

First American(FAF)

\$52.09 (As of 07/29/20)

Price Target (6-12 Months): **\$56.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 07/02/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: C

Momentum: A

Summary

First American's earnings of \$1.05 per share beat the Zacks Consensus Estimate by 26.5% but declined 33.5% year over year. The company should continue to benefit from strength in commercial business and increased traction in P&C business. It 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. Growing direct premiums, escrow fees and agent premiums should drive revenues. Moreover, effective capital deployment bodes well. First American has been consistently increasing its dividend payout each year. Its shares have outperformed the industry year to date. However, higher expenses put strain on margin expansion. Also, high debt level and poor interest coverage pose financial risk to the company.

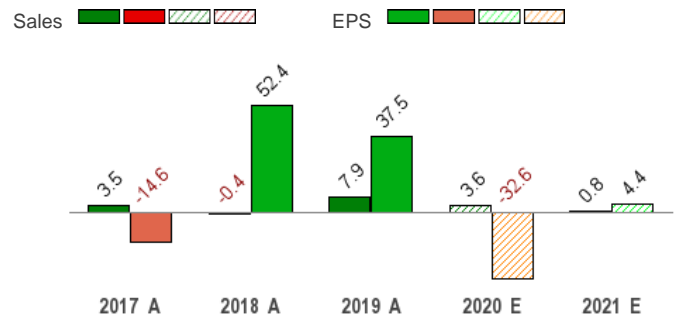
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$66.78 - \$29.36
20 Day Average Volume (sh)	863,412
Market Cap	\$5.9 B
YTD Price Change	-9.1%
Beta	1.06
Dividend / Div Yld	\$1.76 / 3.3%
Industry	Insurance - Property and Casualty
Zacks Industry Rank	Bottom 30% (176 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	26.5%
Last Sales Surprise	5.6%
EPS F1 Est- 4 week change	8.4%
Expected Report Date	10/22/2020
Earnings ESP	0.0%
P/E TTM	9.6
P/E F1	13.4
PEG F1	1.2
P/S TTM	0.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,558 E	1,569 E	1,651 E	1,695 E	6,474 E
2020	1,413 A	1,609 A	1,638 E	1,764 E	6,423 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	\$1.20 E	\$1.16 E	\$1.19 E	\$4.05 E
2020	\$1.06 A	\$1.05 A	\$1.03 E	\$1.17 E	\$3.88 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 07/29/2020. The reports text is as of 07/30/2020.

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.

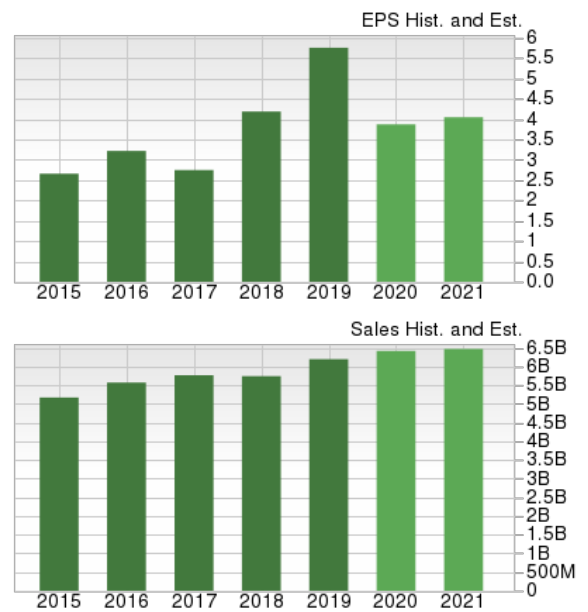
First American Financial core business lines include title insurance and closing/settlement services; property data and automated title plant records and images; home warranty products; property and casualty insurance; banking, trust and wealth management services; and other related products and services.

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. 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. 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 witnessed a slowdown in activity across all commercial asset classes in the second quarter due to economic uncertainty. Revenues in the company's commercial business declined 39.3% year over year in the second quarter of 2020 but were better than the earlier guidance of 50% decline. The company expects revenues to remain under pressure for the rest of the year given slowdown in activity across all commercial asset classes.
- ▲ Net investment income, a major component of an insurer's top line, witnessed 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 the first half of 2020 when the metric slumped 53.4% year over year to \$104.3 million. 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. First American Financial expects investment income in the third quarter in the range of \$40-\$43 million compared with the previous range of \$40-\$45 million in the Title Insurance and Services segment. Increases in short-term interest rates and higher average balances, which is driven by strength in the company's commercial business, are expected to drive the metric going forward.
- ▲ 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 half of 2020 as well, with the metric rising 7.8% year over year to \$3 billion driven by higher direct premiums and escrow fees, agent premiums and information and other. 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 January 2020, First American Financial fully acquired Title Security Agency. Further buyout of Docutech on March 2020, has leveraged 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. In the second quarter, information and other revenues increased 15% year over year owing to the acquisition of Docutech.
- ▲ Given a strong operational performance, the company engages in shareholder-friendly moves. The company has been consistently increasing its dividend payout each year. In January 2020, the board of directors at First American Financial approved a 5% hike in its quarterly dividend to 44 cents per share, which witnessed 5-year CAGR (2015-2020) of 12%. Its dividend yield is currently 3.4%, way above the industry average of 0.5%. Also, the payout ratio of 40 compares favorably with the industry average of 11.9. 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 14.3%, 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 lost 9.1% year to date compared with the industry's decline of 13.6%. Strong fundamentals such as increased demand among millennials for first-time home purchases, growing direct premiums, escrow fees and agent premiums as well as effective capital deployment should help shares bounce back.

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, premium taxes and interests. Expenses increased 12.1% to \$2.7 billion in the first half of 2020, primarily due to increase in operating cost driven by higher production-related costs as a result of the growth in order volume, the impact of recent acquisitions and higher cost in a number of expense categories, partly offset by lower travel expense. The company must strive to control costs or increase revenues at a higher magnitude than expenses, else margin can be eroded. In the second quarter, net margin contracted 50 bps sequentially.
- ▼ First American Financial's debt position also remains a concern. As of Jun 30, 2020, the company's current debt was \$1 billion, up 38.9% from the 2019-end level, with total debt to total capital of 18.1%, down 400 bps from 2019 level. Further, the company's times interest earned of 17.8 as on Jun 30, 2020 was lower when compared with the 2019-end 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 intends to maintain the loss rate at 5%, up from the loss rate of 4% in fourth-quarter 2019.

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 Financial Q2 Earnings & Revenues Beat

First American Financial Corporation reported second-quarter 2020 operating income per share of \$1.05, which outpaced the Zacks Consensus Estimate by 26.5%. However, the bottom line declined 33.5% year over year.

The company's results reflect improved segmental revenues, partially offset by increase in expenses.

Quarter Ending 06/2020

Report Date	Jul 23, 2020
Sales Surprise	5.56%
EPS Surprise	26.51%
Quarterly EPS	1.05
Annual EPS (TTM)	5.55

Behind the Headlines

Operating revenues of \$1.6 billion increased 7.3% year over year on the back of higher agent premiums and information and other revenues. Moreover, the top-line figure beat the Zacks Consensus Estimate by nearly 5.6%.

Net investment income however decreased 24.8% to \$58.4 million.

Total expense of \$1.4 billion increased 9% year over year due to higher personnel costs, premiums retained by agents, provision for policy losses and other claims, depreciation and amortization, interest, and other operating expenses.

Segment Results

Title Insurance and Services: Total revenues increased 7.1% over year to \$1.5 billion. The upside came on the back of improved agent premiums and higher information and other revenues, which can be primarily attributed to the recent acquisition of Docutech and the growth in mortgage originations that led to higher demand for the company's title information products. However, pretax margin contracted 70 basis points (bps) year over year to 16.3%.

Title open orders increased 18.6% to 351,300 while Title closed orders increased 29.5% year over year to 254,500, driven by a 160% surge in refinance orders.

Average revenue per order decreased 21.3% over year to \$7,400.

Average revenue per direct title order declined to \$1,950, primarily due to the shift in order mix to lower-premium residential refinance transactions.

Average revenue per order for purchase transactions increased 0.8% while average revenue per order for commercial transactions decreased 21.2%.

Specialty Insurance: Total revenues increased 8.5% year over year to \$133.5 million, driven by higher direct premiums and escrow fees. However, pretax margin contracted 730 bps to 5.5%.

Financial Update

First American exited the quarter with cash and cash equivalents of \$1.5 billion, up 2.5% from 2019 end. Notes and contracts payable were \$1 billion, up 38.8% from 2019 end.

Stockholders' equity was \$4.6 billion, up 3.3% from 2019 end. Cash flow from operations was \$343.8 million, up 28.9% year over year.

Recent News

First American Financial's Unit Partners With Home Point - Jul 17, 2020

First American Financial's member unit Docutech has entered into a partnership with Home Point Financial to assist borrowers with digital mortgage closing solution. This partnership will provide borrowers of Home Point an efficient and beneficial mortgage process.

First American Financial's Unit Partners With LendingQB - Jun 18, 2020

First American Financial's member unit Docutech has entered into a partnership with LendingQB to enable a complete end-to-end digital mortgage closing solution for lenders, borrowers and settlement agents. This partnership will assist lenders, borrowers and settlement agents with complete digital solution to streamline the closing process with safety and security.

Valuation

First American Financial shares are down 9.1% in the year-to-date period and 8.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 13.6% and 17.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 7.4% and 11.8%, respectively.

The S&P 500 index are up nearly 0.1% in the year-to-date period and 8.4% in the past year.

The stock is currently trading at 1.29x trailing 12-month book value, which compares to 1.29x for the Zacks sub-industry, 2.38x for the Zacks sector and 4.4x 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 \$56 price target reflects 1.36x 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	1.29	1.29	2.38	4.4
	5-Year High	1.98	1.67	2.91	4.56
	5-Year Low	0.84	0.93	1.72	2.83
	5-Year Median	1.55	1.46	2.53	3.71
P/S F12M	Current	0.92	1.64	6.04	3.54
	5-Year High	1.21	11.26	6.66	3.54
	5-Year Low	0.59	1.39	4.96	2.53
	5-Year Median	0.92	1.85	6.06	3.02
P/E F12M	Current	13.34	24.65	16.31	22.44
	5-Year High	16.37	31.55	16.31	22.44
	5-Year Low	6.22	21.01	11.59	15.25
	5-Year Median	12.63	25.42	14.16	17.52

As of 07/29/2020

Industry Analysis Zacks Industry Rank: Bottom 30% (176 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Arch Capital Group Ltd. (ACGL)	Neutral	3
American Financial Group, Inc. (AFG)	Neutral	3
Axis Capital Holdings Limited (AXS)	Neutral	3
Cincinnati Financial Corporation (CINF)	Neutral	3
Markel Corporation (MKL)	Neutral	4
National General Holdings Corp (NGHC)	Neutral	3
The Hanover Insurance Group, Inc. (THG)	Neutral	2
W.R. Berkley Corporation (WRB)	Neutral	3

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	FAF	X Industry	S&P 500	ACGL	AXS	CINF
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	2	-	-	3	3	3
VGM Score	A	-	-	C	F	C
Market Cap	5.91 B	1.16 B	22.69 B	12.52 B	3.52 B	13.42 B
# of Analysts	2	2	14	3	3	2
Dividend Yield	3.32%	1.33%	1.8%	0.00%	3.93%	2.88%
Value Score	A	-	-	B	C	C
Cash/Price	0.25	0.25	0.07	0.07	0.36	0.04
EV/EBITDA	3.96	5.34	13.11	7.45	8.80	5.35
PEG Ratio	1.22	2.24	3.05	5.75	20.18	NA
Price/Book (P/B)	1.29	1.09	3.15	1.14	0.74	1.45
Price/Cash Flow (P/CF)	7.35	9.93	12.28	9.72	9.34	17.80
P/E (F1)	13.43	14.00	22.27	57.50	100.91	27.40
Price/Sales (P/S)	0.92	0.76	2.46	1.73	0.71	1.69
Earnings Yield	7.32%	6.37%	4.25%	1.75%	0.98%	3.66%
Debt/Equity	0.00	0.24	0.75	0.26	0.38	0.10
Cash Flow (\$/share)	7.22	3.12	6.94	3.17	4.47	4.69
Growth Score	C	-	-	C	F	B
Hist. EPS Growth (3-5 yrs)	19.69%	3.24%	10.85%	14.25%	-22.09%	3.24%
Proj. EPS Growth (F1/F0)	-32.73%	-9.42%	-7.70%	-80.97%	-83.60%	-27.50%
Curr. Cash Flow Growth	20.75%	3.79%	5.31%	21.44%	-8.72%	25.16%
Hist. Cash Flow Growth (3-5 yrs)	18.51%	4.78%	8.55%	15.01%	-11.78%	9.30%
Current Ratio	0.85	0.45	1.31	0.52	0.59	0.28
Debt/Capital	0.00%	20.20%	44.23%	19.85%	25.37%	9.46%
Net Margin	10.05%	4.25%	10.45%	15.88%	-0.41%	25.20%
Return on Equity	14.27%	6.57%	14.99%	7.07%	-1.85%	6.46%
Sales/Assets	0.54	0.31	0.53	0.19	0.19	0.32
Proj. Sales Growth (F1/F0)	3.56%	0.00%	-1.97%	4.31%	-5.88%	-7.48%
Momentum Score	A	-	-	F	F	D
Daily Price Chg	1.32%	1.29%	1.52%	2.52%	2.23%	0.05%
1 Week Price Chg	0.41%	0.13%	0.37%	0.52%	0.17%	8.57%
4 Week Price Chg	12.64%	4.30%	5.44%	9.63%	4.80%	30.17%
12 Week Price Chg	19.49%	13.62%	15.38%	31.77%	14.81%	57.08%
52 Week Price Chg	-8.27%	-18.49%	-1.61%	-20.24%	-34.49%	-22.26%
20 Day Average Volume	863,412	109,001	1,846,377	1,607,659	882,343	1,237,307
(F1) EPS Est 1 week change	3.33%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	8.39%	0.00%	0.27%	-37.35%	-50.00%	-9.10%
(F1) EPS Est 12 week change	-14.93%	-12.70%	-0.85%	-77.61%	-55.32%	-12.16%
(Q1) EPS Est Mthly Chg	21.18%	0.00%	0.13%	-33.33%	-41.15%	-5.33%

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	C
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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