. Appreciate it. Thanks a lot.

Operator: [Operator Instructions] We'll take our next question from Will Marks with JMP Securities. Please go ahead.

Will C. Marks
Analyst, JMP Securities LLC

Q

Thank you. Good morning, Willie, Debbie, Claire.

Deborah A. Wilson
Chief Financial Officer, Treasurer and Executive Vice President, Walker & Dunlop, Inc.

A

Hi, Will.

Will C. Marks
Analyst, JMP Securities LLC

Q

I want to first ask on, you talk about your rankings in Fannie, Freddie. What is your approximate market share with the GSEs?

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

A

So we have, if you take Fannie and Freddie, in 2012, Walker & Dunlop and CW combined, Will, so these numbers will be off of the $9.5 billion that was done, combined, not the $7.1 billion that our financial results are based upon. Does that make sense?

Will C. Marks
Analyst, JMP Securities LLC

Q

Yes.

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

A

Okay. So on the $9.5 billion that CW and W&D did, which is what Fannie and Freddie's rankings are based off of because they put us both together in 2012, we had a 12.5% market share with Fannie Mae and we had a 10% market share with Freddie Mac. So one point there that I think is important to keep in mind is that in 2000 – if you look at that and you say, okay, great, Walker & Dunlop needs to grow market share with Fannie Mae, can they grow beyond 12.5%? Last year in Freddie Mac, CBRE originated $6 billion of loans with Freddie Mac and had over a 20% market share – 20.9% or something on Freddie Mac originations in 2012.

And so I truly believe that our ability to continue to scale with both agencies and take market share, given our market position is right there. And so, the scaling back of their aggregate origination numbers, if, for instance, just picking a number, and this is not in any way using guidance, but if you took Walker & Dunlop from what our originations were in 2012 and move them up with Fannie Mae, for instance to $5 billion this coming year, that'd be a 16.5% market share. And so, there is plenty of room here for us to continue to gain scale and market share with the agencies, based off of both our 2012 origination numbers as well as other competitors and how much market share they've had.

Will C. Marks
Analyst, JMP Securities LLC

Q

Okay, that's great. Very helpful, thanks. Couple of other things; one is, in your press release and I guess on the call you talked that the Mortgage Bankers Association estimating 14% annual growth through – until 2015. Is there a specific 2013 number for that?

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

A

I don't know if they have year-on-year. I was trying to give a longer – they clearly have it, we can get it to you. They clearly have a year-on-year number. I was trying to get a longer one just because we have these refinancing volumes that are coming through here. But we can get you the year-on-year; I don't have it off the top of my head.

Will C. Marks
Analyst, JMP Securities LLC

Q

And you've given your own guidance, so it's not as important necessarily. On your number for this year – actually on the first quarter, the $1.9 billion to $2.4 billion, if I just look at it, I think it's slide 10, the – it looks like a pretty – so we can't compare to last year because of your acquisition, but how should we think about seasonality? Obviously, the question is geared towards – and is your guidance – is your guidance too light, could the full-year be higher than the $10 billion to $12 billion based on, looks like a really strong first quarter?

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

A

Will, one of the reasons why we updated our guidance in early January after getting – so as you know, once we close the deal, we gave initial guidance of 8 to 10 for 2013 and then we updated that from $10 billion to $12 billion. And so, I think one of the things you're seeing here is that we are integrating CW and trying to see what the combined platform can do. And everything so far has been that one plus one is equaling more than two, if you will. And so, we're trying to watch it and be obviously as straightforward as we possibly can and also not get, if you will, over our skis. So as we said in the call, we are maintaining our guidance of $10 billion to $12 billion for 2013. But as you can see from the Q1 guidance, the team is executing very well so far this year.

Will C. Marks
Analyst, JMP Securities LLC

Q

Okay, thanks. And just one final question, can you remind me of Fortress' ability to sell stock? Is it on now? It's sometime in March? [indiscernible] (51:55).

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

A

Will, they opened up as far as the deal on March 3, so they are free right now if you will from the lockup. They're outside of the lock-up period.

Will C. Marks
Analyst, JMP Securities LLC

Q

For potentially all of their stock. Is that correct?

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

A

For potentially – with certain restrictions in there, but yes.

Will C. Marks
Analyst, JMP Securities LLC

Q

Okay. That's all from me. Thank you very much.

Operator: We have no further questions in queue at this time. I'd like to call – turn the call back over to Willy.

Willy Walker
Chairman, President and Chief Executive Officer, Walker & Dunlop, Inc.

Great. Appreciate everyone joining us this morning. It was an absolutely fantastic year and a great fourth quarter. We are thrilled with the performance of the two companies coming together in 2012 and look forward to a very successful 2013. So thanks everyone for joining us this morning and have a great day.

Operator: Thank you. This does conclude today's conference. Please disconnect your lines at this time and have a wonderful day.