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Walker & Dunlop, Inc. (WD)

Q3 2016 Earnings Call

CORPORATE PARTICIPANTS

Claire Harvey

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

William M. Walker

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

Stephen P. Theobald

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

OTHER PARTICIPANTS

Steve C. DeLaney

Analyst, JMP Securities LLC

Charles J. Nabhan

Analyst, Wells Fargo Securities LLC

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Walker & Dunlop's Third Quarter 2016 Earnings Conference Call and Webcast. Hosting the call today from Walker & Dunlop is Willy Walker, Chairman and CEO. He is joined by Steve Theobald, 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 11:30 AM Eastern. The dial-in number for the replay is 800-839-2492. The archived call is also available via webcast on the company's website. 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 hand the floor over to Miss Claire Harvey. Please go ahead Ma'am.

Claire Harvey

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

Thank you, Erica. Good morning, everyone. Thank you for joining the Walker & Dunlop third quarter 2016 earnings call. I have with me this morning, our Chairman and CEO, Willy Walker; and our CFO, Steve Theobald. 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. These slides serve as a reference point for some of what Willy and Steve will touch on this morning.

Please also note that we may reference the non-GAAP financial metric, adjusted EBITDA, during the course of this call. Please refer to the earnings release and presentation posted on our website for a reconciliation of this non-GAAP financial metric.

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 describe our current expectations and actual results may differ materially. 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 Annual and Quarterly Reports filed with the SEC.

With that, I will turn the call over to Willy.

William M. Walker

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

Thank you, Claire. Before I begin I'd like to ask call participants to make sure you have the slides posted to our website open during the call. Both Steve and I will reference many slides in discussing our year-to-date results and the opportunities we see ahead.

As our earnings release this morning detailed, Q3, 2016 was an exceptional quarter for Walker & Dunlop. It was the company's best third quarter ever, with \$0.96 per share of diluted earnings, up 45% over Q3, 2015. \$0.96 this quarter follows a \$1.05 in Q2, bringing us to \$2.51 in year-to-date EPS, up 26% over last year. We are clearly tracking to generate double-digit EPS growth for the third consecutive year. The W&D team continues to execute daily for our clients and year-after-year for our shareholders.

Q3 revenue growth was exceptional with a \$155 million representing 28% growth over Q3, 2015. Much of the revenue growth was attributable to very strong Fannie Mae and HUD loans originations along with a 27% increase in servicing fees.

W&Ds loan servicing portfolio now stands at \$59 billion, and with the successful integration of the Oppenheimer portfolio, acquired in Q2, we are on the doorstep of growing our servicing portfolio from \$50 billion to \$60 billion in less than a year. That incremental \$10 billion of servicing will generate over \$26 million in high margin servicing fees in the coming year.

W&D is currently the eighth largest commercial loan servicer in the United States, and at our current rate of loan originations we have our sights firmly set on being the seventh largest by the end of the year.

The growth in loan origination and servicing income has driven dramatic growth and adjusted EBITDA. Our EBITDA totaled \$36 million this quarter, up from \$31 million in Q3, 2015.

I'd like to ask you to turn to slide four at this time. It shows Walker & Dunlop's revenues, adjusted EBITDA and net income for the past 10 years. As you can see, our growth has been truly outstanding. Below the graphs, we have calculated the compound annual growth rate for revenue, adjusted EBITDA and net income for the past three-, five- and 10-year periods.

What's very evident from this graph is that the scale we created by growing revenues at a 10-year compound annual growth rate of 26% created tremendous operating leverage. Just look at the graph and then look at the last three years, where adjusted EBITDA grew at a 62% compound annual growth rate and net income grew at a 34% compound annual growth rate.

Over this 10-year period of incredible financial performance, we expanded W&Ds physical footprint and market presence from one office to 24 offices, from 89 employees to 530 employees, and from basis points of market share to over 5% of the total multifamily lending in the United States in 2015. That point warrants being repeated. Due to continued growth and fantastic financial performance, Walker & Dunlop now has over 5% market share of total lending on multifamily properties in the United States. That is very significant market share, particularly for a non-bank lender in the highly competitive, highly fragmented real estate financial services market. And as anyone who has watched our growth until now knows, we have no intention of stopping at 5%

At the beginning of the year, we laid out several strategic initiatives, generate over \$500 million in total revenue, generate a mid-20s operating margin, a mid-teens return on equity, expand the sales force by 25%, launch an asset management business, and generate year-over-year double-digit EPS growth.

As we have done for many, many years, we will accomplish every goal we established and in many instances exceed those goals by a wide margin. I'd like to spend a moment discussing the growth of our sales force by 25% and entering the asset management business, because these two initiatives will add great value to Walker & Dunlop going forward.

W&D has grown fantastically over the past 10 years through acquisitions and hiring new loan origination talent. If you turn to slide five, it shows W&Ds recent revenue growth on the left Y axis and revenue growth per employee on the right Y axis. In 2009, W&D had 27 sales professionals generating \$89 million of total revenues or \$660,000 of revenue per employee. We were a small company back then. Six years later, we grew to 104 sales professionals, generating \$468 million in revenues, equating to just under \$1 million in revenues per employee.

And as you can see in the final column, we have increased revenues over the past 12 months to push revenue per employee over \$1 million, that's impressive revenue growth, but it also shows the economies of scale and operating leverage we have created.

By investing in companies and sales people, and integrating them successfully, we have created operating efficiencies that are growing EBITDA and net income at tremendous rates. Our acquisition of Elkins Mortgage last week will add another 14 sales professionals to W&D, and along with other hiring we have done this year, we will end 2016 with over 120 mortgage bankers and brokers and revenues greater than \$530 million. We will continue adding sales professionals and companies to Walker & Dunlop to continue growing revenues far faster than market growth with the goal of reaching \$1 billion in revenues by 2020.

The second strategic initiative which is really exciting is the development of an asset management business to raise off balance sheet capital to feed into our loan origination platform. Walker & Dunlop looks at roughly a \$100 billion of transactions per year. And we end up lending or brokering on about 20% of that volume.

We have very successfully used capital from third parties to fund our lending operations, yet that capital is often not discretionary and often doesn't provide the revenue opportunity or returns that using one's own capital would generate. So given Walker now has broad access to deal flow along with our pristine underrating track record, we've embarked on building an asset management business to raise, manage and invest third party capital and commercial real estate. We have made significant progress during Q3 on this initiative and we expect to have something to announce before the end of the year.

We have laid out an ambitious goal of building an \$8 billion to \$10 billion asset management business, which we will do as quickly as possible. And once built, similar to our servicing business, the asset management business will provide W&D with long-term, high-margin steady revenue streams.

I'd like to turn the call over to Steve to run through our financial results for the third quarter and year-to-date in more detail, and then I'll come back to talk about the rest of 2016 and what we see ahead as we continue down the path to making Walker & Dunlop the premier commercial real estate finance company in the United States. Steve?

Stephen P. Theobald

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

Thanks, Willy, and good morning everyone. Third quarter 2016 represents another period of strong financial results for our company, marked by significant volumes with the agencies, double-digit revenue growth and above target returns. Our core business has never been better, and we believe the momentum we have coming into the fourth quarter will carry into next year given the current market dynamics and macro trends shaping both the housing market and the broader U.S. economy.

I will highlight a few key aspects of our results, and how we see those elements of our business performing in the future. We earned \$0.96 per share in the third quarter, an increase of 45% from the prior year.

As you know, we set a goal to grow earnings per share by double-digits this year, and with year-to-date earnings per share now at \$2.51 compared to \$2.65 for all of last year, we will achieve that goal and re-establish it for 2017.

Our results have benefited from across the board revenue growth, at 14% year-to-date this year compared to last while expenses during the same period have increased only 11%. This has pushed our operating margin for the year to 31% above our target of mid 20%.

We continue to see the benefits from scale and are operating our business efficiently even while making investments to continue growing the platform. Based on our current pipeline, we would expect our Q4 operating margin to be around 28% at the high end of our range.

During the quarter we generated a return on equity of 22% bringing our year-to-date ROE to 20%, well above our target return of mid- to high-teens. Our strong ROE this year has been driven almost entirely by earnings growth as our equity balance which is nearly \$570 million as of September 30 has increased 16% from the beginning of the year, yet we are still exceeding our ROE targets.

We ended the quarter with \$84 million of cash on the balance sheet, an increase of \$23 million from June 30, while we also grew the interim loan portfolio from \$242 million to \$265 million in Q3. We decided not to repurchase any shares during the quarter to hold cash for potential M&A transactions, funding of ILP loans and to support the capital needs of our CMBS business.

The increasing capital intensity of the CMBS business, coupled with limited desire by Walker & Dunlop's core client base for CMBS financing have led us to this decision to exit the business. This was not an easy decision for we have put together a fantastic CMBS team and felt there was great opportunity to provide our borrowers with an excellent CMBS product.

Nonetheless, we will wind down the conduit between now and the end of the year and expect to take a charge in the fourth quarter of between \$1 million and \$3 million for severance and other costs. We have no CMBS loans remaining on our balance sheet, and by eliminating the operating cost of the conduit, we will free up capital to further grow our interim loan portfolio, buy back stock and fund any other acquisitions we may complete.

Our gain on sale margin increased to 237 basis points during the quarter, well above our target range of 170 basis points to 190 basis points. Given the significant outperformance, let me take a few minutes to walk through this quarter's margin.

At the highest level, the reason we were well above our target range was the mix of business originated during the quarter. When we established our range, it was based upon an assumption that our Fannie, Freddie and brokered loans would each represent about 30% of our overall volumes, [ph] with hard (13:28) conduit and ILP making up the remaining 10%.

This quarter, 37% of our origination business was with Fannie Mae; 31% was with Freddie Mac and only 22% of our business was brokered. HUD which has the highest gain on sale margins represented 9% of our originations this quarter, up from just 2% last quarter.

Digging a bit deeper, our gain on sale margin also benefited from most of our Q3 deals coming from regular flow business rather than large portfolios, and from the fact that the majority of our Fannie Mae production continues to be fixed rate versus floating rate business.

Based on our current pipeline for the fourth quarter, we don't expect the fixed versus floating rate dynamic to change, although we do expect our Freddie and brokered production to be a higher percentage of our business than in the third quarter.

As we mentioned earlier in the year, HUD has regained some popularity, particularly in the construction financing space as banks have been pulled back by the regulators. HUD has always been a bit of a lumpy business and requires both patience and scale to be successful. The size of our overall platform enabled us to remain one of the largest HUD lenders in the country even when HUD capital was less competitive, and we now expect elevated HUD volumes in the fourth quarter and into 2017.

All told, we don't expect Q4 gain on sale margin to be as high as it was in Q3, but it will be above our 170 basis point to 190 basis point target range.

Adjusted EBITDA for the quarter was \$36 million compared to \$31 million last year. The increase in EBITDA this quarter has been driven by the growth in our servicing portfolio and its related revenues.

Servicing fees of \$37 million increased 27% over the prior year quarter, and interest income from escrow deposits of \$2.6 million increased a 126% from last year. Our escrow balances are now at \$1.7 billion and if the Fed moves rate up -- rates up, our interest income will benefit from that increase.

The servicing portfolio was \$59.1 billion at the end of September and our weighted average servicing fee for the portfolio is now 26 basis points, having moved up from 24 basis points just five quarters ago. We fully expect to be over \$60 billion soon, less than 12 months since we crossed the \$50 billion mark. Offsetting the adjusted EBITDA for the quarter was the \$2.6 million settlement on the last three remaining defaulted Fannie Mae loans.

The settlement was fully reserved and had no P&L impact during the quarter. The settlement of these three loans essentially puts a wrap on our post-financial crisis credit performance. All told, we charged off \$24.9 million between 2008 and 2016, only two basis points of our average our risk portfolio during that time period. We have no delinquencies or loans pending settlement in our at risk portfolio bringing our streak to six straight quarters with

no 60 day delinquencies. Credit quality remains excellent, and we see no signs of any deterioration in performance, nor do we see signs of loose underwriting standards taking over the industry.

Personnel expense this quarter was 42% of revenue, a slightly higher percentage than Q3 of last year, but in line with our expectations for the quarter. Commission expense increased due to the strength of our origination fee growth in the quarter, and our company bonus pool was increased as a result of our overall financial performance.

As we head into the fourth quarter, we would expect personnel costs to increase as a percentage of revenues, likely in the range of 42% to 44%. This fourth quarter increase is normal, as many of our originators are now earning at or near the top end of their commission splits, before they start over in January.

Our annual personnel expense will be around 40% of revenues, consistent with our historical performance. All other expenses grew at a much lower pace than revenues, which as I previously mentioned has contributed to an above target operating margin so far this year.

We met or exceeded all our financial goals in the third quarter. Our fantastic performance sets us up for a strong finish to the year, and the momentum we have achieved should set the stage for continued growth and financial success in 2017.

With that, let me turn it back to Willy.

William M. Walker

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

Thanks, Steve. The strength of our financial performance gives Walker & Dunlop the ability to continue growing by investing in our people, and investing in new products and services for our clients. You notice that Steve said, we didn't buy back any stock in Q3.

Given our extremely strong financial performance this year, coupled with the growth opportunities we see ahead, we would have liked to buy back stock during the quarter, but we held on to our cash for potential investments in companies, people and [ph] newer loan (18:08) originations in our conduit and on our balance sheet. Those types of investments are what will produce continued growth and long-term shareholder value at Walker & Dunlop.

Our current cash balances, monthly cash flow generation and exit from the CMBS business will afford us with the ability to both invest in growing our business, while also buying back stock should the opportunity present itself.

We've established a culture at W&D of setting and exceeding ambitious goals, and once again in 2016 our team will exceed expectations and deliver exceptional performance. What is most gratifying for me personally is that we have built a scaled national platform with the same great company characteristics that placed us on Fortune Magazine's list of Great Places to Work for the first time in 2012, and once again in 2016 for the fourth time in five years.

Making Fortune's list of Great Places to Work is a huge honor. Investors spend a great deal of time focusing on our numbers, and we get that, but it is also important to remember that a financial services company is only as good as its people. We have successfully scaled our business with great people, operating inside a wonderful corporate culture, and that corporate culture is critically important to growing Walker & Dunlop as dramatically over the next 10 years as we have for the past 10 years.

Our money is no greener than money from Goldman Sachs or Wells Fargo, a dollar is the ultimate commodity. Here we are growing faster and maintaining dramatically higher margins and return on equity than our larger competitors, due to our people, who provide our clients with the capabilities and execution of a large financial services institution, while delivering those services with a client focus and customer service that is truly personalized.

It is our big company capabilities, I'd reiterate here that W&D now has over 5% market share of total multifamily lending in the United States, with a small company feel that makes W&D unique, and it all starts with our people, who are immensely talented, hardworking and loyal.

I'd ask you to turn to slide eight for a moment, so we can discuss the changing demographics in America. The United States continues to grow and form over 1 million households per year. Per CoStar Analytics from 1967 until 2007 American home and apartment builders supplied 1.03 units of new housing for every one new household formed. Since 2009, however, America has continued to form over 1 million households per year, yet the supply of new single-family and multifamily homes has dropped to 0.6 units per household. This 40% drop in new home deliveries has largely been due to a lack of new single-family homes, which peaked around 1.3 million per year in 2006, and is currently between 500,000 and 600,000 per year.

And while the Norman Rockwell American Dream of a single-family home in the suburbs with a detached garage is still alive and well. As slide eight clearly shows, for demographic and financial reasons, America is moving away from home ownership and into rental housing. And as the rental housing market continues to grow, so does the multifamily financing market.

If I could ask you to turn to slide nine, it shows the growth of the multifamily financing market from 2011 through 2020. The graph contains actual historic data for 2011 through 2015 and the black line shows Walker & Dunlop's growing market share. As you can see, W&D has grown its share of total lending on multifamily properties from 2.8% in 2011 to 5.4% in 2015, and as I said previously we have no intention of stopping there.

Staying on slide nine, the forecasted numbers for 2016 through 2020 come from Freddie Mac's recently released market analysis. Freddie Mac's market size projections over the past several years have been among the most accurate in our industry. And as you can see, Freddie is projecting total multifamily financing volume of \$282 billion in 2016, growing to \$300 billion in 2017, and \$315 billion in 2018.

That is significant growth based on Freddie Mac's view, their multifamily property values continue to rise and that multifamily owners add leverage to an industry that is currently around 30% levered.

The most recent valuation from the National Multifamily Housing Council for all multifamily properties is \$3.3 trillion, and there is just over \$1 trillion of debt outstanding to multifamily properties across the country. 30% leverage for multifamily compares to over 50% in the single-family industry, and while you could potentially argue that multifamily should not reach the same leverage level of single-family, there's plenty of room to add leverage to the existing multifamily inventory at very reasonable LTV levels.

As a reminder, W&D continues to lend at extremely prudent debt and cash flow levels. In Q3 our average LTV was 68%, in line with Q2, and our average debt service coverage ratio was 1.49 times. And as Steve just mentioned, we are now in our sixth straight quarter without a single loan 60-days delinquent.

If you could turn to slide 10, you can see from this chart developed by Goldman Sachs that U.S. commercial real estate is currently at its lowest loan-to-value ratio in the past 30 years. If we remain in a low interest rate

environment for years to come and the demographic and economic trends I just mentioned continue to drive Americans to multifamily housing, Freddie Mac's projections are not unreasonable and anything close to the growth projected by Freddie Mac would be a fantastic scenario for a high-growth company like Walker & Dunlop.

We have a very clear strategy for growth, some of the greatest clients in the world, a brand that gets bigger by the day and the very best people in our industry, all the ingredients necessary to continue growing Walker & Dunlop over the next decade.

So beyond the macro environment, how will W&D continue driving outperformance in revenue and EPS growth? First, W&D is a tremendous company with tremendous people that sets ambitious goals and exceeds those goals year after year. Second, we have built a scaled lending platform with a leading brand that is predicated on exceeding our client's expectations every day. America will continue to create new households and until new inventories get back above one unit per new household, demand for rental housing will continue to outstrip supply creating strong operating fundamentals upon which to lend.

Third, we will continue to invest in new loan origination talent to grow our platform and expand our financing capabilities. We've shown that our hiring of great talent and buying of tremendous companies has achieved over the past 10 years and we will keep doing it.

W&D grew during The Great Recession due to having negligible loan losses and a business model that continued generating cash. If this cycle continues unabated, we will add to our platform through one-off hires and the acquisition of smaller loan origination platforms. And if this cycle slows, we will take advantage of our strong financial position to make larger acquisitions. W&D is currently generating over \$120 million of adjusted EBITDA on an annual basis and with only \$168 million of term debt on the company, we have plenty of borrowing capacity should large acquisition opportunities present themselves.

Finally, we will execute on our asset management strategy to raise capital around our scaled loan origination platform, to provide our clients with a broader array of capital solutions, our loan originators with more products to sell, and our investors with additional long-term stable revenue streams.

I'd like to thank all of my colleagues at W&D for their incredible performance over the past decade, over the past three years and throughout 2016. We have a truly amazing team and our numbers speak for themselves.

I'd also like to congratulate our team, again, for being named one of Fortune Magazine's Great Places to Work. As we have said many times before, great companies with great people produce great results. Finally, I'd like to thank everyone who joined us on this call this morning for your attention and interest in W&D.

With that, I'd like to ask Erica to open the line for any questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now is open for questions. [Operator Instructions] Our first question is coming from the Steve DeLaney from JMP Securities.

Steve C. DeLaney
Analyst, JMP Securities LLC

Q

Good morning and congratulations on another very strong quarter. We've certainly noted the pickup and the gain on sale margin for the last two quarters, 215 basis points in 2Q and now 237 basis points. When I think about that and I think of all the press releases you've put out over the past year of the new loan officers that have been hired and comments about their background. I'm just curious if the pickup in the gain on sale margin and specifically the HUD component of the origination mix, do you attribute that, any of that to direct hiring decisions bringing in loan officers with specific skills in HUD loans or should we continue to think of sort of the HUD mix being more coincidental?

Thanks.

William M. Walker
Chairman & Chief Executive Officer, Walker & Dunlop, Inc.

A

Good morning, Steve.

Steve C. DeLaney
Analyst, JMP Securities LLC

Q

Good morning, Willy.

William M. Walker
Chairman & Chief Executive Officer, Walker & Dunlop, Inc.

A

I'd say no to your specific question as it relates to the sales force that we brought in over the last 12 months to 24 months. The people we've added have been absolutely fantastic contributors to the platform, but that that, if you will, dramatic outperformance in gain on sale margin is really due to the mix. And as Steve outlined, predominantly due to doing a lot of Fannie business, a lot of Fannie fixed rate business, and then HUD as a percentage of overall origination volumes moving from 2% in Q2 up to 10% in Q3.

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President, Walker & Dunlop, Inc.

A

Yeah. And, I think, Steve on the HUD front, that's just, we've seen a general pick up in our HUD volumes across the board and while we do have a dedicated HUD team, not insignificant amount of our HUD volume is actually coming from either our capital markets folks or our multifamily agency folks as well.

William M. Walker
Chairman & Chief Executive Officer, Walker & Dunlop, Inc.

A

So, I think, Steve does raise a really good point there Steve which is just that we are seeing a tremendous amount of cross-selling amongst the groups where capital markets originator will have a client who needs a HUD

loan and bring in a HUD originator to help work on that deal and similarly a HUD originator might find a GSE deal and bring in a Fannie/Freddie expert to help them get it done.

Steve C. DeLaney

Analyst, JMP Securities LLC

Q

Got it, got it. And as part of or as you formulate your goals for 2017, will you revisit your sort of base range of a 170 basis points to 190 basis points? Is that something that you think you'll be having to discuss internally as you communicate your goals to us for next year?

Stephen P. Theobald

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

A

I think it's fair to say Steve we – whether you subscribe to an annual budget process or not, but each year as we kind of finish off a year and start the next, we revisit all of our goals and targets and if we're going to make changes we'll certainly communicate that out probably in the fourth quarter call.

William M. Walker

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

A

I'd also add one quick point which is just that, if you remember Steve in the last cycle back in the mid 2000s, one of the big pressure points on gain on sale margin was the volume that CMBS was doing. And, as you know, in 2007 that peaked to \$230 billion. This year's [ph] actions (30:20) were that CMBS could do \$100 billion, I wouldn't be surprised if we finish the year seeing CMBS do closer to about \$50 billion to \$60 billion. And so the lack of competitive pressure on gain on sale margins has been a significant, if you will, adjustment to the way that we've been looking at the market.

Steve C. DeLaney

Analyst, JMP Securities LLC

Q

And interesting point, yes, in terms of your ability to price loans to your borrowers versus the required yield from the GSEs. And just to close out, if I may, this is the first time – when you talked about asset management, I believe this is the first time that I heard a specific goal for AUM of \$8 billion to \$10 billion. So can you give us some clarity on that, Willy, when you talk about \$8 billion, are you talking about a loan portfolio, you know, a bridge loan portfolio or other types of loans that would be the principal balance of the target portfolio. And I assume you are going to use some leverage in whatever vehicle you have. And so are we – does that represent something in the order of \$2 billion to \$3 billion of equity – actual equity that would need to be raised or assimilated?

William M. Walker

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

A

So, Steve, the \$8 billion to \$10 billion number comes from this business needing to be meaningful at Walker & Dunlop, and as we just said in the call, finishing 2016 with over \$530 million of revenues with a goal to get revenues over a \$1 billion by 2020 to make the asset management business relative in a company that's growing as fast as we are, it needs to be that size. The, if you will, the components of it, it could end up being that we buy the manager of a mortgage REIT and use that as a vehicle to scale up assets under management.

It could be that we go and raise a fund with institutional investors and use those funds to fund our lending operations and those funds could be a series of funds. You could have one focused on interim loans as we're doing on our balance sheet today. You could have another one that would be focused on preferred equity; you could have another one that would be focused on health care lending, construction loans.

So there are a number of different strategies, if you will, that we would like to be able to provide capital to our clients that are in our current format, probably not things we want to do on our balance sheet, but very clearly would be executions that we'd like to have if we were to raise the capital from third parties and be able to use our broad origination platform to put that capital to work.

Steve C. DeLaney
Analyst, JMP Securities LLC

Q

That's helpful, Willy. Thanks for your comments this morning.

William M. Walker
Chairman & Chief Executive Officer, Walker & Dunlop, Inc.

A

Yeah. Thank you.

Operator: Thank you. [Operator Instructions] . We'll go next to Charles Nabhan from Wells Fargo.

Charles J. Nabhan
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. When we think about Freddie Mac's projections for 2017 and – 2016 and 2017, could you talk about your expectations for GSE market share of the overall market and how that could potentially play out over the next couple of years?

William M. Walker
Chairman & Chief Executive Officer, Walker & Dunlop, Inc.

A

Yes, Chuck. Good morning. If you think about – if you go back to last year's numbers, the number on 2015 was actually just revised by the Mortgage Bankers Association to \$250 billion. So Fannie and Freddie did a combined \$88 billion last year, so their market share last year was in the mid-30%. The regulator has said very clearly that they'd like Fannie and Freddie not to exceed a 40% market share, if the markets remain, if you will, normal and healthy and they are more than happy to see Fannie and Freddie go well beyond 40% market share in any type of market dislocation or whether their – where their capital is needed to provide stability and liquidity.

So, if you think about a \$282 billion 2016, right now both Fannie and Freddie are projecting that they will do between \$53 billion and \$55 billion each, so you're talking about a \$106 billion to \$110 billion between the two of them on a \$282 billion year which is the projection. Again, they will be below 40% market share at those volumes.

So, I think, that you saw the regulator twice this year raise the caps for Fannie and Freddie in a reasonably normal market. And so our view of it is that from a regulatory standpoint, the regulator is very supportive of Fannie and Freddie's growth in the market. And right now there is nothing from a market share standpoint that would cause anyone to think that Fannie and Freddie will be, if you will, restricted in their growth as the multifamily market continues to grow. And, clearly, if it grows from \$282 billion this year to \$300 billion next year, Fannie and Freddie will have the opportunity to continue to grow with the market.

Charles J. Nabhan
Analyst, Wells Fargo Securities LLC

Q

Great. And as a follow-up I wanted to follow-up a bit on Steve's question about the external vehicle. I'm assuming that the primary focus would be in multifamily within that vehicle, but can you talk about your appetite for other property types as well as your expectations for fees from AUM fees?

William M. Walker

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

A

So, as it relates to – the primary focus will be, Chuck, on multifamily because that's our strength. That's the space where today we have a very, very strong market position and market share. And at the same time, as you know, we continue to invest in growing our capital markets business and the acquisition of Elkins Mortgage last week is a perfect example of our desire to continue to grow our capital markets business, where we are interacting with commercial property owners of all asset classes not just multifamily.

So, we will go probably to multifamily as sort of our, if you will, strong point to raise capital because that's where institutional investors seem most excited to put capital to work with Walker & Dunlop. But we, clearly, have the interest over time to broaden that and raise capital that could be lent on non-multifamily commercial properties.

As it relates to fees, as we have looked at this space, quite honestly, I cannot give you a cheat sheet, if you will, on what that – it will look like, because it is all over the place. It will depend greatly on how much of our own capital we put to work. It will depend greatly on what type of discretion we have and it will depend greatly on what the strategy is. A first trust debt fund has a certain return expectation and a hurdle to it and asset management fees versus a preferred equity type fund or a seniors housing skilled nursing fund will have higher return expectations on it and we'll also therefore have higher fees associated with it.

So there is no sort of set asset management fee that we're targeting right now. The real idea is to build this business and grow it to \$8 billion to 10 billion of AUM, and if we do grow it to \$8 billion to \$10 billion AUM, I am certain that Walker & Dunlop shareholders will be very pleased with the asset management fees that we make off of that.

Charles J. Nabhan

Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you.

Operator: [Operator Instructions] We'll go next to Jade Rahmani from KBW.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Good morning. Thanks for taking my questions. Can you discuss the decision to wind down the CMBS conduit? It seems at odds with your comments on risk retention that you've recently made. So I was wondering if this could possibly relate to the asset management initiative you mentioned. Are you looking at entities that currently do have CMBS conduits in their operations?

William M. Walker

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

A

Good morning, Jade. As you know, I won't comment on what we're looking at but I would say to you that the reasons that Steve gave in the call for why we are exiting the CMBS business are exactly that. There's no, if you will, ulterior motive or underlying strategy. We entered that business with great hopes and expectations and we

also entered it at a time where we thought that CMBS volumes were going to grow dramatically, and that we could be a major player in that space.

What we have seen is that our core client base has not looked to Walker & Dunlop for that type of loan execution. And so it has not been as accretive, if you will, to our client relationships as we would have expected.

The second is that the volumes in the CMBS world have not met expectations. And the third is that risk retention and the way the market today is structured is requiring real participants to have a major balance sheet and be able to weather the ups and downs and the cycles of the CMBS business.

And to be honest with you, after having participated in it for two-plus years we made the decision that for us right now, given all the other growth opportunities that we have, we want to focus our time and attentions on our other business lines and exit the CMBS business.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thanks for that. In terms of expanding the business, why do you think asset management is so attractive given the comp intention, modestly sized that the manager's face between raising new funds and dealing with runoff not to mention fee pressure and also increased co-investment requirements from LPs. Have you also looked at growing the origination platform into other property types? You did mention healthcare earlier, so just wondering about the sort of trade-off between those two?

William M. Walker

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

A

So point one is that we have no intentions of becoming a bank, zero. So as a result of that, since that is not how we are going to aggregate capital and the securitization markets on the CMBS side are there for us to lend with, but at the same time we just exited that business.

The asset management business and raising funds provides us with access to capital and the ability to make additional revenues and margin beyond the brokerage business. So, as you know, the brokerage business is a fantastic business, we love it, we're growing it, but that's really an effort to gain access to deal flow where we then will bring in our strong underwriting capabilities and asset management capabilities and servicing capabilities to both lend on properties and then also take the risk on them and asset manage them.

And so the asset management business seems to be a perfect fit where we want to raise capital to feed into our loan distribution network. The second part of your question was?

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Just other origination platforms or business lines to move beyond multifamily into other sectors, and you did mention healthcare?

William M. Walker

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

A

Yeah. I mean the thing about, I mean, look, we are expanding our brokerage business in all asset classes. As it relates to, actually, lending a little bit back to Chuck's question, we will raise funds around multifamily because that is what we are known for, that is where we have a demonstrable track record over 30 years, well, 29 years

taking risk on the Fannie Mae lending that we do, as well as all the expertise we've shown over the last three years lending with our balance sheet where we've had no credit losses and we've converted 92% of the loans that we put on our balance sheet into permanent financing.

So we will play off of that strength as it relates to raising capital. And at the same time, look, there's \$3 trillion of debt outstanding in the commercial real estate, \$1 trillion of it is in multifamily, so we're in the largest asset class with the most amount of debt outstanding. But at the same time, there's \$2 trillion of debt that's going out to office, retail, hospitality and industrial that are markets that we can and probably should enter at some point, but for right now the real focus would be on multi.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. In terms of recruiting, can you comment on how that's going and what processes are in place to maintain discipline on compensation packages? We've definitely been hearing about some agree this package is being offered in the marketplace?

William M. Walker

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

A

We've heard about them too and I'm happy to say that what you've heard about has not been Walker & Dunlop competition package. It's a competitive market. We are working extremely hard to bring in fantastic people, but we're also being very careful to put together compensation packages that allow people to do extremely well at Walker & Dunlop over the long term, and we are being very careful to not be giving people the opportunity to just make a trade, get a big check and head off somewhere else.

So it is a very, very competitive market out there today. I believe that many of our commercial real estate services firms are looking at a slowdown in revenue growth and trying very hard to bring in new origination talent, new leasing talent, new investment sales talent to try and keep their revenue growth up. As you can see from our numbers, Jade, we are doing very well at both organic growth and we are also executing on our strategy to grow the sales force by 25% this year.

So I would just say, you are correct that there are compensation packages that are being talked about on the street, that are – have very big numbers to them. And, I think, as we have shown in the past we're extremely good at both acquiring companies and integrating those companies and holding on to the origination talent, as well as bringing in origination talent to Walker & Dunlop and putting in place long-term compensation plans that align their interest with ours.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

And then Steve, can you just clarify the comments you made about 2017 expectations. I wasn't sure if I heard you correctly.

Stephen P. Theobald

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

A

Yes. Jade, I think, my comment was, you know, as we did this year in setting an objective to grow EPS double-digits, our expectation is we're going to set the same objective for 2017.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thanks very much for taking my questions.

Stephen P. Theobald

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

A

You bet.

Operator: At this time we have no further questions. I'd like to turn it back over to Mr. Walker for closing remarks.

William M. Walker

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

Great. I just reiterate my thanks to those who participated in the call today and my congratulations to the W&D team for an absolutely fantastic Q3 and 2016. Have a fantastic day and thank you all for joining us.

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

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