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# EDITED TRANSCRIPT

FAF - Q4 2011 First American Financial Corporation Earnings  
Conference Call

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## CORPORATE PARTICIPANTS

**Craig Barberio** *First American Financial Corporation - Director of IR*

**Dennis Gilmore** *First American Financial Corporation - CEO*

**Max Valdes** *First American Financial Corporation - EVP & CFO*

**Mark Seaton** *First American Financial Corporation - SVP, Finance*

## CONFERENCE CALL PARTICIPANTS

**Mark Devries** *Barclays Capital - Analyst*

**John Campbell** *Stephens, Inc. - Analyst*

**Jim Ryan** *Morningstar - Analyst*

## PRESENTATION

### Operator

Welcome to the First American fourth-quarter 2011 earnings call. At this time all participants are in a listen-only mode. (Operator Instructions). A copy of today's press release is available on First American's website at [www.firstam.com/investor](http://www.firstam.com/investor). Please note that the call is being recorded and will be available for replay from the Company's Investor website and for a short time by dialing 203-369-1811. We will now turn the call over to Craig Barberio, Director of Investor Relations, to make an introductory statement.

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### **Craig Barberio** - *First American Financial Corporation - Director of IR*

Good morning, everyone, and thank you for joining us for our fourth-quarter and 2011 year and earnings conference call. Joining us on today's call will be our Chief Executive Officer, Dennis Gilmore; Max Valdes, Executive Vice President and Chief Financial Officer; and Mark Seaton, Senior Vice President of Finance.

At this time we'd like to remind all listeners that management's commentary and responses to your questions today may contain forward-looking statements such as those described on page 5 of today's news release, and other statements that do not relate strictly to historical or current fact.

The forward-looking statements speak only as of the date they are made and the Company does not undertake to update forward-looking -- to update the forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

Risks and uncertainties exist that may cause results to differ materially from those set forth in any forward-looking statements. Factors that could cause the anticipated results to differ from those described in the forward-looking statements are also described on page 5 of today's news release.

Also, management's commentary contains, and responses to your questions may also contain certain financial measures which are not presented in accordance with Generally Accepted Accounting Principles, including an adjusted pre-tax margin. The Company is presenting these non-GAAP financial measures because they provide the Company's management and investors with additional insight into the Company's operational performance relative to prior periods and relative to the Company's competitors.

The Company does not intend for these non-GAAP financial measures to be a substitute for any GAAP financial information. In the news release that we filed today which is available on our website, [www.firstam.com](http://www.firstam.com), the non-financial measures disclosed in management's commentary are presented with and reconciled to the most directly comparable GAAP financial measures. Investors should also use these non-GAAP financial measures only in conjunction with the comparable GAAP financial metrics. With that I will now turn the call over to Dennis Gilmore.



**Dennis Gilmore** - *First American Financial Corporation - CEO*

Thanks, Craig. Good morning and thank you for joining our call. I will start with a review of our fourth-quarter results; I will then touch briefly on our results for the full year and our outlook for the future.

On total Company revenues of approximately \$1 billion we generated net income of \$40 million or \$0.38 per share. Our Title segment generated an adjusted pre-tax margin of 10%, the highest margin of the year, which reflects the impact of our efficiency initiatives coupled with strong commercial and refinance transactions.

The adjusted pre-tax margin excludes the previously disclosed \$19.2 million charge taken in the quarter for the final settlement of the Bank of America lawsuit and \$2 million in net realized investment losses which together reduced the pre-tax title margin by 230 basis points to 7.7%.

Regarding the settlement with Bank of America, I'd like to make two key points. First, the settlement satisfied all claims and terminated all outstanding policies of the type that were the subject to the lawsuit. And second and most importantly, we were able to maintain a strong business relationship with the bank throughout a difficult situation.

Turning back to the quarter, the title segment benefited from a 14% increase in closed orders per day. Our commercial division had a particularly strong quarter with revenues up 10% compared to last year. And the rebound in our international division continued with revenues up 6%. The quarter also benefited from the annualized \$40 million shared service expense reduction program that we completed in 2011.

Our specialty insurance segment achieved pre-tax earnings of \$10 million for a 14% margin. Both the home warranty and property and casualty businesses continue to perform well. Overall 2011 was an encouraging year. For the second year in a row we improved our adjusted pre-tax margins despite lower revenues resulting from a 20% decline in mortgage originations in each of the last two years.

Now looking forward to the first quarter of 2012, year-to-date open orders are up 19% versus the fourth quarter. The increase in refinance orders combined with a solid commercial pipeline indicates the year is off to a strong start. And we do expect our 2.0 program to generate additional refinance activity beginning in the second quarter.

Throughout the last several years we've aggressively managed our cost structure to achieve greater efficiencies across our organization and going forward we will continue our focus on expenses while at the same time renewing our emphasis on profitable growth. In particular we will focus on organic growth in targeted markets along with strategic acquisitions like the recent transaction with Hexter-Fair, a leading title agent in the Dallas-Fort Worth market.

Based on the Company's efficient operating structure and strong order flow we are optimistic about delivering improved performance in 2012. And given our positive outlook for the business, I'm pleased to report that our Board of Directors approved a 33% increase in our quarterly dividend. I'd now like to turn the call over to Max for greater detail on our financial results.

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**Max Valdes** - *First American Financial Corporation - EVP & CFO*

Thanks, Dennis. The Company generated total revenues of \$997 million for the quarter, down 3% when compared with the same period of last year. Net income was \$40.2 million or \$0.38 per share compared with net income of \$47.1 million or \$0.44 per share for the same period of last year. Our results include the previously disclosed \$19.2 million reserve charge in connection with the settlement of a loss with Bank of America which reduced earnings per share by \$0.11.

In the Title Insurance and Services segment total revenues were \$923 million, down 3% compared with the same quarter of last year. Direct premium and escrow fees were down 4%, driven by a 16% decline in closed orders largely offset by higher average revenue per order closed. Average revenues per order closed increased 14% to \$1,504 compared to the same quarter of last year. This increase primarily reflected the strength in higher premium resale and commercial transactions.



Agent premiums were down 2% in the fourth quarter which is comparable with the 1% decline in direct premiums we experienced in the third quarter reflecting a normal reporting lag in agent revenues of approximately one quarter.

Information and other revenues totaled \$154 million, down 4% compared with the same quarter last year. This decline was driven by the same factors impacting direct title operations. Total investment income was \$15.6 million, up 7% from the same quarter of last year, reflecting net realized investment losses of \$2 million, down from \$3 million in losses last year.

We continued to benefit from our cost reduction initiatives during the fourth quarter including the full benefit of the annualized \$40 million shared services expense reduction program that we implemented at the end of the second quarter.

Personnel costs were \$288 million, down \$12.3 million or 4% compared with the same quarter of last year. This decline primarily reflected a reduction in headcount and reduced costs related to employee benefit plans.

Other operating expenses were \$168 million, down \$19.4 million or 10% from the same quarter of last year. This decrease reflects lower expenses for professional and other outside services.

Agent retention was 80% of agent premiums compared with 80.2% in the fourth quarter 2010. The improvement in agent retention was due to the geographic mix of agent revenues and our continued progress in improving agent splits on both new and existing agency relationships.

The provision for title losses was 8.6% of premium and escrow revenue compared with 5.5% in the same quarter of last year. The fourth-quarter rate of 8.6% includes the \$19.2 million reserve charge for the Bank of America lawsuit. Excluding this charge the current quarter rate was 6% which reflects an ultimate loss rate of 5.6% for the 2011 policy year and a net increase in the loss reserve estimates for prior policy years.

Pre-tax income for the title insurance and services segment was \$71.4 million for the fourth quarter, a decline of 12%. The segment generated an adjusted pre-tax margin of 10%. The GAAP pre-tax margin was 7.7% which includes the \$19.2 million settlement charge and \$2 million in net realized investment losses which together lowered the pre-tax margin by 230 basis points.

Turning to the specialty insurance segment, total revenues were \$72 million, flat compared with the same quarter of the prior year. Total expenses were slightly higher year over year with the overall loss ratio steady at 54%. Higher home warranty claims in the current quarter were offset by lower claims experienced in the property and casualty business. The specialty insurance segment pre-tax margin was 13.9% for the current quarter and 14.3% for the same quarter of last year.

Lastly, corporate expenses were \$15.3 million in the quarter, in line with our quarterly expectations. With that I will turn the call over to Mark.

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**Mark Seaton** - *First American Financial Corporation - SVP, Finance*

Thank you, Max. I will provide a few comments on our liquidity and capital. Cash provided by operations in the fourth quarter was \$108 million, up from \$53 million in the third quarter. Capital expenditures during the quarter were \$24 million which includes investments in technology, software development and title plan expansion.

In terms of liquidity, we currently have \$83 million of operating cash at our holding company. In addition to our operating cash we also have 6 million of our 8.9 million shares of CoreLogic at the holding company. Based on yesterday's closing price our stake in CoreLogic was valued at \$126 million, \$84 million of which is held at the holding company. In addition, we also have \$200 million available on our \$400 million line of credit.

Our cash and investment portfolio totaled \$3.1 billion as of December 31, which includes \$1.1 billion of fiduciary funds. The portfolio is comprised of debt securities of \$[2.2 billion], cash and short-term deposits of \$475 million, equity securities of \$184 million and \$201 million and less liquid long-term investments.

Overall we have a high quality portfolio with just 1% of our debt securities rated below investment grade. Debt on our balance sheet totaled \$300 million as of December 31. Our debt consists of \$200 million funded on our credit facility, \$45 million of trustee notes and \$55 million of other notes. Our debt to capital ratio as of December 31 was 12.8%.

I would now like to turn the call back over to the operator to take your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Mark Devries, Barclays Capital.

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### Mark Devries - Barclays Capital - Analyst

With the stocks still trading well below book, can you just talk about your thoughts around using buybacks as a way of returning capital?

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### Dennis Gilmore - First American Financial Corporation - CEO

Sure, Mark, this is Dennis. Actually we actually went in and bought some shares late in the fourth quarter. We purchased approximately 200,000 shares for approximately \$2 million, that was late in the fourth quarter. We'll continue to look at all appropriate uses of our capital as we go forward and we think the dividend raise was an important step in that direction and we'll just continue to look at all our available opportunities going forward.

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### Mark Devries - Barclays Capital - Analyst

Okay. Can you remind us what your current remaining authorization is for buybacks?

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### Dennis Gilmore - First American Financial Corporation - CEO

It's approximately \$148 million.

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### Mark Devries - Barclays Capital - Analyst

Okay. What type of benefit are you guys looking for from HARP 2.0 as far as incremental volume that you might see there?

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### Dennis Gilmore - First American Financial Corporation - CEO

Yes, sure, it's a great question. We're optimistic on HARP 2.0 at this point. We think that we'll start to see incremental revenue in orders and closings in the second and third quarter. We do know that our customers are gearing up for HARP 2 implementation right now. So from our perspective it will just be added benefit for the year. And when we look forward also on HARP 2, at this stage we do not anticipate any material increase in our staffing levels to deal with that volume.

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**Mark Devries** - *Barclays Capital - Analyst*

Okay. And is there anything about like the average loan size of a HARP loan that may cause the premiums to be even lower than you would normally see on a refinance transaction?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

At this stage I wouldn't change our approach to modeling. We have no indication that will be anything materially different than what we're seeing right now.

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**Mark Devries** - *Barclays Capital - Analyst*

Okay. And just finally, how much more room do you think there is for the commercial business to grow? I mean, we've had a nice recovery here. Do you expect further expansion in that business in 2012?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

Yes, it's been a -- obviously it's been a very strong segment for us over the last five quarters and it's interesting, it's been a very broad-based recovery for us too. We continued to gain strength throughout 2011 and our current forecast and our current view on the market is that that trend will continue into '12. So we're looking for a very strong '12 out of our commercial group also.

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**Mark Devries** - *Barclays Capital - Analyst*

Okay. So is the potential like double-digit year-over-year growth in revenues there?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

I'm not going to give a forecast on the actual size of the market. We just anticipate a strong '12 out of commercial.

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**Mark Devries** - *Barclays Capital - Analyst*

Okay. All right, thanks.

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**Operator**

Brett Huff, Stephens, Inc.

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**John Campbell** - *Stephens, Inc. - Analyst*

It's John Campbell in for Brett Huff, good morning. Just a quick question here. As far as -- nice work on the Title pre-tax margin in the quarter. You guys mentioned some benefit was driven from the efficiency from your cost saves program and strong commercial. Could you just maybe give us a sense of how sustainable you see this going forward?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

John, if you don't mind -- we had trouble understanding the question. Could you ask it again, please?

**John Campbell** - *Stephens, Inc. - Analyst*

Yes, I was just commenting on the Title pre-tax margin. You guys mentioned that you received some benefit from your cost saves program as well as just strong commercial. If you guys can maybe just give us a sense of -- if you expect that kind of strength in margin to continue?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

Okay, sure. Thanks for the question. We were definitely encouraged by the performance in the fourth quarter. We're seeing a few things going on in the business right now that's increasing our optimism as we look forward. Obviously the market is still difficult, but we're comfortable operating in the size of the market we're in right now.

I think we're starting to see the real benefits of our efficiency programs we've been driving across this Company for the last few years; we've been very focused on our expense structure. And what we're actually seeing right now in the business is when we get any incremental increase in revenue we can really bring it down to the bottom line.

So we like our operating structure. We're also encouraged by the first quarter here. Our orders are up in our typically weakest quarter. But we have a positive outlook going into 2012 right now.

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**John Campbell** - *Stephens, Inc. - Analyst*

Okay. And then on the cost saves program, so the \$40 million this past year, you mentioned that you guys obviously continue to focus on cost saves for 2012. Have you guys put a target out there, any additional color you can maybe provide there?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

No, we don't have a publicly stated target. But we're going to stay very consistent with our approach, as we have over the last few years. It's really very straightforward -- continue to drive efficiencies across the business wherever we see opportunities, that's an ongoing effort. The second focus for us is to grow strategically in key markets and we're very focused on that. And third for the Company is to continue to look for opportunities to create long-term shareholder value. So it's just very focused on our approach here.

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**John Campbell** - *Stephens, Inc. - Analyst*

And then just two quick housekeeping items here. So the residential order mix between purchase and refi in 4Q, could you guys maybe provide that?

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**Mark Seaton** - *First American Financial Corporation - SVP, Finance*

Yes, the open order mix in the fourth quarter was about [65%] refi and that's actually been increasing. In November it was [64%]. And in December, January and February, all three months it was [68%]. So we're seeing an increased mix in the refi percentage the last couple months.

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**John Campbell** - *Stephens, Inc. - Analyst*

Great. And then maybe just the tax rate for next year, what you guys are expecting?

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**Max Valdes** - *First American Financial Corporation - EVP & CFO*

Tax rate should be approximately 40%.

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**John Campbell** - *Stephens, Inc. - Analyst*

Okay, great. Thanks, guys.

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**Operator**

(Operator Instructions). Jim Ryan, Morningstar.

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**Jim Ryan** - *Morningstar - Analyst*

Good morning. I just want to focus a little bit on the international possibilities. The first question is, is the valuation problem from the Canadian policies completely done with? And then the second part is, where do you see the future in terms of International growth? Is it entirely in Canada? I mean, could you give a little idea on what you might be thinking along those lines?

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

Sure. Let me break the question up into two parts here. First on the guaranteed valuation product in Canada, we actually made a lot of progress in that product in 2011, we restructured it extensively, we've lowered our risk profile we think materially on that product. And we also successfully reinsured out the bulk of that product.

So as we go forward and we're optimistic on that product, the second thing is we secured the majority of those customer relationships through a difficult transitioning time.

With regards to claims, we have to just let that continue to develop and we'll see how that progresses.

With regards overall to international, a key market for us. It's been showing a nice rebound over the last year. Our primary focus right now will be in our Canadian market to continue to grow that share both in our current products and potential new product offerings there.

And the second key focus will be in the -- primarily out of the UK where we have some -- we have some good momentum going there. So those are our two key focuses.

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**Jim Ryan** - *Morningstar - Analyst*

Great, thank you.

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**Operator**

There are no additional questions at this time.

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**Dennis Gilmore** - *First American Financial Corporation - CEO*

Thank you, everybody, and appreciate you joining our call.



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**Operator**

This concludes this morning's call. We would like to remind listeners that today's call will be available for replay on the Company's website or by dialing 203-369-1811, the Company would like to thank you for your participation. This concludes today's conference call. You may now disconnect.

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