First American Financial Corp (FAF)

Updated July 26th, 2024 by Quinn Mohammed

Key Metrics

Current Price:	$58	**5 Year CAGR Estimate:**	6.0%	**Market Cap:**	$6.0 B
Fair Value Price:	$41	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date[1]:**	09/06/2024
% Fair Value:	142%	**5 Year Valuation Multiple Estimate:**	-6.8%	**Dividend Payment Date[1]:**	09/16/2024
Dividend Yield:	3.7%	**5 Year Price Target:**	$66	**Years of Dividend Growth:**	13
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Rating:**	Hold

Overview & Current Events

First American Financial Corporation traces its roots back to 1889 when two firms opened to handle title matters in the brand-new county of Orange County, California. In 1894, these two entities merged into the Orange County Title Company, the immediate predecessor to what is known today as First American Title Insurance Company, the largest subsidiary of First American Financial Corporation. In 1988, First American opened title insurance offices in Canada. Shortly after, it used a similar business model to develop international operations across the globe. First American was the first title insurance provider in Mexico, Korea, and Hong Kong and today has the leading market share in Australia and England.

First American trades on the NYSE under the ticker FAF and has a market capitalization of $6.0 billion. FAF provides insurance through two segments: title insurance and related services and specialty insurance. Title insurance and related services include real estate insurance, property closing services, escrow, risk mitigation, real estate data products and related real estate transaction services. The title insurance sector provides insurance to residential and commercial customers. In 2023, First American Financial generated $6 billion in revenue.

On August 22nd, 2023, First American Financial raised its dividend 2% to $0.53 quarterly per share. This marked its 13th consecutive annual dividend increase.

On July 24th, 2024, First American reported second quarter results. The company generated revenue of $1.6 billion, which was down 2% compared to the prior year quarter. Adjusted net income equaled $1.27 per share, a 6% decline from $1.35 in second quarter 2023.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.15	$2.62	$3.09	$3.76	$4.19	$6.22	$6.16	$11.14	$2.45	$2.07	***$3.88***	***$6.25***
DPS	$0.84	$1.00	$1.20	$1.44	$1.60	$1.68	$1.78	$1.94	$2.06	$2.10	***$2.12***	***$2.58***
Shares[2]	107.5	109.1	110.0	110.9	111.5	112.5	113.0	111.4	104.9	104.4	***104.0***	***95.0***

Earnings per share trended substantially higher into 2019, and the COVID pandemic did not cause significant distress for the firm in 2020. In 2021, FAF generated very strong results but in 2022 the company suffered net investment losses which caused a downturn in its reported earnings. Due to lackluster performance in 2023 as a result of softness in the title market, the nine and five year EPS CAGR of FAF is just -0.4% and -13.2%.

First American's markets previously experienced higher revenue and increased transaction activity as a result of low interest rates. However, while low interest rates fueled the demand for home purchasing, and residential refinancing in prior years, the recent runup in interest rates weighed heavily on sales in 2023 and is expected to continue in 2024. Housing affordability at its lowest level in over three decades, limited inventory, and elevated mortgage rates are all major headwinds to the company's near-term growth. As a result, the company is putting more emphasis on expense management.

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[1] Estimate

[2] In millions

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Over the next five years, we expect the title insurance market to recover, and from this low comparison base in 2024, FAF can be expected to grow EPS by 10%. We also expect the dividend to grow at half the pace of earnings, or 5%.

First American's growth strategy revolves around three pillars: profitably grow the core title and settlement business, strengthen the enterprise through data and process advantage, and manage and actively invest in complementary business where it has a strategic advantage. The company will also make value-creating investments in the core business and acquire or invest in businesses that fit within its strategy, such as the ServiceMac acquisition in 2021 and Mother Lode in 2022. It also launched Sequoia, a pilot program for automating underwriting for purchase transactions, in mid-2024.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	13.1	14.1	12.4	12.1	12.7	8.9	8.4	7.8	7.8	25.8	***15.0***	***10.5***
Avg. Yld.	3.0%	2.7%	3.1%	3.2%	3.0%	3.0%	3.5%	2.9%	3.4%	3.6%	***3.7%***	***4.1%***

First American Financial Corp trades at 15.0 times this year's earnings expectations of $3.88 per share. This is above both the ten-year average P/E ratio and the five-year average ratio. Our estimated fair value of 10.5 times earnings implies the potential for a valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

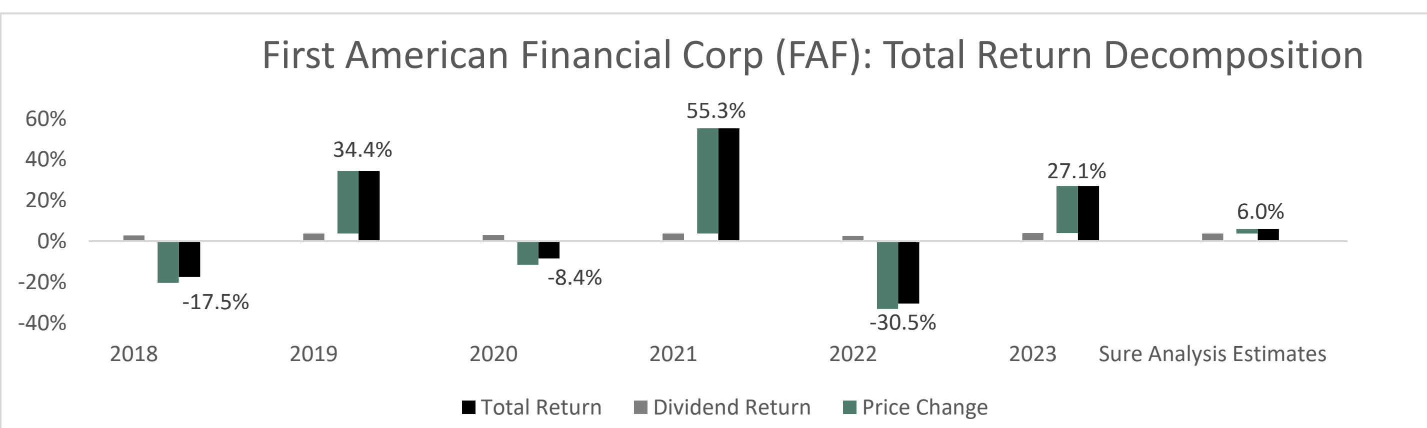
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	39%	38%	39%	38%	38%	27%	29%	17%	84%	101%	***55%***	***41%***

FAF has had a fairly stable payout ratio in the 30% to 40% range on average, however since 2022 it has exceeded this meaningfully. FAF was not a public company during the great financial crisis, however it's entrenchment into the housing market which had great difficulties in that recession would have likely caused problems in the company's earnings, so we don't consider FAF to be recession resistant. FAF has a data advantage amongst its peers, which they can leverage to achieve market-leading title automation. Additionally, FAF is geographically diversified and was even the first title insurer in some countries, and in others they possess the leading market share.

Final Thoughts & Recommendation

First American Financial Corporation has more than one hundred years in the title insurance business and is investing into technology to raise its top and bottom lines. We believe the company can achieve EPS growth of 10.0% along with the 3.7% starting yield, partly offset by -6.8% multiple compression. We forecast total annualized returns of 6.0% over the intermediate term and believe the company trades in excess of our estimate of fair value. FAF earns a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	4,678	5,175	5,576	5,769	5,745	6,199	7,081	9,214	7,594	6,004
SG&A Exp.	1,436	1,595	1,655	1,724	1,749	1,806	1,941	2,350	2,340	1,989
D&A Exp.	86	86	99	128	126	129	149	158	167	
Net Profit	234	288	343	423	474	707	696	1,241	263	217
Net Margin	5.0%	5.6%	6.2%	7.3%	8.3%	11.4%	9.8%	13.5%	3.5%	3.6%
Free Cash Flow	263	428	357	498	675	806	971	1,059	520	
Provision for Tax	116	144	134	23	134	195	223	393	61	59

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2023
Total Assets	7,666	8,237	8,832	9,573	10,631	11,519	12,796	16,451	14,955	16,800
Cash & Equivalents	1,212	1,051	1,027	1,429	1,503	1,530	1,321	1,286	1,287	3,605
Accts Receivable	277	288	330	334	349	337	399	455	388	
Goodwill & Intang.	1,016	1,012	1,096	1,213	1,254	1,243	1,573	1,806	1,992	1,961
Total Liabilities	5,090	5,484	5,817	6,090	6,885	7,094	7,874	10,668	10,267	16,800
Accounts Payable	26	56	59	68	47	59	56	87	51	
Long-Term Debt	587	581	737	733	808	1,007	1,527	2,186	2,012	0
Total Equity	2,573	2,750	3,008	3,480	3,742	4,420	4,910	5,767	4,665	4,848
LTD/E Ratio	0.23	0.21	0.24	0.21	0.22	0.23	0.31	0.38	0.43	0.00

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.3%	3.6%	4.0%	4.6%	4.7%	6.4%	5.7%	8.5%	1.7%	1.4%
Return on Equity	9.3%	10.8%	11.9%	13.0%	13.1%	17.3%	14.9%	23.2%	5.0%	
ROIC	7.9%	8.9%	9.7%	10.6%	10.8%	14.2%	11.7%	17.2%	3.6%	3.8%
Shares Out.	107.5	109.1	110.0	110.9	111.5	112.5	110.4	111.4	107.3	104.6
Revenue/Share	43.04	47.12	50.16	51.31	50.72	54.54	62.65	82.71	70.77	57.39
FCF/Share	2.42	3.89	3.21	4.43	5.96	7.09	8.59	9.51	4.85	

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.