Company: Walker & Dunlop
Executive/s: Willy Walker - Chief Executive Officer
Date: 5/15/2012

I would like to introduce Willy Walker. Claire Harvey is also in the audience. Willy runs the company as the CEO. Claire is head of investor relations. There will be a breakout afterwards.

Willy, we've been covering the company since the recent IPO and it really has a dominant position and a niche within our broader property services space. They don't really compete so much with other companies we cover, maybe one. They're very focused on a niche that they've been dominating for some time. Thank you, Willy.

Willy Walker

Thank you, Will. Will's research on us has been absolutely terrific and it's great to be here. Let me just get right into things. We have one reasonably large ambition, which is to be the premier commercial real estate finance company in the United States. It's a $3.1 trillion aggregate market of all commercial real estate finance and in the next five years $1.9 trillion of commercial mortgages are coming up for refinancing.

Given that we did $4 billion of financing last year and have given guidance for doing $4.5 billion to $5.25 billion of financing in 2012, it is a massive market with huge opportunity. It is a fragmented market. I'll show you the league tables on who the big lenders are in a moment.

We've got an established platform. We went into this business in 1937, and have been in the business ever since. So we're actually in our 75th year now. We have exceptional credit performance in the loans that we've originated, particularly for Fannie Mae where we take risks on those loans.

The people that we have at Walker & Dunlop are truly the differentiator. We're in a people business and a money business. Our money is no greener than anybody else's, so it all comes down to the people inside of Walker & Dunlop that differentiate us from some of the big competitors that we compete with.

We have 11 offices across the country. Those are the red dots on the slide. We also have correspondent relationships with local mortgage banks that feed us deals, which we underwrite, process, and then lend on. On the right-hand side of this slide you can see our origination volumes back to 2007 there.

You can see that during the downtrend and the crisis we were able to maintain our lending activities at about $2 billion a year, and then started hitting the gas pedal, if you will, in 2010, in 2011. That's continued into 2012.

I think that if you look at other lenders during the downturn and how they suffered, one of the major advantages that Walker & Dunlop had was to doing very, very well in the downturn and then doing our IPO right at the beginning of this next cycle, not midway through or at the end of the cycle, which has given us the capital and the market positioning to be able to grow dramatically over the coming years.

If I turn to our financial performance here, Q1 '11, Q1 '12, and then full year '10 into full year '12, you can see our origination growth at 33% year-on-year, and that is right around where the industry was year-on-year. Just about when Mortgage Bankers Association came out with that, some of our competitors were actually below that from an origination growth standpoint.

You can see that revenues were up 19% quarter-on-quarter. As we described in our earnings call, two things happened in the quarter that brought our profit ability down on a yearly basis. One was, we've been adding a lot of origination talent and underwriting staff to be able to deal with the large origination volumes, and so that played through our P&L. And the other is that we had a write off of a mortgage servicing right, where we did not receive a prepayment penalty on that one large portfolio of loans. We explained in our quarterly call that that's actually a unique circumstance, and that we actually only have two loans in our entire portfolio with Fannie and Freddie that we would not get the prepayment protection that we have on our mortgage servicing rights.

If you turn to the right-hand side of the slide, year-on-year you can see the type of growth that we've had, 27% origination growth, 25% revenue growth and 41% operating income growth year-on-year. I'll show you another slide in a moment which shows our growth rates compounded annually over the last four years, and they are pretty terrific numbers.

Who do we compete with? You can see on the upper left-hand corner is who the largest providers of capital to commercial real estate are; large commercial banks, as well as large life insurance companies. I think if you took that list home, and showed anyone in your house that list, there are probably at least 12 or 13 names that are pretty much household names, and then there are a couple, including Walker & Dunlop, that are not household names.

I think that's both an advantage and a disadvantage. It's hard to compete with Wells Fargo's reach and brand, and at the same time if you're focused on a certain market, we can do a lot more than a Wells Fargo can. Our originators can call me up and say, 'Hey, can you come to a meeting?' I can guarantee you the CEO of Wells Fargo is not making a client call for a $20 million Fannie Mae DUS loan.

On the upper right is the rankings as it relates to Fannie Mae originations. You can see Wells Fargo and Deutsche Bank at number one and two, Walker & Dunlop is number three. You will, I'd just point out, that if you look at the Fannie Mae rankings, those are really lenders, because you're taking credit risk on the originations to Fannie Mae. On the bottom left is Freddie Mac, those are really brokers, because you're taking no credit risk. So as you can see there, CBRE, NorthMarq, HFF, brokerage firms. No credit inside of those shops, really to speak of. They're not lenders, they are originators and brokers. So Freddie is kind of dominated by the brokerage firms, Fannie is dominated by the lending firms. And then as it relates to FHA Ginnie Mae, hard to kind of characterize that, if you will, of either lenders or brokers. It's really people who don't mind watching paint dry as you wait for a HUD loan to be processed by HUD. But if you do have the fortitude to wait, HUD deals are both very profitable, and they're also very long-term deals with very significant mortgage servicing rights as well as escrows.

So, what's our strategic plan? We want to grow our core business, which is Fannie, Freddie and HUD. And we want to be a top-five lender in those three disciplines. We want to diversify our lending operations from not just multifamily, but into other asset classes. And the other is to create proprietary sources of capital. We today have a Balance Sheet as a publicly-traded company, and so taking access to the public markets and using that to our benefit is something that we are very focused on. All of that is to create, as I said at the beginning, the premiere commercial real estate finance company in the country.

So, how will we get there? To be a top-five lender with Fannie or Freddie, we've got to add somewhere around $600 to $700 million dollars of annual originations to move up in the league tables to be a top five with Freddie as well as with HUD. That's either adding teams of people across the country or going and doing a major acquisition. We understand this space, and as one of the few non-bank public companies in this space, there are lots of opportunities for companies that want to come into Walker & Dunlop to be a publicly traded company, to do a reverse merger, to get liquidity on a private investment, etc. So the ability for us to scale our core business right now, I think is both present and something that we're very focused on.

You can see the opportunity in the multifamily lending space as it relates to refinancing volumes. These are non-bank refinancing volumes, and you can see over the next five years, between 2012 and 2016, we did $3.2 billion of multifamily financing last year. So the market opportunity for us is massive, to a point where we don't even, you know. If we're at 10 or 15 share in multifamily specific, we've grown our origination significantly, to a market that has got, if you will, built-in deal activity.

Unlike investment sales, where you really need a robust economy, or unlike leasing activity, where you need a robust economy for you to be able to sign new leases and take more space, or sell properties or buy properties, this stuff all happens automatically. You can't get around the refinancings that are coming up, so it's sort of, if you will, forced deal flow.

Diversifying our lending operations: We have a Capital Markets Group, a brokerage business that did about $800 million of originations last year, where they originate loans for life insurance companies and CMBS. We want to build that platform out. Nobody should think that we're trying to compete with Holliday Fenoglio. I don't like the brokerage business as a stand-alone business. It's much lower margin than our lending business, and you also have originators who come to your office every single day, and by the grace of God, they show back up the next day. Because they could just as easily be working for Holliday Fenoglio tomorrow or CBRE tomorrow. And so, it's not a business we love, but at the same time, it gives you great access to deal flow.

And so we're right now close to about a billion dollars of originations in that business. We just added a big team in Florida, and we're looking to build that out across the country. We want to build that business to be about a $4 billion a year origination business, four to five. Not 10, not 20, not 30 billion. But what that will allow us to do is A: diversify the asset classes that we lend on, so we'll get access to deal flow and access to borrowers, but then the third piece of the strategy is to start to use proprietary products to lend into that origination activity. It also expands the pie for us.

So this chart shows you that the multifamily market, there's about $841 billion dollars of paper outstanding in multifamily, but the overall commercial real estate market is a $3.1 trillion dollar market. So by going and creating a national brokerage platform, we're moving from an $840 billion market basically to a $3.1 trillion dollar market. And just like in multifamily, you can see the refinancing wave that's happening over the next five years. There is a huge amount of paper that is coming up for refinancing in the next five years. Anybody who has the feet on the street and the ability to process and underwrite those loans is going to have more deal flow than they can put their arms around.

Q: Just to be clear, you were referring to capital markets. And the opportunity, you're still not focused on investment sales. This is all on the debt side?

A: Correct. That's exactly right. So, if other people use terms distinctly, that's exactly right, Will. We are talking about just debt origination and potentially equity, but finance company, not real estate services company. So, no desire on Walker & Dunlop's part to try and broaden out and be a competitor to CBRE, as it relates to doing investment sales, leasing, property management, things of that nature; all really focused on finance.

The final is to create new proprietary sources of capital. We started to use our balance sheet for some lending. We did our first interim loan in the first quarter of 2012. We actually just rate-locked on our second interim loan, and those are loans that are not stabilized to be able to put a permanent loan on with Fannie or Freddie. So, we are putting bridge financing on them for a year or two and then we will take those off and put permanent financing on them. We've used our balance sheet and warehouse lines to be able to fund that activity.

This strategy is two-fold. One, if we just built out our brokerage business and built out our agency business. The brokerage business is diluted. It's not nearly as profitable as our core lending business. But, if you build out the brokerage business and you create proprietary sources of capital to be able to feed into that, you are able to maintain our margins.

The other piece to it is that we get asked a lot about what the future is of Fannie and Freddie. Rather than sitting there and trying to talk about what is going on in the Senate

Banking Committee and what Senator Warner or what Secretary Geithner are thinking as it relates to Fannie and Freddie reform, we are embarked on a very ambitious strategy to basically sit there and create funding sources at Walker & Dunlop that say, "While Fannie and Freddie are around, we will continue to grow that business and we will continue to make a lot of money on that business."

But we want to show investors that if anything were to happen to Fannie and Freddie that Walker & Dunlop has the access to capital and the underwriting capability to be able to take all of that deal flow, that we do now for the agencies, and do it either for our own balance sheet, for some remotely managed funding mechanism, or take it off the shelf, if it belongs to somebody else.

What we don't want to do, and what would be a huge failure on our part, is to allow Fannie and Freddie to go away and then convert our originations just into brokerage deals because that business model is not a business model I like and it's not a business model that is nearly as profitable or durable as our existing business.

Let me turn for a second, as it relates to the servicing portfolio which goes back to my durability comment, we presently have a $17 billion servicing portfolio. There are a lot of, if you will, a lot of investors that ask us about the value of our MSRs and I think a lot of people look at Walker & Dunlop’s mortgage servicing rights and think, "Oh, I understand that it's single family. There's duration risk, there's hedging risk and if you're good you can kind of originate your loans. If it's something of a loss and then you can book the MSR and you can make some money on it. But, if interest rates fall everyone's going to refinance out of it and the MSR is not really worth anything."

Completely different in the commercial space. All of our loans with Fannie Mae as well as Freddie Mac are protected, as I said previously. That's about $13.5 billion of our $17 billion. The average servicing fee in our portfolio is 22 basis points and the average duration of the portfolio is 8.8 years.

So, what we are presently getting off of this portfolio is close to $40 million a year in revenue. That revenue, other than having significant defaults, which in the last quarter we took a loan loss reserve provision of 2 basis points of the outstanding principal balance in our at-risk portfolio. As a comparison point, the numbers reported this morning by Trepp were that multi-family mortgages in CMBS pools are at a 60-day delinquency rate of 11.52%, ours is 2 basis points. So our credit history has been dramatically different from clearly the CMBS world. The default risk issue here or the risk to our portfolio is de minimus and you've got these revenue streams locked in for, right now the next 8.8 years.

What does that look like as far as how we have this value booked on our balance sheet? The number up top shows you what we're getting as far as revenues off of the servicing portfolio. You can see twelve, we're expected to get $36.2 million of revenue off of the servicing portfolio As we continue to add loans, that fall off obviously doesn't fall off the way it does as we're originating billions of dollars a year.

You can see that the total contractual servicing fees that we have in the portfolio today are $308 million. The amortized book value of the MSRs is what we're actually carrying them on our balance sheet at is $137 million. At the end of 2011 we got a third party Prestwick to come in and value our MSRs and they have a valuation on them of $159 million.

We have this servicing right sitting out there that barring, quite honestly I'm kind of hard pressed to think given what we've just gone through, other than some massive default scenario. Which given the way we've been originating loans, and particularly the way we've been originating loans since the downturn, where every loan we're doing is over a 1.25 debt service cover. We've a lot of equity in front of us and with really good operators. I'm very hard pressed to think how the future revenue streams that we're getting out of this servicing portfolio don't happen, if you will.

What have we done from a gross standpoint? You can see the compound annual growth rate on origination since 2008, it's been 27%. On total revenues it's been 46% and on our operating income it's grown at a compounding annual growth rate of 59%. That is all due to staying focused on our market. It's been to recruiting great people and it has been being in a market where I think when we went public, a lot of people asked us, "Okay, you've been in an abnormal market. The crisis has made it so that banks aren't that competitive, life insurance companies aren't that competitive, CMBS has gone away. What happens to Walker & Dunlop when all these other sources of capital come back?"

As we very clearly showed in 2011 in a very normalized market, we have been able to not only hold our own, but actually expand and it's due to the people and to our focus and the capital raised in IPO, which we plan on deploying over the next couple quarters and years to continue to grow the platform.

So, I'd just run through my slides, but I'd actually like to go to questions if anybody has any questions. I've got some other slides in here if there's a question comes up that's applicable to one of the slides, but, thank you.

Questioner

Thanks, Willy. Any questions out there? I want to start out with, just in terms of, you know, a lot of the real estate people in different sectors talked about the distressed opportunities that have never come to fruition. How would you look at that for your business?

Willy Walker

Our core business doesn't really focus on distress very well because Fannie and Freddie haven't been great at distressed opportunities, if you will, because of 1.25 debt service cover and generally speaking lower leverage deals. I think a lot of people went out and raised real estate opportunity funds that have not been deployed and had to go and find other ways to deploying that capital.

One example would be the yield that Barry Sterling thought that he was going to give their investors on their mortgage REIT that he raised in July of 2010 where he ended up having to go buy that features portfolio of loans at a much lower coupon that he expected but it was just because there was no opportunity for him to deploy the capital at higher yield.

As it relates to these huge volumes of refinancings, if you look in those slides, I don't know if they can back up here but, if you look in here, you can see the blue is the CMBS at the bottom or the purple. On the right hand side you can see CMBS, CDO and ABS. You can see the billions of dollars of CMBS loans that are coming up for refinancing over the next 5 years.

Those aren't all great loans. And so the ability to be able to lend on those properties is going to be determined upon, you know, life insurance companies really aren't going to go after that deal flow. Banks generally speaking are going to do interim loans, short term floaters but not long term fixed rate and so if you have the capability to either have a fund or a REIT that can lend in to that with fixed rates deals that have proper structure on them, there's a huge opportunity for you.

We're focused on that purple part. I guess it's the blue part, the purple's up on top. So we're focused on the blue part or the refinancings coming out of CMBS.

Questioner

It has to turn into something, right? Theoretically you can't just be is the, I guess it could be CMBS again.

Willy Walker

It can stay under special servicing but as every special servicer will tell you, those are melting ice balls, if you will or melting snow cones. They're sitting out there in special servicing portfolios, are all being played out and they can't sit around forever on those loans and so other than banks doing extend and pretend, you really in the CMBS world, have to deal with it and it's got to either be paid off it goes into default, special service steps in but it gets worked out, there's pressure to get it done.

So clearly in the bank portfolios you could see just pushing, kicking the cans down the road but in the CMBS world, it's very difficult to just push them out.

Questioner

On your balance sheet and for your type of business, I mean, you're somewhat unique, what really is the best structure, your company has been around a long time, what do you think is the best structure, the best amount of leverage?

Willy Walker

We have very little leverage on the company today. We have $22 million of debt in a bank line and the bottom line there, Will, is the capital that we raise in the IPO as we go to creating new lending sources. So whether it's in a fund format, whether it's on a REIT format or whether it's using warehouse lines to lend off of, our equity capital is precious to us.

And so one of the things that we're, if we go out and do an acquisition, the debt capital markets are wide open to us because we've got very little leverage on the company and whatever we would acquire would be both in an accretive manner and we can put quite a bit of leverage on it because most of these businesses cash flow very, very well.

But as it relates to actually applying debt to the C-Corp, we're trying to stay in a very de levered mode just because we want to use our equity capital to creating new funding sources and we need that equity capital to sit in there and put in as co-investments or as collateral against any loans we might..

Questioner

You think there are some opportunities, like, Column Financial out there?

Willy Walker

So Will's referring to a deal we did in 2009 of buying Column Financial or Column Guaranteed from Credit Suisse in the depths of the crisis, which was an absolutely fantastic deal for us. Yes, there are clearly opportunities.

Somebody asked me earlier today, where are we in the cycle as it relates to, they were talking through and this is somebody else's words, not mine, they said, "But it looks like these kind of companies trade sort of every five to ten years and the time to really figure out when to sell the companies is when banks start buying because they're," this is someone else's terms, not mine, "they're sort of dumb money and they're at the end of the cycle. So where are we in the cycle?"

And I said, "Banks aren't even looking at these companies today. Investment banks aren't looking at these companies today. Private equity has made some very good investments in some of these companies over the last year or two. There's a cycle that will take place here as these companies continue to build value. They will start to be sold to large financial services institutions, I believe. They want either the MSRs, want the escrows or want the origination pipeline. So I think we're just at the infancy of that cycle." That's one of the reasons I was so happy we went public when we went public is because we raised the capital to grow aggressively during this period of time and not raise capital in the middle or at the end of it.

Questioner

That makes sense. Anyone out there have a few others? Just in terms of personnel, your producers, I think, are well-paid, as I understand, which is one way to hold on to them. I mean, they earn their keep, but how do you keep people, in general, working for you as opposed to going somewhere else?

Willy Walker

It's a very competitive market. Very good originators make a solid seven figures. What they end up doing is creating relationships with borrowers that are sort of these gravy trains, and everybody knows it. So you've heard today from my competitors at CBRE and JLL and HFF and all the others. I think that the real value add that they have is A: Having access to product. So what they are concerned about is, "Can I win the deal? And does Walker & Dunlop or does CBRE have all the products I need to be able to win the deal?" And then they're very focused on the origination fee because that's where they're making their money, at the front-end. They're not concerned about the servicing strip or anything on at the back-end.

So what you really need to be able to do is make them as competitive as possible in the front-end, of winning the deal and getting it done. So the way that we do it is we have a very efficient process. We're not Wells Fargo where the Credit Committee sits in some big box up in the corner. They have access to our Chief Underwriter. They have access to me. I'll get on the road and go visit any client that a big producer says, "Come visit." It's that personal touch, I think, that does differentiate us.

As I think about the comparison, there's no reason Allen & Company should compete with Goldman Sachs when News Corp. is going and doing an M&A transaction. There's just no reason. Goldman Sachs has got much wider reach, everything else. But as we all know, News Corp., because of their relationship between Rupert Murdock and Mr. Allen, goes back to him every single time whenever they have an M&A transaction. They've got a very specialized focus in that sector. They have the best people in that sector, and big companies like News Corp. keep going back to them time and time again. I think there's some big parallels between the way that Walker & Dunlop competes in this space with a Wells Fargo. Wells Fargo has got much wider reach. They've got a much bigger brand, and we compete successfully with them and win every single day.

Questioner

Unlike with an investment sales broker at CB who can go on his own and keep all the commission, you can't really do that in your business because you have to work under a firm that has a DUS provider.

Willy Walker

The bottom line is there are clearly independent mortgage brokers out there who will put out their own shingle and do their own business. What's critical in our business is, having access to the capital. So, in the agency worlds you have to have a license for Fannie, Freddie or HUD. In the life insurance company world you have to have a correspondent relationship with a life insurance company. Conduits are wide open to anybody.

But people leaving to set up their own shop really isn't the big concern. Its other firms poaching people from us and given our successes since going public, we’ve got a big red X on our back. We've done really well, we've grown originations really well and everyone knows we've got very talented people. It's our job and it's my job, specifically as CEO, to make sure those people have reasons to stick around.

Questioner

Great, I think we're out of time. Thank you, Willy.

Willy Walker

Great. Thank you all.