

First American(FAF)

\$37.43 (As of 03/19/20)

Price Target (6-12 Months): **\$43.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 02/16/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: A

Summary

First American Financial 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 pursuing acquisitions to strengthen its core business, and expand its valuation and data businesses. It also expects increased demand among millennials for first-time home purchases. Shares of the company have underperformed its industry in a year. Nevertheless, we believe that its strong balance sheet and effective capital deployment bode well. The company has been consistently increasing its dividend payout each year. However, increasing expenses due to higher operating expenses and interests can put a strain on its margin expansion.

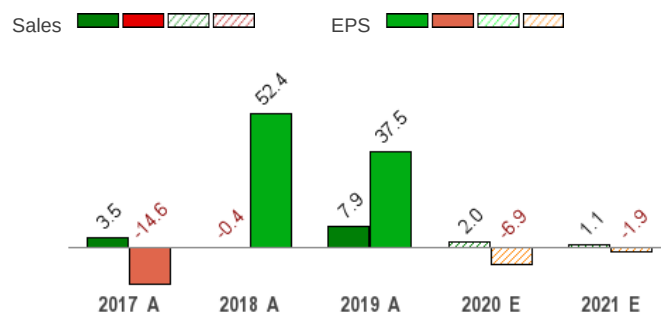
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$66.78 - \$29.36
20 Day Average Volume (sh)	1,598,957
Market Cap	\$4.2 B
YTD Price Change	-35.8%
Beta	0.88
Dividend / Div Yld	\$1.76 / 4.7%
Industry	Insurance - Property and Casualty
Zacks Industry Rank	Bottom 33% (171 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	33.3%
Last Sales Surprise	6.9%
EPS F1 Est- 4 week change	3.2%
Expected Report Date	04/23/2020
Earnings ESP	0.0%
P/E TTM	6.5
P/E F1	7.0
PEG F1	0.6
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,399 E	1,569 E	1,729 E	1,700 E	6,398 E
2020	1,419 E	1,557 E	1,690 E	1,662 E	6,328 E
2019	1,304 A	1,499 A	1,671 A	1,729 A	6,202 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.84 E	\$1.44 E	\$1.47 E	\$1.39 E	\$5.26 E
2020	\$0.90 E	\$1.48 E	\$1.51 E	\$1.41 E	\$5.36 E
2019	\$0.74 A	\$1.58 A	\$1.64 A	\$1.80 A	\$5.76 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 03/19/2020. The reports text is as of 03/20/2020.

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.

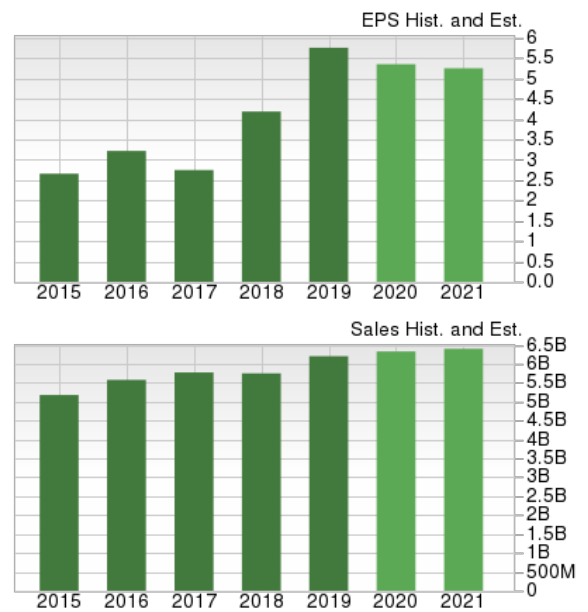
First American Financial core business lines include title insurance and closing/settlement services; property data and automated title plant records and images; home warranty products; property and casualty insurance; banking, trust and wealth management services; and other related products and services.

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 (91.8% of 2019 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 (8.2%) 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:

- ▲ First American Financial remains well poised to capitalize from the increased demand among millennials for first-time home purchases. 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. Also, though the rate has been recently brought down to the near-zero level on account of the pandemic spread, we remain hopeful about its improvement in the near future. The company noted that strength in purchase market along with low mortgage rates is 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. Investment income continues to witness improvement, up nearly 37% in 2019.
- ▲ The company has been generating improving revenues over the years on the back of growing direct premiums and escrow fees, agent premiums and net investment income. Revenues witnessed 5-year (2013-2018) CAGR of 6%. The momentum continued in 2019 with the metric rising 8%. 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. In February 2020, it inked a deal to acquire Docutech, a leading entity in the U.S. document technology solutions industry. The buyout of Docutech will leverage First American's existing abilities as well as property and homeownership data to offer enhanced end-to-end digital mortgage and settlement services to customers.
- ▲ The company has a strong balance sheet. While its cash improved 23% in the last five years (2013-2018), 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 was 18.5% at fourth-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 4.7%, way above the industry average of 0.5%. Also, the payout ratio of 29.2 compares favorably with the industry average of 11.5. 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 is 15.7% which compares favorably with the industry average of 6.4%. The company aims 12-14% return on equity over the long term.
- ▲ Shares of First American Financial have underperformed its industry in a year. Nevertheless, strong fundamentals such as increased demand among millennials for first-time home purchases, improved rate environment and effective capital deployment should drive growth.

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

Risks

- First American Financial has been recording escalating expenses over the year, attributable to higher personnel costs, premiums retained by agents, operating expenses, premium taxes and interests. Expenses increased 10.9% in 2019. The company must strive to control costs or increase revenues at a higher magnitude than expenses, else margin can be eroded.
 - The central bank recently lowered interest rates to its near-zero level due to COVID-19 pandemic. This is expected to slow down economic growth and lead to a sluggish inflation in 2020.
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Last Earnings Report

First American Financial Q4 Earnings & Revenues Beat

First American Financial Corporation reported fourth-quarter 2019 operating income per share of \$1.80, which outperformed the Zacks Consensus Estimate by 33.3%. Moreover, the bottom line improved 41.7%.

Increase in investment income and improved segmental performance were partially offset by increase in expenses.

Quarter Ending **12/2019**

Report Date	Feb 13, 2020
Sales Surprise	6.91%
EPS Surprise	33.33%
Quarterly EPS	1.80
Annual EPS (TTM)	5.76

Behind the Headlines

Operating revenues of \$1.7 billion increased 22% year over year and beat the Zacks Consensus Estimate by 6.9%.

Net investment income grew 24.5% to \$78.8 million.

Closed title orders increased 27%, attributable to 131% increase in refinance orders.

Average revenue per order decreased 8%, driven by the shift to refinance transactions.

Total expense of \$1.4 billion increased 10.9% year over year, attributable to increase in personnel costs, premiums retained by agents, other operating expenses, premium taxes and interest.

Full-Year Highlights

Operating income per share of \$5.76 outpaced the Zacks Consensus Estimate of \$5.38. Moreover, the bottom line surged 25.8%.

Revenues of \$6.2 billion increased 8% from 2018 and beat the Zacks Consensus Estimate by 1.8%.

Segment Results

Title Insurance and Services: Total revenues increased 21.1% year over year to \$1.6 billion.

Pre-tax margin expanded 740 bps.

Direct open orders increased 24.4% to \$251.7 billion while Direct closed orders increased 27% to \$224.2 billion year over year.

Specialty Insurance: Total revenues increased 17.9% year over year to \$131.6 million.

Pre-tax margin was 16.7%, much higher than 0.7% in the year-ago quarter.

Financial Update

First American exited 2019 with cash and cash equivalents of \$1.5 billion, up 1.3% year over year. Notes and contracts payable were \$728 million, down 0.5% year over year.

First American exited 2019 with stockholders' equity of \$4.4 billion, up 18.1% year over year.

Return on equity was 17.3% in 2019.

Cash flow from operations was \$913.1 million, up 15% from 2018.

Recent News

First American Signs Agreement to Acquire Docutech – Feb 13, 2020

First American Financial inked an agreement to acquire Docutech, a leading entity in the U.S. document technology solutions industry. Subject to customary approval, the \$350-million deal is expected to close by the end of March.

The buyout of Docutech will leverage First American's existing abilities as well as property and homeownership data to offer enhanced end-to-end digital mortgage and settlement services to customers.

First American Hikes Dividend to Boost Shareholder Value – Jan 23, 2020

The board of directors of First American recently approved a 5% hike in its quarterly dividend to enhance shareholder value. The company will now pay a dividend of 44 cents per share compared with 42 cents paid on Dec16, 2019. Shareholders of record as of Mar 09 will be paid with the dividend on Mar 16, 2020.

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.

Valuation

First American Financial shares are down 35.8% in the year-to-date period and 24.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 25.1% and 34.4% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 17.8% and 28.9%, respectively.

The S&P 500 index is down nearly 24.9% in the year-to-date period and down 16.3% in the past year.

The stock is currently trading at 1x trailing 12-month book value, which compares to 1x for the Zacks sub-industry, 1.9x for the Zacks sector and 3.3x for the S&P 500 index.

Over the past five years, the stock has traded as high as 2x and as low as 0.8x, with a 5-year median of 1.6x. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$43 price target reflects 1.1x 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	0.95	0.98	1.86	3.25
	5-Year High	1.98	1.67	2.89	4.55
	5-Year Low	0.84	0.97	1.83	2.85
	5-Year Median	1.55	1.47	2.52	3.63
P/S F12M	Current	0.66	1.73	5.99	2.6
	5-Year High	1.21	11.26	6.64	3.43
	5-Year Low	0.59	1.55	5.39	2.54
	5-Year Median	0.89	1.89	6.04	3
P/E F12M	Current	7.02	19.91	10.05	14.3
	5-Year High	16.37	31.55	16.21	19.34
	5-Year Low	6.22	19.91	10.05	14.3
	5-Year Median	12.81	25.42	13.97	17.42

As of 03/19/2020

Industry Analysis Zacks Industry Rank: Bottom 33% (171 out of 254)



Top Peers

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

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	FAF Outperform	X Industry	S&P 500	ACGL Neutral	AXS Neutral	CINF Neutral
VGM Score	A	-	-	B	D	C
Market Cap	4.21 B	1.11 B	16.45 B	11.00 B	3.25 B	13.29 B
# of Analysts	2	2	13	4	3	3
Dividend Yield	4.70%	1.45%	2.67%	0.00%	4.24%	2.93%
Value Score	B	-	-	C	C	C
Cash/Price	0.25	0.22	0.06	0.13	0.43	0.05
EV/EBITDA	2.46	5.16	10.36	6.30	8.38	5.16
PEG Ratio	0.63	1.24	1.49	0.91	1.51	NA
Price/Book (P/B)	0.95	0.81	2.16	0.96	0.68	1.36
Price/Cash Flow (P/CF)	5.19	8.53	8.92	8.53	8.67	17.47
P/E (F1)	6.98	9.07	13.12	9.07	7.54	21.28
Price/Sales (P/S)	0.68	0.63	1.72	1.59	0.63	1.68
Earnings Yield	14.32%	10.42%	7.54%	11.01%	13.26%	4.70%
Debt/Equity	0.00	0.21	0.70	0.25	0.41	0.09
Cash Flow (\$/share)	7.22	2.92	7.01	3.17	4.47	4.69
Growth Score	B	-	-	B	D	B
Hist. EPS Growth (3-5 yrs)	19.36%	2.31%	10.85%	11.92%	-22.01%	3.06%
Proj. EPS Growth (F1/F0)	-7.03%	10.27%	4.90%	5.85%	103.57%	-8.33%
Curr. Cash Flow Growth	20.75%	5.61%	6.03%	21.44%	-8.72%	25.16%
Hist. Cash Flow Growth (3-5 yrs)	18.51%	8.21%	8.55%	15.01%	-11.78%	9.30%
Current Ratio	0.81	0.43	1.23	0.56	0.57	0.29
Debt/Capital	0.00%	18.05%	42.57%	19.06%	26.09%	8.23%
Net Margin	11.41%	8.63%	11.57%	23.47%	6.25%	25.20%
Return on Equity	15.68%	8.30%	16.74%	10.92%	5.39%	7.50%
Sales/Assets	0.54	0.32	0.54	0.19	0.20	0.32
Proj. Sales Growth (F1/F0)	2.03%	1.42%	3.13%	2.13%	1.70%	2.61%
Momentum Score	A	-	-	B	D	D
Daily Price Chg	12.88%	2.29%	1.03%	-1.56%	8.52%	-4.03%
1 Week Price Chg	-19.22%	-13.37%	-11.01%	-19.48%	-21.50%	-7.77%
4 Week Price Chg	-42.44%	-32.83%	-33.45%	-43.51%	-38.37%	-26.93%
12 Week Price Chg	-35.19%	-29.74%	-30.67%	-35.85%	-35.02%	-20.88%
52 Week Price Chg	-24.51%	-24.51%	-23.69%	-16.20%	-31.27%	-3.51%
20 Day Average Volume	1,598,957	147,260	3,981,936	2,238,755	869,073	1,304,451
(F1) EPS Est 1 week change	0.00%	0.00%	-0.01%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	3.18%	-0.37%	-0.85%	-0.17%	0.00%	-0.43%
(F1) EPS Est 12 week change	5.21%	-0.60%	-1.70%	-0.50%	2.12%	3.36%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.88%	-0.33%	0.00%	0.00%

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	B
Growth Score	B
Momentum Score	A
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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