

First American (FAF)

\$59.19 (As of 01/06/20)

Price Target (6-12 Months): **\$62.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/03/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: D

Summary

Shares of First American have outperformed the industry year to date. First American third-quarter EPS beat estimates. It has been continually investing to increase efficiency, improve risk profile and enhance product offerings. First American should continue to benefit from strength in commercial business and increased traction in P&C business. The company has been actively investing in its core business and valuation and data businesses. Also, First American is focusing on expansion of digital closing services. It also expects increased demand among millennials for first-time home purchases. The company enjoys a strong balance sheet and engages in effective capital deployment. It aims 12-14% return on equity over the long term. However, increasing expenses are a concern. It expects the purchase market to remain a headwind in 2019.

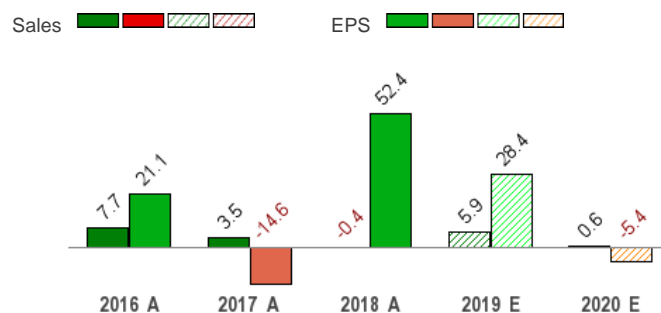
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$64.37 - \$45.30
20 Day Average Volume (sh)	635,751
Market Cap	\$6.6 B
YTD Price Change	1.5%
Beta	0.84
Dividend / Div Yld	\$1.68 / 2.8%
Industry	<u>Insurance - Property and Casualty</u>
Zacks Industry Rank	Top 30% (76 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	13.1%
Last Sales Surprise	3.7%
EPS F1 Est- 4 week change	-2.6%
Expected Report Date	02/13/2020
Earnings ESP	0.0%
P/E TTM	11.3
P/E F1	11.6
PEG F1	1.1
P/S TTM	1.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,352 E	1,510 E	1,675 E	1,591 E	6,128 E
2019	1,304 A	1,499 A	1,671 A	1,617 E	6,090 E
2018	1,297 A	1,491 A	1,542 A	1,417 A	5,748 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.84 E	\$1.46 E	\$1.47 E	\$1.32 E	\$5.09 E
2019	\$0.74 A	\$1.58 A	\$1.64 A	\$1.35 E	\$5.38 E
2018	\$0.71 A	\$1.33 A	\$1.30 A	\$1.27 A	\$4.19 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/06/2020. The reports text is as of 01/07/2020.

Overview

Headquartered in Santa Ana, CA., First American Financial serves homebuyers and sellers, real estate professionals, loan originators and servicers, commercial property professionals, homebuilders and others involved in residential and commercial property transactions with products and services specific to their needs.

The company was founded in the state of Delaware in January 2008. On Jun 1, 2010, the company's common stock was listed on the New York Stock Exchange.

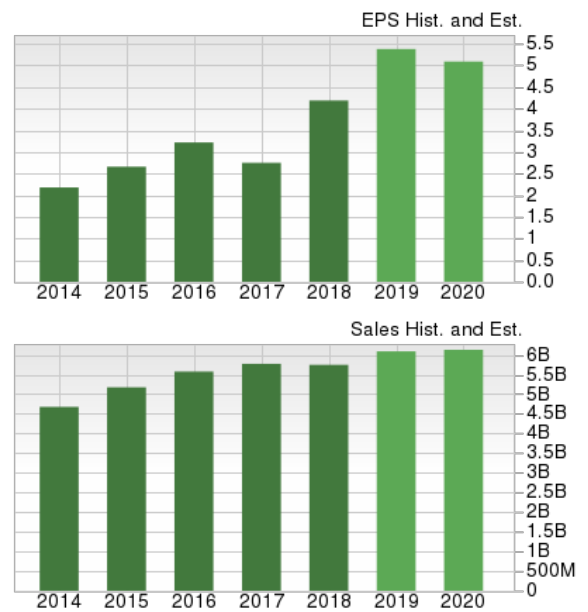
First American Financial core business lines include title insurance and closing/settlement services; property data and automated title plant records and images; home warranty products; property and casualty insurance; banking, trust and wealth management services; and other related products and services.

Further, providing banking services via First American Trust enhances agents' efficiency and lowers risk.

The company provides financial services through its Title Insurance and Services segment and its Specialty Insurance segment.

Title insurance and Services segment (92% of 2018 revenues) provides title insurance, closing and/or escrow services and similar or related services domestically and internationally in connection with residential and commercial real estate transactions. It also provides products, services and solutions that are designed to mitigate risk or facilitate real estate transactions. Many of these products, services and solutions involve use of real property-related data, including data derived from proprietary databases. It maintains, manages and provides access to title plant records and images. It also provides banking, trust, document custodial and wealth management services. This segment offers products through a network of direct operations and agents in 49 states and in the District of Columbia, and Canada, the U.K., Australia, South Korea, and internationally.

Specialty insurance segment (8%) issues property and casualty insurance policies and sells home warranty products. Additionally, corporate function consists of certain financing facilities and the corporate services that support business operations.



Reasons To Buy:

- ▲ Shares of First American Financial have gained 29.6% in a year's time, outperforming the industry's increase of 11.9%. Increased demand among millennials for first-time home purchases, improved rate environment, and effective capital deployment should drive growth.
- ▲ A better rate environment (from the near zero level when the financial crisis hit the economy) clearly signals a gradually improving economy. An economic improvement boosts housing demand. First American Financial remains well poised to capitalize from the opportunities. Purchase transactions generate more than twice the revenues of refinance transactions. The company thus anticipates housing inventory constraints to continue, driving further price appreciation and in turn incremental revenues. First American Financial also expects increased demand among millennials for first-time home purchases. Also, though the rate improved from the near-zero level, it is still low. The company noted that the same is strengthening the purchase market along with low mortgage rates, driving substantial growth in refinance activity and supporting a healthy commercial market. It expects sustained solid performance from its commercial business.
- ▲ Net investment income, a major component of an insurer's top line, continues to rise. The central bank lowered rates twice in the third quarter of 2019 and hinted at one more rate cut in 2019 due to slowing economic growth and sluggish inflation. The rate currently stands at 2% compared with the near-zero level at the time of the financial crisis. Also, investment income continues to witness improvement, increasing nearly 42% in the first nine months of 2019. However, the company believes that a reduction in interest rate will affect investment income.
- ▲ The company has been generating improving revenues over the years on the back of growing premiums and net investment income. Revenues witnessed 5-year CAGR of 6%. The momentum continued through the first nine months of 2019 with the metric rising 3.3%. Though expenses have been increasing over the years, the magnitude of revenue increase has been driving margin expansion.
- ▲ First American Financial pursues strategic acquisitions that in turn strengthen its core business and expand its valuation and data businesses. The company has consolidated its capabilities with Forsythe Appraisals, RedVision and TD Service Financial, among others. The company also pursued small title agency buyouts in the regions that it identifies as growth markets. The company spent \$83 million in acquisitions in 2018. Recently, it agreed to acquire Bank of America's lien release business, which complements First American Mortgage Solutions' post-closing and document management capabilities. The company remains committed to making acquisitions that meet its risk-adjusted return target.
- ▲ The company has a strong balance sheet. While its cash improved 23% in the last five years, the company has been consistently lowering its leverage ratio over the last three years. Total debt to capital ratio improved 490 basis points in the last three years (2016-2018) and another 240 basis points at third-quarter 2019 end. A solid balance sheet cushions financial flexibility.
- ▲ Given a strong operational performance, the company engages in shareholder-friendly moves. The company has been consistently increasing its dividend payout each year and witnessed 5-year CAGR of more than 11%. Its dividend yield is currently 2.9%, way above the industry average of 0.4%. Also, the payout ratio of 32.1 compares favorably with the industry average of 11.5. With respect to share buybacks, the company still has \$161.6 million worth of shares remaining as of Sep 30, 2019. These make the stock an attractive pick for yield seeking investors.
- ▲ Return on equity, a measure of profitability reflecting how efficiently the company is utilizing its shareholders' value, has improved to 15.2% from 9% in 2014. Return on equity also compares favorably with the industry average. The company aims 12-14% return on equity over the long term.

Increased demand among millennials for first-time home purchases, improved rate environment, strength in commercial business and effective capital deployment should drive growth.

Reasons To Sell:

- ▼ First American Financial has been recording escalating expenses over the year attributable to higher personnel costs, premiums retained by agents, operating expenses and interests. Expenses increased 0.4% in the first nine months of 2019. Expenses increased 2% in Title insurance and services segment and about 12% in Specialty Insurance over the last three years. However, through the first nine months of 2019, expenses increased at Title insurance but declined at Specialty Insurance. The company must strive to control costs or increase revenues at a higher magnitude than expenses, else margin can be eroded.
- ▼ Shares of First American Financial seem to be overvalued. The company is trading at 1.53X in terms of price to book value, the best for valuing insurers because of their unpredictable financial results. This is expensive when compared with the industry average of 1.42X.
- ▼ The company expects the purchase market to be a somewhat lesser a headwind in 2019, though low rate environment should put pressure on investment income. According to the Mortgage Bankers Association Mortgage Finance Forecast as on Feb 11, 2019, residential mortgage originations in the United States (based on the total dollar value of the transactions) decreased 6.6% year over year in 2018 while refinance originations declined 25.6%.

Escalating expenses escalating expenses attributable to higher personnel costs, premiums retained by agents, operating expenses and interests and continued decline in the purchase market are headwinds.

Last Earnings Report

First American Q3 Earnings and Revenues Top Estimates

First American Financial reported third-quarter 2019 operating income per share of \$1.64, which outperformed the Zacks Consensus Estimate by 13%. Moreover, the bottom line improved 26% year over year.

The quarter benefited from growth in investment income along with broad-based revenue growth across key markets.

Quarter Ending 09/2019

Report Date	Oct 24, 2019
Sales Surprise	3.70%
EPS Surprise	13.10%
Quarterly EPS	1.64
Annual EPS (TTM)	5.23

Behind the Headlines

Operating revenues of \$1.7 billion increased 8.4% year over year and beat the Zacks Consensus Estimate by 3.7%, led by higher, direct premiums and escrow fees, agent premiums, information and other and net investment income.

Net investment income increased 12.8% to \$76.6 million.

Closed title orders increased 21.4%, driven by 89% increase in refinance orders.

Average revenue per order decreased 6% due to a shift in the mix of direct orders closed to lower-premium refinance transactions.

Segment Results

Title Insurance and Services: Total revenues increased 9.2% year over year to \$1.54 billion.

Pretax margin expanded 230 basis points to 16.4%.

Title open orders increased 27.4% to 317,300 million while Title closed orders increased 21.4% year over year to \$224,100 million.

Specialty Insurance: Total revenues increased 4.9% year over year to \$128.1 million, led by higher contribution from home warranty business.

Pretax margin expanded 440 basis points to 7.8%.

Financial Update

First American exited the quarter with cash and cash equivalents of \$1.7 billion, up 16.6% from 2018 end. Notes and contracts payable were \$728.3 million, down 0.3% from 2018 end.

First American exited the quarter with stockholders' equity of \$4.2 billion, down 0.5% from 2018 end.

Cash flow from operations was \$310.6 million, up 34.5% year over year.

Recent News

First American Financial Corporation Acquires Title Security Agency — Jan 02, 2020

Earlier being a minority owner, First American Financial Corporation has now fully acquired Title Security Agency, a premier brand in real estate community. This will help the company deliver enhanced services and innovation. Customers will have access to better resources for residential transactions and improved title production capabilities.

First American Launches Endpoint — Nov 12, 2019

The company introduced a mobile-first title and escrow company to provide its customers with a digital real estate closing experience from start to end. It invested \$30 million to drive this stand-alone company's development and growth.

First American Declares Cash Dividend of 42 Cents Per Share — Nov 05, 2019

The company cleared a quarterly dividend of 42 cents per share payable Dec 09, 2019.

First American Announces Dividend — Aug 13, 2019

The board of directors approved a quarterly cash dividend of 42 cents per common share paid on Sep 16, 2019 to shareholders of record as of Sep 9, 2019

Valuation

First American Financial shares have gained 28.3% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Finance sector are up 15.8% and 16%, respectively.

The S&P 500 index are up 24.5% in the past year.

The stock is currently trading at 1.57X trailing 12-month book value, which compares to 1.42X for the Zacks sub-industry, 2.83X for the Zacks sector and 4.41X for the S&P 500 index.

Over the past five years, the stock has traded as high as 1.98X and as low as 1.28X, with a 5-year median of 1.54X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$62 price target reflects 1.64X trailing 12-month book value.

The table below shows summary valuation data for FAF

Valuation Multiples - FAF					
		Stock	Sub-Industry	Sector	S&P 500
P/B TTM	Current	1.57	1.42	2.83	4.41
	5-Year High	1.98	1.67	2.89	4.45
	5-Year Low	1.28	1.26	1.83	2.85
	5-Year Median	1.54	1.47	2.5	3.6
P/S F12M	Current	1.09	1.67	6.53	3.47
	5-Year High	1.17	11.26	6.61	3.47
	5-Year Low	0.66	1.55	5.2	2.54
	5-Year Median	0.87	1.92	6.04	3
P/E F12M	Current	11.63	26.37	14.79	18.71
	5-Year High	16.37	31.55	16.21	19.34
	5-Year Low	9.2	22.77	12.01	15.17
	5-Year Median	12.98	25.67	13.98	17.44

As of 01/06/2020

Industry Analysis Zacks Industry Rank: Top 30% (76 out of 254)



Top Peers

Markel Corporation (MKL)	Outperform
The Hanover Insurance Group, Inc. (THG)	Outperform
Arch Capital Group Ltd. (ACGL)	Neutral
American Financial Group, Inc. (AFG)	Neutral
Cincinnati Financial Corporation (CINF)	Neutral
National General Holdings Corp (NGHC)	Neutral
Alleghany Corporation (Y)	Neutral
Axis Capital Holdings Limited (AXS)	Underperform

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	FAF Neutral	X Industry	S&P 500	ACGL Neutral	AXS Underperform	CINF Neutral
VGM Score	A	-	-	B	D	D
Market Cap	6.65 B	1.97 B	23.72 B	17.64 B	5.00 B	17.27 B
# of Analysts	2	2	13	4	3	2
Dividend Yield	2.84%	1.00%	1.79%	0.00%	2.76%	2.12%
Value Score	A	-	-	C	B	D
Cash/Price	0.26	0.17	0.04	0.27	0.24	0.05
EV/EBITDA	6.15	9.35	13.90	15.61	21.47	47.31
PEG Ratio	1.05	1.44	2.00	1.45	1.39	NA
Price/Book (P/B)	1.57	1.25	3.34	1.57	1.04	1.84
Price/Cash Flow (P/CF)	9.85	13.71	13.67	16.63	12.11	28.10
P/E (F1)	11.57	14.01	18.72	14.51	11.85	28.37
Price/Sales (P/S)	1.13	1.03	2.66	2.70	0.98	2.66
Earnings Yield	8.60%	7.10%	5.31%	6.89%	8.44%	3.52%
Debt/Equity	0.00	0.21	0.72	0.26	0.33	0.09
Cash Flow (\$/share)	6.01	3.05	6.94	2.62	4.91	3.76
Growth Score	B	-	-	C	F	C
Hist. EPS Growth (3-5 yrs)	19.22%	-0.55%	10.56%	8.71%	-23.80%	2.58%
Proj. EPS Growth (F1/F0)	-5.39%	7.23%	7.42%	9.19%	77.08%	-7.80%
Curr. Cash Flow Growth	43.44%	9.94%	14.83%	84.88%	-541.78%	20.00%
Hist. Cash Flow Growth (3-5 yrs)	12.41%	7.23%	9.00%	11.39%	-13.32%	3.59%
Current Ratio	0.94	0.44	1.23	0.69	0.55	0.29
Debt/Capital	0.00%	17.79%	42.92%	20.08%	22.20%	8.63%
Net Margin	9.76%	5.34%	11.08%	21.97%	2.68%	14.18%
Return on Equity	15.21%	6.81%	17.16%	10.31%	2.02%	7.44%
Sales/Assets	0.52	0.31	0.55	0.19	0.20	0.27
Proj. Sales Growth (F1/F0)	0.62%	5.00%	4.15%	-4.89%	1.19%	NA
Momentum Score	D	-	-	C	C	C
Daily Price Chg	1.72%	0.08%	0.10%	0.39%	-0.28%	-0.77%
1 Week Price Chg	0.62%	0.86%	-0.30%	1.86%	0.08%	2.50%
4 Week Price Chg	-5.11%	0.59%	2.33%	4.99%	0.57%	-0.55%
12 Week Price Chg	-0.59%	1.30%	7.02%	4.64%	-4.22%	-9.02%
52 Week Price Chg	30.26%	10.20%	24.61%	65.29%	12.73%	39.88%
20 Day Average Volume	635,751	114,679	1,589,897	937,514	419,901	486,323
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-2.61%	0.00%	0.00%	0.00%	-0.33%	0.00%
(F1) EPS Est 12 week change	0.59%	-0.82%	-0.56%	0.00%	-4.64%	0.00%
(Q1) EPS Est Mthly Chg	-8.20%	0.00%	0.00%	0.00%	-1.21%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	D
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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