Our Research. Your Success.

May 28, 2020

First American(FAF)

$52.90 (As of 05/27/20)

Price Target (6-12 Months): **$55.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 04/09/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**4-Sell**
	Zacks Style Scores:	VGM:C
	Value: C | Growth: D | Momentum: C	

Summary

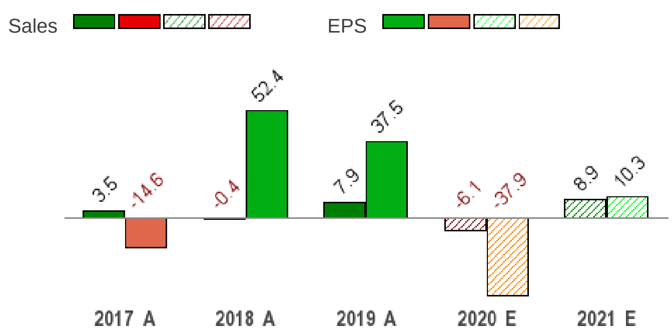
Shares of First American Financial have outperformed its industry in a year's time. The company should continue to benefit from strength in commercial business and increased traction in P&C business. The company has been actively pursuing acquisitions to strengthen its core business, and expand its valuation and data businesses. It also expects increased demand among millennials for first-time home purchases. Moreover, it is believed that strong balance sheet and effective capital deployment of the company bode well. The company has been consistently increasing its dividend payout each year. However, increasing expenses can put a strain on its margin expansion. First American Financial's first-quarter earnings per share of $1.06 beat the Zacks Consensus Estimate by 10.4% and improved 43.2% year over year.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$66.78 - $29.36**
20 Day Average Volume (sh)	**872,340**
Market Cap	**$5.9 B**
YTD Price Change	**-9.3%**
Beta	**1.04**
Dividend / Div Yld	**$1.76 / 3.3%**
Industry	**Insurance - Property and Casualty**
Zacks Industry Rank	**Bottom 21% (190 out of 248)**
Last EPS Surprise	**10.4%**
Last Sales Surprise	**-4.9%**
EPS F1 Est- 4 week change	**-16.1%**
Expected Report Date	**07/23/2020**
Earnings ESP	**0.0%**
P/E TTM	**8.7**
P/E F1	**14.8**
PEG F1	**1.3**
P/S TTM	**0.9**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	1,454 E	1,525 E	1,705 E	1,661 E	6,345 E
2020	1,413 A	1,375 E	1,461 E	1,576 E	5,826 E
2019	1,304 A	1,499 A	1,671 A	1,729 A	6,202 A

EPS Estimates

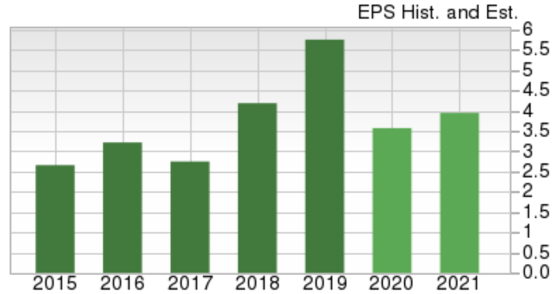
	Q1	Q2	Q3	Q4	Annual*
2021	$0.85 E	$1.03 E	$1.09 E	$1.23 E	$3.95 E
2020	$1.06 A	$0.70 E	$0.85 E	$1.11 E	$3.58 E
2019	$0.74 A	$1.58 A	$1.64 A	$1.80 A	$5.76 A

*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 05/27/2020. The reports text is as of 05/28/2020.

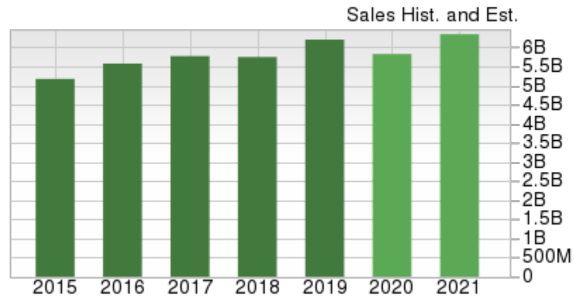
Overview

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:

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

- 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. In spite of purchase orders commenced 2020 on a solid note, the same have fallen sharply in the mid of March on account of the present volatile situation in markets. The company's open purchase orders are expected to witness year-over-year decline of 45% in second-quarter 2020. Nevertheless, we remain optimistic about its improvement in the near future.

- The company noted that strength in purchase market along with low mortgage rates has been driving substantial growth in refinance activity and supporting a healthy commercial market. However, the company's commercial business is also likely to suffer a setback due to the current dismal period.Consequently, revenues from the company's commercial business are also estimated to decline 50% year over year in the second quarter. Nevertheless, refinance orders are expected to remain strong for the full year.

- Net investment income, a major component of an insurer's top line, continued to witness improvement in the past several quarters, witnessing a CAGR of 21.2% over the past five years (2014-2019). However, this momentum did not continue in first-quarter 2020, whenthe metric slumped 44.2% year over year. The current low interest rate environment in the United States is likely to keep investment yields under pressure, which would consequently weigh on its overall investment income.Consequently, the metric is expected to witness a sharp fall in second-quarter 2020. Nevertheless, First American Financial expects investment income in the range of $40-$45 million for each remaining quarter of 2020 with respect to its Title Insurance and Services segment.

- 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. The momentum continued in first-quarter 2020 as well, with the metric rising 8.4% year over year. 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 the beginning of this year, First American Financial had fully acquired Title Security Agency. Further 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. Notably, Docutech had contributed $6.4 million to the company's topline in the first quarter of 2020.

- 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%. In January 2020, the board of directors at First American Financial approved a 5% hike in its quarterly dividend to 44 cents per share.Its dividend yield is currently 3.7%, way above the industry average of 0.5%. Also, the payout ratio of 28 compares favorably with the industry average of 11.3. 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 16.1% which compares favorably with the industry average of 6.5%. The company aims 12-14% return on equity over the long term.

- Shares of First American Financial have outperformed its industry in a year. Moreover, strong fundamentals such as increased demand among millennials for first-time home purchases, improved rate environment 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, premium taxes and interests. Expenses increased 15.4% in first-quarter 2020.It also incurred professional expenses related to Docutech buyout of around $4 million, which has impacted the first-quarter margin to some extent. The company must strive to control costs or increase revenues at a higher magnitude than expenses, else margin can be eroded.

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.

- First American Financial's balance sheet position also remains a concern. As of Mar 31, 2020, cash and cash equivalents of $1.04 billion have declined 29.3% from the prior-quarter's figure. The net debt is 23% of its total capital in the first quarter, which is higher than the prior-quarter's figure of 18.5%. Further, the company's times interest earned of 18.4 as on Mar 31, 2020 is lower when compared with the prior-quarter's figure of 19.9, implying that its earnings are not sufficient to cover interest obligations.Thus, the company's inadequate financial flexibility remains a concern for investors.

- This year in March, the central bank 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. Given the present financial market volatility on account of the pandemic, First American Financial expects a rise in its claims.Consequently, the company has decided to maintain the loss rate at 5%, up from the loss rate of 4% in fourth-quarter 2019.

Last Earnings Report

First American Financial Q1 Earnings Beat, Improve Y/Y

Quarter Ending	03/2020
Report Date	Apr 23, 2020
Sales Surprise	-4.92%
EPS Surprise	10.42%
Quarterly EPS	1.06
Annual EPS (TTM)	6.08

First American Financial reported first-quarter 2020 operating income per share of $1.06, which surpassed the Zacks Consensus Estimate by 10.4%. Moreover, the bottom line improved 43.2% year over year.

The company's results reflect strong performance at its Title Insurance and Services segment, which was partially offset by increase in expenses.

Results in Details

Operating revenues of $1.4 billion increased 8.4% year over year. The improvement came on the back of strong direct premiums and escrow fees, and higher agent premiums. However, the top line missed the Zacks Consensus Estimate by 4.9%.

Net investment income declined 44.2% to $45.9 million.

Closed title orders increased 34%, which can be attributed to 144% increase in refinance orders.

Average revenue per order decreased 6%, driven by the shift to refinance transactions.

Total expense of $1.3 billion increased 15.4% year over year, primarily due to rise in personnel costs, premiums retained by agents, other operating expenses, provision for policy losses and other claims, premium taxes and interest.

Segment Results

Title Insurance and Services: Total revenues increased nearly 11% year over year to $1.3 billion. The upside came on the back of improved premiums and escrow fees, which can be primarily attributed to higher number of direct title orders closed. However, pre-tax margin contracted 650 bps year over year to 5.6%.

Direct open orders increased 55.6% year over year to 354,400 while direct closed orders improved 34.3% to 202,700 year over year.

Specialty Insurance: Total revenues remained flat year over year at $122 million. Strong property and casualty (P&C) and home warranty business have contributed to the segment's top line. However, pre-tax margin contracted 410 bps year over year to 10.5%.

Share Repurchase Update

In the first quarter, the company bought back 1.7 million shares worth $65.8 million. Such shareholder friendly moves reflect the company's strong liquidity position.

Financial Update

First American Financial exited first-quarter 2020 with cash and cash equivalents of $1.1 billion, down 29.3% from Dec 31, 2019-level. Notes and contracts payable were $847 million, up 16.3% from 2019-end level.

As of Mar 31, 2020, the company had stockholders' equity of $4.4 billion, down 1.4% from Dec 31, 2019-end level.

2020 Outlook

The interest rate cut by the Federal Reserve in the United States is likely to keep investment yields under pressure.

For its Title Insurance and Services segment, First American Financial expects investment income in the range of $40-$45 million for each remaining quarter of 2020. This segment's pretax margin is estimated between 9% and 11% in 2020.

Q2 Guidance

The company's open purchase orders are expected to witness a year-over-year decline of 45% in second-quarter 2020. Moreover, revenues from the company's commercial business are also estimated to decline 50% year over year in the second quarter.

Recent News

First American Financial Declares Quarterly Dividend – May 5, 2020

The board of directors at First American Financial has approved a quarterly cash dividend of 44 cents per share. The dividend will be paid on Jun 15, 2020 to shareholders of record as on Jun 8.

First American Financial Completes Buyout of Docutech – Mar 3, 2020

First American Financial has announced that it has completed the acquisiton of 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.

Valuation

First American Financial shares are down 11.6% in the year-to-date period and 13.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 18.4% and 20.9% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 9.8% and 172.2%, respectively.

The S&P 500 index is down nearly 5.7% in the year-to-date period and up 8.9% in the past year.

The stock is currently trading at 1.35x trailing 12-month book value, which compares to 1.23x for the Zacks sub-industry, 2x for the Zacks sector and 4.15x for the S&P 500 index.

Over the past five years, the stock has traded as high as 1.98x and as low as 0.84x, with a 5-year median of 1.55x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $55 price target reflects 1.44x 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	1.35	1.23	2	4.15
	5-Year High	1.98	1.67	2.9	4.56
	5-Year Low	0.84	0.93	1.71	2.83
	5-Year Median	1.55	1.46	2.53	3.65
P/S F12M	Current	0.98	1.4	5.81	3.42
	5-Year High	1.21	11.26	6.7	3.44
	5-Year Low	0.59	1.4	4.99	2.53
	5-Year Median	0.9	1.87	6.05	3.01
P/E F12M	Current	14.19	23.93	16.52	22.08
	5-Year High	16.37	31.55	16.52	22.08
	5-Year Low	6.22	21.01	11.58	15.23
	5-Year Median	12.66	25.42	13.94	17.49

As of 05/27/2020

Industry Analysis **Zacks Industry Rank:** Bottom 21% (190 out of 248)

Top Peers

Company (Ticker)	Rec	Rank
National General Holdings Corp **(NGHC)**	Outperform	1
American Financial Group, Inc. **(AFG)**	Neutral	3
Cincinnati Financial Corporation **(CINF)**	Neutral	4
The Hanover Insurance Group, Inc. **(THG)**	Neutral	4
Arch Capital Group Ltd. **(ACGL)**	Underperform	3
Axis Capital Holdings Limited **(AXS)**	Underperform	5
Markel Corporation **(MKL)**	Underperform	5
Alleghany Corporation **(Y)**	Underperform	4

Industry Comparison Industry: Insurance - Property And Casualty

Industry Peers

	FAF	X Industry	S&P 500	ACGL	AXS	CINF
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Underperform	Neutral
Zacks Rank (Short Term)	4	-	-	3	5	4
VGM Score	C	-	-	C	F	B
Market Cap	5.89 B	1.21 B	21.39 B	12.14 B	3.30 B	9.87 B
# of Analysts	2	2	14	3	2	3
Dividend Yield	3.33%	1.14%	1.97%	0.00%	4.19%	3.91%
Value Score	C	-	-	B	C	B
Cash/Price	0.19	0.25	0.06	0.08	0.39	0.05
EV/EBITDA	4.37	5.17	12.63	7.27	8.91	3.98
PEG Ratio	1.31	2.43	2.91	3.49	NA	NA
Price/Book (P/B)	1.35	1.06	2.99	1.10	0.77	1.23
Price/Cash Flow (P/CF)	7.33	9.17	11.80	9.43	8.77	13.10
P/E (F1)	14.43	13.44	21.42	34.93	40.58	17.88
Price/Sales (P/S)	0.93	0.79	2.29	1.80	0.66	1.25
Earnings Yield	6.77%	6.81%	4.44%	2.87%	2.45%	5.59%
Debt/Equity	0.00	0.26	0.76	0.26	0.48	0.12
Cash Flow ($/share)	7.22	3.12	6.96	3.17	4.47	4.69
Growth Score	D	-	-	C	F	B
Hist. EPS Growth (3-5 yrs)	19.58%	4.86%	10.87%	14.25%	-22.09%	3.24%
Proj. EPS Growth (F1/F0)	-37.93%	-1.98%	-10.41%	-69.62%	-61.71%	-18.25%
Curr. Cash Flow Growth	20.75%	5.61%	5.46%	21.44%	-8.72%	25.16%
Hist. Cash Flow Growth (3-5 yrs)	18.51%	7.31%	8.55%	15.01%	-11.78%	9.30%
Current Ratio	0.76	0.45	1.29	0.52	0.56	0.26
Debt/Capital	0.00%	20.55%	44.54%	19.85%	30.01%	10.66%
Net Margin	10.47%	3.92%	10.59%	19.61%	0.73%	25.20%
Return on Equity	16.08%	7.52%	16.29%	9.93%	-0.38%	7.24%
Sales/Assets	0.54	0.31	0.55	0.18	0.20	0.32
Proj. Sales Growth (F1/F0)	-6.06%	0.00%	-2.34%	3.48%	-6.50%	2.63%
Momentum Score	C	-	-	F	F	F
Daily Price Chg	6.37%	2.43%	2.29%	1.82%	0.03%	3.65%
1 Week Price Chg	11.04%	6.92%	4.99%	23.15%	10.79%	16.39%
4 Week Price Chg	8.74%	-0.15%	2.47%	16.97%	3.54%	-12.81%
12 Week Price Chg	-17.76%	-16.13%	-6.13%	-30.55%	-34.04%	-41.21%
52 Week Price Chg	0.92%	-16.99%	0.67%	-12.59%	-33.27%	-37.66%
20 Day Average Volume	872,340	143,751	2,423,651	2,609,247	810,990	1,760,632
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.96%
(F1) EPS Est 4 week change	-16.08%	-9.14%	-2.07%	-64.26%	-77.66%	-8.85%
(F1) EPS Est 12 week change	-31.12%	-18.82%	-16.07%	-71.30%	-81.19%	-11.21%
(Q1) EPS Est Mthly Chg	-2.78%	-6.99%	-3.59%	-101.88%	-4.58%	-4.23%

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	C
Growth Score	D
Momentum Score	C
VGM Score	C

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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock.The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment.This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time.ZIR is not a broker-dealer.ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients.Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.