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Kelsey Montz
Walker & Dunlop
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Operator: Welcome to the Walker & Dunlop second quarter 2017 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 Kelsey Montz from Investor Relations. Today's call is being recorded and will be available for replay beginning at 11:30 A.M. Eastern. The dial-in number for the replay is 800-839-2398. 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. If you would like to ask a question at that time, please press star/one on your touchtone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. We ask that you please pick up your handset to allow optimal sound quality. Lastly, if you should require operator's assistance, please press star/zero. It is now my pleasure to turn the floor over to Kelsey Montz. Please go ahead, ma'am.

Kelsey Montz: Thank you, Erica. Good morning, everyone. Thank you for joining the Walker & Dunlop second quarter 2017 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 will reference the non-GAAP financial metric, adjusted EBITDA, during the course of this call. Please refer to the earnings release 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'll turn the call over to Willy.

Willy Walker: Good morning and thank you for joining us. You just heard Kelsey Montz kick off our earnings call for the first time and I'd like to take this opportunity to announce that Kelsey will be taking over for Claire Harvey in leading Walker & Dunlop's Investor Relations activities. As many of you know, Claire has been out on maternity leave and recently made the decision to continue focusing on her family. Claire has been with Walker & Dunlop's since we went public in 2010 and I want to personally thank Claire for her many contributions to Walker & Dunlop over the years and wish her and her family all the best. I also want to welcome Kelsey into her new role. It's nice to have you at this table Kelsey.

Our second quarter earnings reflect yet another quarter of fantastic execution and financial performance by the Walker & Dunlop team. For the past several years, we have continually reported record numbers and Q2 2017 is no exception. We originated $5.7 billion of loans during the quarter, an all-time record, along with $352 million of investment sales for total transaction volume of $6 billion, our most active Q2 ever and the second highest total transaction volume in W&D's history. Solid transaction activity coupled with the continued growth of our servicing portfolio generated 8% net income growth over Q2 2016, resulting in $1.08 of diluted earnings per share, beating the extremely strong Q2 2016 comp of $1.05 per share. This is our fifth consecutive quarter of year-over-year growth in diluted earnings per share and over those five quarters we have grown EPS by an average of 70%. The platform, brand, and client base we have built coupled with the strong macroeconomic drivers behind commercial real estate, and more specifically, multifamily, lead us to believe we will continue growing quarterly EPS for many quarters to come.

I'd like to ask you to turn to Slide 1 in the presentation posted to our website as it summarizes the dramatic growth at Walker & Dunlop over the past five years and how that growth has manifested itself into our financial results.

As you can see at the bottom of the slide, from 2012 until today, we have more than doubled the number of bankers and brokers at Walker & Dunlop from 67 to 138. During that time period we have increased annual transaction volumes from $7 billion in 2012 to over $22 billion during the past 12 months. That dramatic growth in transaction volumes took net income from $32 million in 2012 to $144 million on a trailing 12 month

basis today and drove EBITDA from $29 million to $172 million over the past 12 months. As proud as we are of the dramatic growth in bankers, brokers, transaction volumes, net income, and EBITDA over the past five years, there's almost no limit to our ability to continue scaling this company. Our 138 bankers and brokers at Walker & Dunlop is by far the smallest sales force amongst our publicly traded peer set, providing us with a huge opportunity to continue recruiting and acquiring talented professionals, and with over $1 million in revenues per employee and a scaled servicing portfolio that help generate $51 million of EBITDA in Q2, we have the management discipline and cash flow to continue investing in our future. The core to our success has been our scale, brand development, and capabilities in the multifamily finance industry. We have invested considerable energy and capital in building our loan origination platform to capture deal flow and then use the underwriting and closing talent at W&D to deliver a best-in-class financing experience to our customers.

As Slide 2 shows, we've been a top Fannie Mae and Freddie Mac lender since 2012, and originated tens of billions of dollars of loans with them while gaining one of the most respected reputations in the industry for excellence and execution. The strength of our platform clearly played a role in having the opportunity to form the recently announced joint venture with Blackstone Mortgage Trust. We've already closed deals for the new joint venture and are very excited to scale this partnership significantly over the coming years.

As our reputation and client base continue to grow, so do the opportunities to work on larger and larger transactions. In Q2, we financed the $550 million portfolio of loans for a public REIT, and also financed a $289

million portfolio of affordable properties across the Western U.S. for one of the premier affordable housing owner operators in the country. Then in early July, we were thrilled to announce that we have been retained by Greystar Growth and Income Fund to finance their acquisition of Monogram. Being selected by Greystar to finance such a large marquee deal is both an honor and a wonderful opportunity to showcase Walker & Dunlop's capabilities.

With the fundamentals of the multifamily industry positive and the investments we have made to build out our brokerage operation across the country generating record origination volumes, we feel well-positioned to maintain our growth in the coming quarters and years. U.S. economic data continues to be positive and although significant new apartment supply is coming online in the next 24 months, renter demand is in the near record level, and the oncoming supply is predicted to be absorbed without issue.

As Slide 3 shows, even with high levels of supply hitting the market, housing starts are still well below the historic average. The combination of a healthy economy and strong renter demand has renewed investor interest in the multifamily industry which should boost investment sales activity and continue to drive strength in the financing markets.

I would like to ask you to turn to Slide 4 as I spend a moment on the dramatic growth in adjusted EBITDA that W&D has generated in both Q1 and Q2 of this year. As we've said in our Q4 2016 earnings call, the growth in our loan origination platform has built a scaled loan servicing portfolio that would lead directly to substantial growth in servicing fees and EBITDA. After growing EBITDA in Q1 2016 from $32 million to $50 million in Q1 of this year, we grew Q2 EBITDA from $27 million last

year to $51 million this year or 88%. That brings our key 12 EBITDA to over $170 million and our 2017 EBITDA run rate to over $200 million. We saw this dramatic growth in EBITDA coming, given the size of the servicing portfolio and current pace of new loan originations. To help investors track the growth in our servicing portfolio and future growth and EBITDA, last quarter we introduced a new key operating metric called Net New MSRs.

If you turn to Slide 5, you can see that it lays out quarterly Net MSR additions over the past year. It is important to keep track of MSR growth for several reasons. First, some investors and analysts back out Walker & Dunlop's non-cash mortgage servicing right revenues in their financial models, which misses the future cash and adjusted EBITDA value of the servicing rights. Second, loan origination volumes are only half the story with regard to long-term servicing rights and value, as loan payoffs and prepayments diminish the size of the loan servicing portfolio. MSR growth provides investors with a clear metric on whether W&D added or lost mortgage servicing rights in the quarter.

As slide 5 shows in Q2 last year we added $46.5 million of Net MSRs, but $44.8 million of that number was related to the acquisition of a large HUD servicing portfolio. So net of the acquisition we added $1.7 million of MSRs in Q2 2016 versus $10.6 million of Net New MSRs in Q2 of this year. This is fantastic organic growth and is directly related to the hiring we have done over the past several years and our market leading position with HUD and the GSEs.

I'd like to now turn the call over to Steve to run through our Q2 financial performance in more detail.

Steve Theobald: Thank you, Willy, and good morning to everyone. Our team continued its solid execution in the second quarter as you can see on Slide 6 delivering record loan origination volume of $5.7 billion and record adjusted EBITDA that surpassed $50 million in the second consecutive quarter. We earned $1.08 per share in Q2 putting us at $2.43 of earnings per share year-to-date, 57% higher than the same period last year. Year-to-date financial highlights can be seen on Slide 7.

Our year-to-date return on equity of 24% is outpacing last year's 19% while revenues in the first half of this year of $325 million are up 34% over the $242 million we posted in the first six months of last year. Based on our strong performance in the first half of 2017 and the robust pipeline of business currently in place, we are confident in our ability to meet or exceed the annual financial and operational goals we set out at the beginning of the year. Q2 '17 total transaction volume of just over $6 billion was up 12% from Q2 '16 driven by positive market fundamentals and from growing the number of bankers and brokers at Walker & Dunlop by 33% over the past year and the entire employee base by 17%. Yet even with a 17% increase in total headcount, we maintain compensation expense as a percentage of revenue at 38% in Q2 and produced a very healthy operating margin of 34%. These numbers clearly show the economies of scale we have achieved as we have grown our business. The $6 billion of total transaction volumes was driven by an impressive 78% year-over-year growth in brokered volumes to a record level of $1.9 billion. Fannie Mae and Freddie Mac originations were strong at $3.3 billion, down slightly from the prior year quarter, but up 31% year-to-date from $4.9 billion last year to $6.4 billion this year. Our HUD originations were up 261% reaching their highest quarterly level in four years at $404

million and putting us well on the way to originating over $1 billion of HUD loans this year. Investment sales volumes of $352 million were down from Q2 '16 but the pipeline for Q3 is large and our expectation is for increased investment sales activity in the second half of the year.

Turning to Slide 8, the second quarter origination mix was characterized by an increase in brokered and floating rate loans as compared to previous quarters resulting in a gain on sale margin of 180 basis points, at the low end of our 180 to 200 basis point range. This is to be expected when brokered volumes make up 34% of our loan originations in the quarter; The growth in brokered volumes help drive the $12.4 million year-over-year increase in cash origination fees, significantly boosting our Q2 '17 adjusted EBITDA. Institutional investors and commercial real estate still seem to favor floating rate debt and the recent signals from the Fed have provided additional incentive for borrowers to float. During Q2 38% of our Fannie Mae and Freddie Mac loan volume was floating, compared to only 30% in Q2 '16. It is our expectation that we will see an increase in Freddie Mac volumes in the back half of the year as Freddie continues to be more aggressive on floating rate financing than does Fannie. This expected increase in Freddie Mac volumes in combination with the projected growth in brokered volumes will result in a gain on sale margin in the 160 to 190 basis point range for the remainder of this year. Even with lower gain on sale margin, we expect operating margin to remain in the low 30% range while adjusted EBITDA continues to increase from the prior year.

Let me take a few moments to provide a bit more color on our expectations for the financing of the Greystar transaction. As we've mentioned in our press release a few weeks ago, we expect the closing of

the deal to be sometime in the second half of this year. At this point, we are simply working hard in the underwriting and structuring of the financing. There are a lot of steps that need to be completed, not the least of which is approval by the seller shareholders, which has not yet been scheduled. We are honored to have been chosen by Greystar to finance this deal and look forward to closing it by the end of the year.

As you can see on Slide 9, the servicing portfolio ended the quarter at $66 billion, an increase of nearly $9 billion from the end of Q2 '16. As of June 30, 2017, the portfolio's weighted average servicing fee remained at 26.5 basis points, up from 25 basis points a year ago. During the quarter we booked $10.6 million in net new mortgage servicing rights. These current period additions are important indicators of our future cash servicing fees which totaled $43.2 million in Q2 '17, an increase of 32% over the prior year quarter; 87% of our servicing fees are protected from prepayment risk in the MSRs we record each quarter representing cash flow stream that we are contractually obligated to receive for many years to come. For the ninth straight quarter, we have no 60-day delinquencies in the at-risk portfolio, an impressive feat even within today's strong credit environment. Underwriting standards remain sound with this quarter's average LTV on GSE loans at 67% compared to 68% in Q2 '16 and debt service coverage ratios at 1.51x versus 1.45x in the year ago quarter. The impressive growth in servicing and servicing related revenues along with a 23% increase in origination fees drove the 88% growth in adjusted EBITDA to $51 million. Along with the increases in servicing and origination fees, adjusted EBITDA benefited from an increase in interest income of $4.8 million and other revenues of $3.7 million offset by an increase in cash compensation expense of $7.1 million. Adjusted EBITDA

has surpassed $50 million for the second straight quarter and now totals $172 million on a trailing 12-month basis.

Our joint venture with Blackstone Mortgage Trust is now operational with two warehouse lines in place. We closed the first loan to the venture three weeks ago and are excited to begin growing the portfolio to a meaningful size. After the quarter end, we moved $120 million of loans from our portfolio into the joint venture recycling around $30 million in cash. These loans were moved to the held-for-sale category during the second quarter. At the end of Q2, $169 million of loans remain on our balance sheet as held-for-investment. We will continue to collect interest income on these remaining loans until they pay off over the coming months. Our financial performance in the first half of the year has been spectacular and it is gratifying to see the return on our investments materialize in our top and bottom line results. With that, let me turn the call back to Willy.

Willy Walker: Thank you, Steve. I'll finish our prepared remarks by reiterating a number of goals and objectives we have established at Walker & Dunlop that we continue to execute upon every day. First, it is still our goal to create the premier commercial real estate finance firm in the United States. We just held our annual summer conference in Sun Valley, Idaho with 635 people in attendance, and from the remarks made about the W&D team and the culture we have created at Walker & Dunlop, I'd say we are well on our way to achieving that long-term mission. Second, we established aggressive 2017 financial and operating goals at the beginning of the year that, as Steve just reported, we are ahead of schedule in meeting. Finally, we have established longer-term financial goals of $1 billion in revenues, $100 billion servicing portfolio, and building an $8 billion to $10 billion asset management business by the end of 2020. We've finished the first

half of 2017 on a run rate well over $600 million in annual revenues, the servicing portfolio that will likely exceed $70 billion by the end of the year, and the announcement of our first venture in the asset management space with the largest private equity asset manager in the world. Our team has never been shy about establishing ambitious long-term objectives and then achieving them, and we continue down that path stronger than ever today.

Walker & Dunlop's business success and unique corporate culture are often recognized through prestigious awards, and in Q2, we were named the best workplace for millennials by Fortune magazine and the top workplace in the Greater Washington area by the Washington Post.

Our commitment to the great people and clients we have at Walker & Dunlop will continue as well our focus on driving strong financial performance and long-term shareholder value. I'd like to thank all of you for joining us on this morning's call. I'll now ask the operator to open the line for any questions. Thank you.

Operator: Thank you. As a reminder, at this time, if you would like to ask your question, please press the star and one on your touchtone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. Again, we do ask that while you pose your question, you pick up your handset to provide optimal sound quality. Thank you, and our first question is coming from Jade Rahmani from KBW. Please, go ahead. Your line is open.

Jade Rahmani: Thanks very much. Just wondering if you could discuss the competitive landscape and specifically, tie-ups between large commercial real estate

brokerage firms and GSE multifamily originators, just thinking of the recent Newmark-Berkeley Point deal, and if that changes anything, and how you think of current competitive dynamics.

Willy Walker: Good morning, Jade. So, as you know, since going public at Walker & Dunlop, we have been consistently – well, as I – the slide, what slide was it that we showed you the rankings of the GSEs? Slide 3, I think it was or was it Slide 2? I'm not exactly sure which one it was. Yes, Slide 2. As you can see since 2012, we've been at the very top of Fannie and Freddie's lead tables as either the number one or two Fannie Mae DUS Lender, and the other number three or number four Freddie Mac seller/servicer, and during most of that time, we didn't have an investment sales business at Walker & Dunlop. So, not having investment sales clearly has not inhibited Walker & Dunlop from being at the very top of the lead tables, and so to be straightforward with you, we've been dealing with that competitive pressure for many years without having a platform. Now that we have a platform, we've seen the benefit that it has brought to Walker & Dunlop as far as the client relationships and the ability to work on both investment sales as well as financing for them. But quite honestly with the HFS, Eastdil Secured and CB's out there, that change doesn't change the competitive landscape when I order.

Jade Rahmani: Okay, I appreciate that. Can you just comment on the tone of what you're seeing from investors and if anything in the mix of your originations, whether it be refi versus acquisition deals or average loan size, whether there are any notable trends in the quarter?

Willy Walker: So, I think as Steve pointed out, in Q2 we saw institutional real estate investors come back into the market and typically opt for floating rate debt

due to the payoff flexibility that floating rate debt provides; and he also highlighted the fact that during the quarter average LTV on deals went down year-on-year and average debt service cover on deals went up year-on-year. So somewhat counter-intuitively, we are seeing people asking for lower leverage deals that have higher debt service cover at a time in the cycle when in past cycles most people start to stretch on deals asking for more leverage and looking to make deals work that one might think they shouldn't be going after. So from those two data points, I would say to you that we feel extremely good about not only where we are in the cycle, but the type of debt financing that our borrowers are asking us for.

Jade Rahmani: Are you seeing, I mean, increased participation from institutions as a result of delayed capital deployments and now they're behind their business plans, maybe they are on the sidelines waiting to see if there would be any volatility in pricing, and so is it a temporary phenomenon or do you think it speaks to a better outlook for, say, 2018?

Willy Walker: So, I'd sort of turn that question around to you because, you've been quite bearish on where the market was going. We have been quite bullish on the market throughout both '16 as well as into '17. It's an extremely active market on both the debt side. I think as you well know, investment sales activity fell off quite dramatically in Q1, started to recover a little bit in Q2, but your own research has shown that it was still off year-on-year in Q2, but as Steve pointed out in his comments, our pipeline investment sales activity is strong for what we see for the rest of the year. So I would say that I think the election changed a lot, Jade, as you and I have discussed beforehand. I think that as rates started to move in Q1, many investors were waiting to see whether there would be a cap rate adjustment as rates started to move, and then rates rallied, cap rate didn't move, and I

think Q2 was a sense of investor saying it’s time to get back to work, it's time to start deploying capital again because this market has more legs to it than we thought, and so I think that what you're seeing in Q2 is sort of the renewed interest, renewed investment and that we expect to carry on for the rest of the year.

Steve Theobald: Jade, I’d just add the majority of our financing activity in Q2 was actually refi versus acquisition financing, and I think that’s – you’ve heard us both made comments about our optimism about the investment sales market for the back half of the year. So we’re starting to see if transaction activity pick up there, and that should bode well for the financing side of the business as well.

Jade Rahmani: Just finally, could you share your thoughts on what percentage of adjusted EBITDA is coming from the servicing fee stream since I think you've been highlighting how well that business has grown?

Steve Theobald: Yes, Jade, as you know, we don't provide the underlying economics behind the servicing business within our financials, so it’s difficult to answer that question precisely.

Jade Rahmani: Just looking at your personnel expense, how do you think we should think about the allocation between originations and servicing?

Willy Walker: Personnel expense allocation between originations and service, I mean, we break out commission expense and…

Steve Theobald: I guess the other thing I would say is we had 33% headcount growth in our origination team and only 17% companywide. So I would posit that that

would imply that the majority of our headcount growth is actually supporting the origination activities of the company as opposed to other elements of operations.

Jade Rahmani: Great. Well, thanks so much for taking the questions.

Willy Walker: Thank you, Jade.

Operator: Once again, as a reminder, if you do have a question, you may press the star and one on your touchtone phone at this time. We'll go next to Steve DeLaney with JMP Securities.

Steve DeLaney: Good morning, everyone. Congratulations on the quarter and I also give my congratulations to Kelsey and to Claire. We look forward to working with Kelsey going forward. Thanks.

Willy Walker: Thanks Steve.

Steve DeLaney: Hi Willy. So I wanted to talk about recruiting, because if I guess there's a single thing that I would point to that’s led to kind of the breakout performance year-over-year, it's the success in moving to this 140 producers versus 99 last year; now that's a 41% increase year-over-year that would not appear to be a sustainable average absent – some kind of an M&A transaction. Two-part question, do you have a specific goal for the next second half of this year or for the next 12-month period? That would be part one. And would you think that over the next three to five years that if we were to model, say, a minimum of 10% producer bank or broker headcount growth, if that would be a reasonable assumption?

Willy Walker: Steve, as I mentioned in my comments, if you look at the W&D sales force versus any of our peers, we are very small, and the revenue per – not only per banker or broker, but revenue per employee at Walker & Dunlop, if you comp that to any of our peers, is sort of off the charts. Most of them are in the low hundreds of thousands of dollars and we're over $1 million per employee in revenue. So we are just, as it relates to the size of the platform and the efficiency that we get from everybody who is on the platform, we are far, far above our peer set on that metric. So with 136, 140 brokers and bankers on the Walker & Dunlop platform, we have the ability to continue to actively recruit, and unlike many of our peers, we don't run into while that market is saturated with bankers at X company, or that client is already covered by a banker at Y company. So our ability to continue to go and hire either from competitors or acquire smaller brokerage operations, which has really been the strategy, I mean, the Deerwood acquisition that we just did is our fifth acquisition, and I think that it – hiring individual people is very difficult. I think we've been wildly successful in not overpaying in signing bonuses to bring on talent, and in many instances we've gone and we've acquired firms and done a very good job of both finding roles for the management team at Walker & Dunlop that wants to be part of a larger platform, and then made sure that the talented loan origination professionals as well as investment sales brokers at those firms stick around. So I think your question mark, we clearly have annual goals and we have long-term goals as it relates to the growth. I think your question as it relates to should we model 10% broker/banker growth over the next several years, I would say you're well under our plans as it relates to continued growth in bankers and brokers at Walker & Dunlop over the coming years if you do your 10% as the growth rate there.

Steve DeLaney: Great.

Steve Theobald: Yes, we should – to add onto that, I think we did establish the goal in the beginning of the year to grow 15 to 25 in number of…

Steve DeLaney: 15, 25 headcount from yearend to yearend.

Steve Theobald: Correct.

Steve DeLaney: Okay. That's helpful, thanks. Then switching over to the bridge loan JV, we know it's 85/15 and now we see the initial movement of loans post 630 which Blackstone also cited on their call. One thing we've never heard, I don't believe, publicly, is any discussion about the ultimate size of that joint venture either in terms of total loans funded or total capital committed. Have you said anything publicly, are you in a position where you can talk about how large that joint venture could grow?

Willy Walker: Yes. Steve, we've – so we were at $330 million of loans on our balance sheet, and I believe that we mentioned that we wanted to through this joint venture scale it to $1 billion of loans. That's sort of, if you will, the first hurdle that we and Blackstone are headed towards, but Blackstone has been very clear in saying if we're capable of scaling it to $1 billion, there's no reason we can't continue to scale it. So there's no, if you will, limit to the amount of capital that Blackstone is willing to commit to this venture and there's no limit to the amount of capital that Walker & Dunlop is willing to commit to it particularly only because we're only a 15% partner, and so given the amount of cash sitting on our balance sheet and the amount of cash we're generating today, we have lots of opportunity to continue to fund loans in that joint venture. I would say the other piece to

it is I've been extremely pleased with the way that the Blackstone team and the Walker & Dunlop team have been interacting with one another as it relates to underwriting loans, figuring out where we can and can't play with this new joint venture, and I would say that, quite honestly, we are playing in a much bigger sandbox today having Blackstone as our partner given that we can go after larger deals and we can also go after deals, quite honestly, that are a little bit more complex than we were looking at previously just because of Blackstone and everything they do at BXMT and across the platform of Blackstone. So it's a great start. It obviously just started in Q2 and we have, as they do, high expectations for this joint venture.

Steve DeLaney: Right. Well, thanks for the comments this morning, and great quarter.

Willy Walker: Thanks Steve.

Steve Theobald: Thanks Steve.

Operator: At this time, we have no further questions, so I'd like to turn the call back over to Willy Walker for any closing remarks.

Willy Walker: Great. Thank you, Jade and Steve, for your questions. Also, thank you everyone, for joining us this morning and we hope you have a fantastic day.

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