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FAF - Q1 2017 First American Financial Corp Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the First American Financial Corporation First Quarter Earnings Conference Call. (Operator Instructions) A copy of today's press release is available on First American's website at www.firstam.com/investor. Please note that the call is being recorded, and it will be available for replay on the company's investor website for a short time by dialing (877) 660-6853 or (201) 612-7415 and entering the conference ID, 13658887. I'd now like to turn the call over to Craig Barberio, Vice President of Investor Relations, to make introductory statement.

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

Good morning, everyone, and welcome to our 2017 First Quarter Earnings Conference Call. Joining us today will be our Chief Executive Officer, Dennis Gilmore; and Mark Seaton, Executive Vice President and Chief Financial Officer. Some of the statements made today may contain forward-looking statements that do not relate strictly to historical or current fact. These forward-looking statements speak only as of the date they are made, and the company does not undertake to update these 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 these forward-looking statements. For more information on these risks and uncertainties, please refer to this morning's earnings release and the Risk Factors discussed in our Form 10-K and subsequent SEC filings. Our presentation today contains certain non-GAAP financial measures that we believe provide additional insight into the company's operational efficiency and performance relative to earlier periods and relative to the company's competitors. For more details on these non-GAAP financial measures, including presentation with and reconciliation to the most directly comparable GAAP financial measures, please refer to this morning's press release, earnings release, which is available on our website, www.firstam.com. I'll now turn the call over to Dennis Gilmore.

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Good morning, and thank you for joining our call. I'll review our first quarter results and provide a few comments regarding our outlook for the remainder of 2017. In the first quarter, our earnings per share rose 11% to $0.52. Total revenues were up 10%, driven by growth in our purchase business. Our closed purchase orders were up 4% compared to last year. The average revenue per purchase transactions increased by 8%, driven by higher real estate values and premium and fee increases. Despite the tight housing inventory in many markets across the country, we believe the purchase market is poised for a strong year in 2017. Our commercial revenues grew 2% during the quarter, rebounding from the revenue decline we experienced throughout 2016. Overall, I think 2017 will be a good year for our commercial business. The loss provision rate in our Title Insurance business declined to 4% this quarter, reflecting the improvements we made to our underwriting and claims process over the past several years. These improvements, coupled with favorable economic conditions, have had a significant positive impact on our claims for recent policy years. We feel confident about our loss provision rate, given the strength of our reserves and our outlook for claims experience. As you know that refinance business dropped sharply in late 2016. So far, this year, our refinance orders have stabilized at about 1,200 per day. However, as we close our pipeline, we expect continued pressure on our refinance revenue throughout 2017. In response, we will continue to aggressively manage the cost structure of our central lender business, but we expect this business to be a drag in our margins throughout 2017. In terms of recent acquisitions completed in 2016, our overall integration efforts are on schedule, and we expect full integration by year-end. Looking forward, we anticipate shifting our emphasis from realizing cost synergies to growing the revenue of these companies. Though currently dilutive to margins, long term, we expect these acquisitions to collectively produce pretax margins at or better than our title segment.

Despite the decline in refinance activity and our ongoing integration of recent acquisitions, first quarter pretax margin for our Title Insurance segment was a strong 8.2%. We continue to maintain expense management discipline throughout our core title business. Turning to our Specialty Insurance segment. Revenues grew by 7%, led by strength on our Home Warranty business. Segment delivered a pretax margin of 9.1%. Home Warranty had seen a noticeable improvement in the claims experience and a continued benefit from targeted price increases. However, higher property and casualty claims due to weather-related events on the West Coast caused our overall claim ratio for this segment to increase to 59.5%. We are optimistic on our outlook for 2017. We'll continue to focus on operating efficiencies. Our purchase revenue is showing strong growth, commercial is poised for another good year and we are realizing the benefits of our underwriting discipline. In closing, I'm proud to announce for the second year in a row, we were named to Fortune's 100 Best Companies to Work For. This designation is a testament to the quality and dedication of our workforce. I'd now like to turn the call over to Mark for a more detailed review of our financial results.

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Thank you, Dennis. Total revenue in the first quarter was $1.3 billion, up 10% compared with the first quarter of 2016. Net income was $58 million or $0.52 per diluted share. The current quarter results include a tax benefit of $2.4 million or $0.02 per diluted share due to a new accounting requirement related to stock-based compensation. In the Title Insurance and Services segment, direct premium and escrow fees were up 4% compared with last year. This increase was driven by a 5% increase in the average revenue per order, offset by a 1% decrease in the number of orders closed. The average revenue per order increased to $2,035 due to a shift in the mix to higher premium, purchase and commercial transactions. The average revenue per order for purchase transactions increased 8% due to higher real estate values and premium and fee increases. We are in the process of simplifying our rate structure in many areas, which includes combining certain ancillary items into our escrow rates. This initiative makes our escrow process more efficient and provides simplicity to the consumer and also has the effect of grossing up our revenue and expenses to include certain costs that historically had been passed through to customers. Agent premiums were up 12%, reflecting the normal reporting lag of agent revenues of approximately one quarter. The agent split was 79.0% of agent premiums. Information and other revenues totaled $180 million, up 17% compared with last year. The increase was driven by recent acquisitions, which contributed $26 million of revenue this quarter. Personnel costs were $385 million, up 8% from the prior year. This increase was driven by the impact of recent acquisitions, higher salary expense and an increase in incentive compensation as a result of higher revenue and profitability. Other operating expenses were $183 million, up 11% from last year. The increase in expenses during the quarter was primarily attributable to recent acquisitions and the favorable impact in 2016 of an insurance claim recovery. The ratio of personnel and other operating expenses to net operating revenue was 78.6% compared with 78.2% last year. The provision for title policy losses and other claims was $40 million or 4.0% of title premiums and escrow fees compared with the loss provision rate of 5.5% in the same quarter of the prior year. The current quarter rate reflects an ultimate loss rate of 4.0% for the current policy year with no change in the loss reserve estimates for prior policy years. We expect to book our loss provision rate at 4.0% this year. However, as always, we will monitor claims on a regular basis, and we'll adjust our loss rate when appropriate. Pretax income for the Title Insurance and Services segment was $98 million in the first quarter compared with $88 million in the first quarter of 2016. Pretax margin was 8.2% compared with 8.0% last year. Turning to the Specialty Insurance segment, total revenues were $110 million, up 7% compared with last year. The loss ratio in the Specialty Insurance segment this quarter was 60%, up from 58% in the prior year. Claims experience improved notably in our Home Warranty business due to operational improvements, particularly in our contractor management function. In addition, we began to see the benefit of price increases. The loss ratio for the Home Warranty business improved 330 basis points to 49.8% this quarter. Offsetting this favorable claims experience are higher claims from our Property and Casualty business. Storms in the West Coast caused the loss ratio in Property and Casualty to climb to 82% versus 68% last year. Pretax margin for the segment was 9% compared with 12% in the first quarter of last year. Net expenses in the Corporate segment were $24 million, unchanged relative to last year. The effective tax rate for the quarter was 30.8%. As I previously mentioned, we recorded a $2.4 million benefit related to stock-based compensation. Excluding this benefit, our tax rate would have been closer to our normalized rate of 34%. This accounting change will create more volatility on our tax rate, particularly in the first quarter when most of our restricted stock units vest. Debt on our balance sheet totaled $736 million as of March 31. Our debt consists of $546 million of senior notes, $160 million on our credit facility, $26 million of trusteed notes and $4 million of other notes and obligations. Our debt-to-capital ratio as of March 31 was 19.3%. We have $540 million remaining on our $700 million revolving credit facility. In terms of cash flow, cash provided by operations was $6 million, an improvement relative to the $56 million cash outflow in the first quarter of 2016, primarily due to benefits from income tax accounts. Lastly, I'd like to provide a brief update on our pension. Our pension termination process is on track, and we expect to record a $159 million expense within our Corporate segment in the second quarter once the termination is final. Upon final termination, we estimate an annual reduction of approximately $22 million personnel expenses within the Corporate segment, based on these levels of expenses in 2016.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Mark DeVries with Barclays.

Mark C. DeVries - *Barclays PLC, Research Division - Director and Senior Research Analyst*

We were pleased to see the continued strength in the commercial line. We're kind of bracing for a little bit down year from a revenue perspective. Dennis, could you just talk about kind of what you are seeing there? What the outlook is? What the mix is like? Are you getting a healthy mix of large deals, small deals? Any kind of color would be helpful.

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Sure. Yes. Thanks for the questions. Yes, we're optimistic also. Our large deals did pick up in the first quarter. We've had a revenue increase in the first quarter, really first time since the fourth quarter of 2015. Pipeline looks good going into the second quarter. So all in all, optimism. I will tell you though, internally, our forecasts do still show a modest decline for the full year. And I think it's probably just -- we're just being cautious there. But overall, pretty optimistic right now going into the year.

Mark C. DeVries - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Okay, that's helpful. And then Mark, on the provision rate, what did you guys see that caused you to take it to 4%. I think we were expecting something more like a 5% rate, going forward?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Couple of things. First, I'd say, we monitor our claims every quarter. Our claims -- our incurred claims in Q1 were 25% below our forecast. So we had a good claims experience relative to our forecast. We had a -- we've had a reserve put up on a claim that was a $15 million reserve. We've had it on for few years, and we settled it for a very favorable amount, so we were able to take a benefit there. And so when you look at our last 5 policy years, we really run -- our last 5 policy years, between 2012 and 2016, have averaged 3.9%. So really what we are doing is we are bringing the rate down to where our claims experience is, around the 4.0% level.

Mark C. DeVries - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Okay. And what fundamentally is driving that? I mean, are you guys just doing better job of searching? Is home price appreciation really just limiting damage in an event that there are title defects around? What's driving that rate lower?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Well, I mean, just exactly what Mark said, we are performing well. We have performed very well over the last 5 years. Then we've just done a lot of things internally, I mean, I'll give just a few. We centralized the claims management, and that's allowed us to just have a better handle on that all over the last number of years. We continued to have constant feedback loop, really, from clients to underwriting. So if you see trends, we adjust and modify underwriting requirements. We established a number of years ago, a special investigating unit that attracts -- I mean, goes after anything high fraud, tries to identify it, tries to stop it. So a lot of things like that have just made our claims experience very strong.

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

And Mark, this is Mark. Just one thing I'll add to is, we feel good about the strength of our reserves. When you look at where we are relative to the range of our actuaries best estimates, we're at the high end of the range in terms of reserves. So really the claims experience, coupled with the fact that we got a very strong reserve, gave us a lot of confidence to bring the rate down this quarter.

Operator

On next question comes from the line of Jason Deleeuw with Piper Jaffray.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

I was just wondering, historically, what's the lowest claims level that you've seen over time?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Well, we have been around for over 100 years, so I don't have all that data in front of me. But when you look over the last 20 years, the lowest loss ratio we have, in terms of a policy basis, is 3.3%, that was 2012. So the last 5 years, postcrisis, we've been anywhere from 3.3% to 4.7%, but the average a shade under 4.0%.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

Got it. And so I think you said we've averaged 3.9% over the last 5 years?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Yes.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

So we're probably a little bit lower than that right now, in terms of run rate, going forward?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

No. I would say we are right around the 4% range. I don't think it's lower than 3.9%. I think 4% is really our best estimate at this point.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

Cool. And then on the average revenue per order for the purchase was stronger and called out the mix with the home prices, but also it sounds like there's some premium and fee benefits that you're getting also. And then there was a gross up of revenue, it sounds like also gross up of cost. So I'm just trying to get a sense, is there a margin benefit that we're getting from the premium and fee changes?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Yes, we are getting a benefit from our premium fee increases. So our average fee per file for the purchase transactions was up 80%. And roughly a third of it's coming from housing prices, which we get a benefit, roughly a third is coming from the fact that we are taking rate in many areas, which we get a benefit. And then another component of it, about 1/3 is just the fact that we are simplifying on rate structure, which we wouldn't necessarily get in earnings benefit from that piece. But overall, we absolutely are getting earnings benefit from the higher-rate environment.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

All right. Sounds good. And then just a last thing, I think, you gave us the refinance orders per day for April, 1,200. Do you have that for purchase also?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Yes, purchase, we're running about 2,300 a day in April, which is roughly about 1% over the last year, consistent with what we'd saw in the first quarter.

Operator

Our next question comes from the line of John Campbell with Stephens, Inc.

John Robert Campbell - *Stephens Inc., Research Division - Research Analyst*

Nice job on the claims history. I guess, it's getting back to this point of strength. I know it's something you guys you worked hard on. But in the quarter, it looks like Title pretax margin, if I look at that year-over-year and kind of normalize the loss provision rate or give it the same rate this year, it looks like margin, title pretax margin, would have compressed about 100 bps year-over-year. I know you guys saw a greater mix of kind of that lower margin agency revenue, but can you talk about kind of what held the rest of the business back, excluding that favorable loss provision rate?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Sure. This is Dennis. The core title business consisted of the direct. The agency and the commercial has had a very strong quarter. The drag really was our essential refinance business. They flipped to a negative, so we had actually lost money on that business in the first quarter. And we had to really aggressively control our cost, our staffing levels are down 40% in that business alone on a sequential basis. So -- as I mentioned in my prepared remarks, this business is going to be a drag on us all through '17. So we just -- rightsized this business for the market. So we're running right now around 1,200 orders per day. We may get some pick up back in the refinance business as (inaudible) come in, so we'll see. So that's #1. #2 is our acquisition. We are running on plan right now. We're right on plan for our integrations. We think integration will be done by the end of the year.

We're actually ahead of our cost savings there. But they are drag on our margins as we are getting integrated. So we're also changing our focus on those to complete the integration and move to increase the sales levels. And we do believe that those acquisitions will all run at or better than the title margins as we exit 2017 going into '18.

John Robert Campbell - *Stephens Inc., Research Division - Research Analyst*

Okay. That's helpful. And then I guess we kind of heard a similar commentary by different guys in the industry. Is it rightsizing in the centralized refi channel? Or is it also some pricing pressure you're seeing there?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Not on the price. It's rightsizing. I mean, whenever we have such a volatile swing, that business gets hit really hard. We've done a really good job rightsizing it. We are optimistic. Again, we are optimistic that we are stabilizing now, but I'm planning for that business to stay volatile all year long. I think that's probably just a safer bet right now.

John Robert Campbell - *Stephens Inc., Research Division - Research Analyst*

Okay. That's helpful. And so I guess, is it fair to say you can actually maybe see a positive margin mix shift if you roll off some of that refi rev? And then I guess as you get some of the acquisitions kind of integrated, is that fair to say?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Absolutely. As we transition to a purchase market, net-net, that's going to be beneficial to us.

John Robert Campbell - *Stephens Inc., Research Division - Research Analyst*

Okay. That's helpful. And then last one for me. I think we seemed to underestimate kind of the below-the-surface drivers on rising rates. It seems like you guys are maybe a little bit better suited than some of your peers. I think we got a glimpse of that in the quarter. You had better investment income. Looks like it was kind of flattish year-over-year. So could you guys walk us back through kind of what those underlying drivers are? And maybe help us frame up some potential upside from higher rates?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Well, we do get benefits, especially when the short end of the curve rises. So whenever the Fed raises rates, we go and renegotiate our rate with our banking partners. And it really reflects 1031 Exchange business, where we -- investment income as a primary driver. Off balance sheet, escrow deposits were in a certain way that we can get benefits there. That -- we've been renegotiating rates with the bank on that side. And we also own a bank called First American Trust. We'll do better in a higher-rate environment. And so we started to see a little bit of that in the first quarter. I think you'll start to see more of that in Q2 and rest of this year.

Operator

Our next question comes from the line of Mark Hughes with SunTrust.

Mark Douglas Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

In the Home Warranty business, are you going to have another round of price increase just to drive the margins higher? Or is this kind of reflect the full impact of your pricing actions?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

It's going to be little of both, we are going to continue to seek out price increases where we can. We're more moderate there. Really, happy with our Home Warranty group that they had a really nice turnaround. We've been focused on this now for about 3 quarters. They saw a nice improvement in their leverage, had a very strong margin in the business and our claim cost continue to drift down here. So all in all, good. As I've said before, though, the real challenge for this business is the second and the third quarter. So we're optimistic starting the year, we're optimistic going into those quarters. But that's when really -- when the rubber meets the road in that business of second and third quarter.

Mark Douglas Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Revenue per order and purchase, I think, you've touched on this. I think the historical formulation was that when prices go up, you maybe get about half of the price increase flow through your revenue per order. Is that still the case or little less or a little more?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

I'd say everything else being equal, it's roughly right, maybe a little bit more, just if it was just housing prices. But the reason why we're significantly outperforming that with our 8% number again is because we've been taking rate in a lot of areas.

Operator

Our next question comes from the line of Chris Gamaitoni with Autonomous Research.

Edward Christopher Gamaitoni - *Autonomous Research LLP - Partner, Mortgage and Consumer Finance*

I want to clarify on the recent accident year incurred statistics. Is this 3.8%, is that claims paid? Or what are you referring to there?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

I think I said -- when I -- well, a couple of things. When I look at the ultimate loss ratios by policy year for the last 5 years, by accident year, the average ultimate loss ratio has been 3.9% over the last 5 years. And the other number that I mentioned was that, in the first quarter, our claims were -- came in 25% less on incurred basis relative to our forecast. That's not on a policy basis. That's just claims that were incurred on a calendar-year basis in the first quarter.

Edward Christopher Gamaitoni - *Autonomous Research LLP - Partner, Mortgage and Consumer Finance*

Okay. So the 3.9% is incurred, not claims paid, also...

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Well, it's ultimate.

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Edward Christopher Gamaitoni - *Autonomous Research LLP - Partner, Mortgage and Consumer Finance*

Yes, okay. Then I wanted -- if I could get some clarity on the simplifying the rate structure. If you're adding the same amount, if you're grossing up revenue and expenses, that should be negative to the margin. I was just wondering if you could give us a potential impact that will have on the margin?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

It's negligible. Because it's very small amount. So it wouldn't have any impact on our margin.

Edward Christopher Gamaitoni - *Autonomous Research LLP - Partner, Mortgage and Consumer Finance*

Okay. And is that -- are the revenue and expense recognition in the same period? Was there a lag? I had seen other industries transition this and there is a lag?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

It would be in the same period. I mean, in theory, there's a little bit of margin, but it's negligible, though, given the size of our revenue.

Edward Christopher Gamaitoni - *Autonomous Research LLP - Partner, Mortgage and Consumer Finance*

Okay. And then I guess the final follow-up is, could you explain or just give us a little more color, how you're taking rate? It seems kind of counterintuitive insurance that loss ratios are going down, margins are going up and you're taking rate in a relatively regulated environment? So just any more color on that would be great.

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Well, I mean, we have a continual process where -- couple things I would say, we have a continual process to evaluate rates in all areas, this isn't like a one-time thing. The costs for title and escrow are different. So our escrow costs have been coming up cost because a lot of these [trig] costs that we had to incur. So we've been raising our escrow rates because of that. The other thing I would say is, yes, when you look at our P&L, our loss ratios are coming down. Last year, we booked at 5.5%, this year it's 4%. But when you look at the last 5 years, economically, our loss ratios have been very consistent. And so I think our reserving has just been conservative for the last couple of years. Now we're kind of getting back to where we're sort of economically now, which is the 4% loss ratio.

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

But the other thing I'd say is, every time we raise rates, the states are more and more -- they want more and more information. They want actual real justification, and we provide that to make sure rates are fair and appropriate and adequate.

Operator

Our next question comes from the line of Kevin Kaczmarek with Zelman & Associates.

Kevin Michael Kaczmarek - *Zelman & Associates LLC - Director*

One more on purchase fee profile growth. I guess, maybe you hinted at his, just but how long will these items that you mentioned that are driving the growth last? And how long will they phase in? So should we expect to step down at some point? Or should it maybe be a gradual moderation? And if so, for what time frame?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Kevin, I'll start. This is Dennis. I mean, one of the main drivers here is the purchase price appreciation going on in the country, and that's really driven by the inventory shortages. We look at our top 40 -- 50, excuse me, our top 50 markets. 80% of them have inventory shortages. Some have acute inventory shortages. So when we start to see more supply coming on in the market, I think we'll start to see appreciation start to slow down, which will probably slow down our rate increase. So it's really, I call -- the main driver, right now, is the market dynamic going on.

Kevin Michael Kaczmarek - *Zelman & Associates LLC - Director*

Okay. But I think the market dynamic would say home prices are going up 60-ish percent. I would think that maybe you would have the fee per file up 4%. So I guess, I'm wondering should this 8% moderate to 4%, assuming all else equal over maybe the next few quarters or could it last for longer than that?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Well, we think that we should see roughly a similar ARPO that we saw this quarter for the next couple of quarters. Because some of these increases just went into effect over the last quarter or 2. So we'll still see a tailwind for the next couple of quarters. Eventually, when our initiative is finished, it'll moderate back to whatever the housing price increase is. But we should see some benefits for the next few quarters, at least.

Kevin Michael Kaczmarek - *Zelman & Associates LLC - Director*

Okay. That's helpful. I guess one more. On your agent network, can you talk about the growth there? Have you guys have been adding agents? If so, how fast. I think it has been a number of quarters that the agent revenue has been outpacing the previous quarters direct. So I just went looking for some color there?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Again, a little of both. We've actually been cutting some agents, we've been adding some agents. And that's something we do on a regular basis. So nothing new there. What we're really focused on is giving high-quality agents in the states we are operating and getting a larger share of their wallet. And we're doing a very good job there. And so I think the trends will continue. Very optimistic in our agent approach right now.

Operator

Our next question comes from the line of Bose George with KBW.

Bose T. George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Actually, just on the Home Warranty business, can you remind us what the normalized margin is in that business? And could this be the year when you're kind of back to normal?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

It depends on the severity of the summer months. So you start there, but normalize would it anywhere from low-single digits to mid-single digits. And again, if the summer months will drive it, if we have a really hot summer, we'll be under pressure. If we have, what we call, more of a mild summer, we'll have better margins.

Bose T. George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay, great. And then actually switching to the price changes that you mentioned, are there other, like, compliance-related reasons or other reasons that make it easier for making those changes?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

No, nothing material.

Bose T. George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. And then actually one last one on the loss provision. You said it was 4% for this year, is it safe to assume it's 4%, going forward?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Yes, that's right, Bose. I mean, as we sit here now, I mean, we're expecting a 4% loss ratio for the year, but as -- let's say, we always look at it and -- it could always go up or down.

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

We'll evaluate it every quarter, but it looks appropriate to us.

Operator

(Operator Instructions) Our next question comes from the line of John Campbell with Stephens, Inc.

John Robert Campbell - *Stephens Inc., Research Division - Research Analyst*

Just a 2-part question. As I think about the -- just from a premium standpoint, I guess, first, can you guys talk about just the price increases you've seen in some of the states? And whether you'd expect more of that this year or maybe next? And then secondly, I guess, maybe more difficult question. Do you guys ever worry that loss provision rates and even margins get too good, and the industry maybe faces pricing pressure from the regulators?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

Well, I'll start and hand it over to Dennis. I'd say the increases that have gone through were primarily in the Western State of California, Washington. That were the 2 states that we got the benefit off this quarter. And obviously, California is the largest state that we have. So we're going to continue to look at other states, but those are 2 that we really focused on recently. In terms of our margin, I mean, we have been focused on our 10% to 12% margin goal. And last year, we were at the higher end of that goal. This year, we've obviously got refi headwinds. But because of the loss provision coming down, we're hopeful that we can be at the high end of that goal again this year. And so we haven't really had a fear that our margins have gotten too high because we've been trying to improve them over recent years. But only time will tell.

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

And John on the second part of your question is, we approach pricing as we have for years on a state-by-state basis. We feel our returns are appropriate on a state-by-state basis.

Operator

Our next question comes from the line of Jason Deleeuw with Piper Jaffray.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

Just quick one on the tax rate going forward, any help you can give us there?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

34% is our best estimate, Jason. I know, lot of quarters, it has tended to be lower than that. But really 34% is our best estimate unless there's a one-time benefit that we got. There was accounting change that went into effect in Q1 of this year, so we're always going to have -- Q1 is going to be a more volatile tax rate. At the end of the day, if our stock rises through the year, we'll have a tax benefit like we did. If the stock falls, we'll have higher loss provision rate. But 34% is what we would expect for the rest of the year.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

Good. And then on commercial, just looking for little bit more color or just -- has there been any change in your outlook for commercial for the year? Because I believe last quarter, you guys were still pretty bullish on commercial, but I think the expectations were kind of flattish to slightly down. And I'm just wondering we did have commercial revenue at the national level up 2% this quarter. So any change in your outlook for commercial on the full year?

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Yes, Jason, no, not really. I mean, just from a conservative perspective, I still anticipate some modest decline for the full '17. I have been pretty consistent in that position for a number of years saying the market is going to continue to normalize. But with that said, strong first quarter, strong pipeline going into the second quarter. So outlook stays the same, but I'm optimistic in the year right now.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

And then the last one. What are the drivers or what types of claims are you getting right now. What are the key areas to call out in terms of refi versus commercial and lender versus borrower side? I mean, just where are the claims? What are kind of the key drivers of the claims right now?

Mark Edward Seaton - *First American Financial Corporation - CFO and EVP*

When you look at the mix of claims, I would say, they really haven't changed a lot other than the pool has been coming down at a fairly proportionate manner. So there's different way to slice it. 51% of our claims are owner's policies and 49% lender's policies. Right now, about roughly 60% of our claims come from the direct channel and 40% from the agency channel. And in terms of like the causes of claims due to the whole -- obviously, we get -- most of our claims come from just miscellaneous, the fraud. We certainly have fraud claims and (inaudible) claims. So there's a whole -- lots of different, obviously, sources that we can have claims. But I would say about 35-or-so percent comes from miscellaneous, that's the biggest bucket.

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

And Jason, we've done a really good job over the last number of years. Again, I mentioned it earlier, we've got a special investigation unit that does nothing but try to identify before they happen and try to prevent large claims that are associated with fraud. And I think it's making a material difference for us, and we've been at this for, again, a number of years with a sizable unit doing a lot of data analytic work with it.

Operator

There are no further questions at this time. I'd like to turn the floor back to management for closing comments.

Dennis J. Gilmore - *First American Financial Corporation - CEO and Director*

Thank you everybody. We look forward to a strong 2017.

Operator

This concludes this morning's call. We'd like to remind listeners that today's call will be available for replay on the company's website or by dialing (877) 660-6853 or (201) 612-7415 and entering the conference ID, 13658887. The company would like to thank you for your participation. This concludes today's conference call. You may now disconnect.
