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First American Financial Corp. (FAF)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the First American Corporation Q4 and Full-Year 2018 Quarter Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Craig Barberio, Vice President, Investor Relations. Thank you. You may begin.

Craig J. Barberio
Director, Investor Relations, First American Financial Corp.

Good morning, everyone, and welcome to our 2018 fourth quarter and year-end 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 forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made. Risk 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 today'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 operational efficiency and performance of the company 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 today's earnings release which is available on our website, www.firstam.com.

I will now turn the call over to Dennis Gilmore.

Dennis J. Gilmore

Chief Executive Officer & Inside Director, First American Financial Corp.

Good morning, and thank you for joining our call. Today, I will begin with a review of our fourth quarter and full-year results and then discuss our outlook for 2019.

Fourth quarter earnings per share were $0.81 or $1.27 excluding net realized losses primarily related to a decline in the fair value of our equity securities. Our earnings this quarter were largely driven by a combination of strength in our commercial business while our revenue was up 18% as well as rising investment income from our cash and investment portfolio.

Growth in our commercial business was broad-based across most markets, asset types and transaction size. In addition, growth in our commercial escrow balances had a positive effect on our investment income in the quarter.

Revenue from our residential purchase business fell 5%, and we saw a decline in open purchase orders of 4%. This trend continued in January as open purchase orders declined 4%. So far in February, orders are down 6% as recent severe weather across the country has had a negative impact on volumes.

Refinance revenue dropped 33% in the fourth quarter, as the market continued to adjust to increasing mortgage rates. Refinance revenue accounts for 8% of our direct revenue in the fourth quarter, down from 13% a year ago. Overall, our title segment posted a pre-tax margin of 10.4% this quarter or 14.2% excluding net realized investment losses.

Our home warranty business continues to deliver strong returns for our Specialty Insurance segment. However, our property and casualty business was once again impacted by California wildfires. This quarter, our property and casualty business had one wildfire event in Northern California that exceeded our $5 million reinsurance retention limit compared with two such events last year. As a result, the segment's overall loss ratio declined modestly to 62%, with a pre-tax margin of 0.7% or 8.5% excluding net realized investment losses.

Turning to full-year 2018, the company delivered earnings per share of $4.19 or 11% increase over last year. Our pre-tax title margin was 12.4% or 13.2% excluding net realized investment losses, the highest in our company's history.

With regards to capital management, we remained active in 2018, completing acquisitions valued at $83 million. The addition of FirstFunding, PCN Safe Escrow, and a complementary lien release business, enabled us to offer our customers new ways to reduce risk and increase efficiency. We raised our dividend by 11% and repurchased $21 million of our stock at an average price of $44.20. We continue to allocate our capital to opportunities with the highest risk-adjusted return.

Turning to our outlook, given the decline in residential orders, we have aggressively adjusted our cost structure to position ourselves for 2019. Net of acquisitions, we reduced our domestic title head count by 4.5% in the fourth quarter compared to last year. We believe we are staffed appropriately, given the current order trend, but we will continue to monitor market conditions closely and adjust as needed.

We anticipate that the ongoing decline in the purchase market will be a headwind in 2019, but will be partially offset by rising investment income. We also expect our commercial business will deliver another strong year.

In 2019, we expect to achieve our long-term financial objective of pre-tax title margins of 11% to 13% and a return on equity of 12% to 14%. As part of our growth strategy, during 2019, we will continue to focus on developing innovative solutions that improve the customer experience and increase our efficiency. These include the expansion of our digital closing services, further automation of our title production process and utilization of artificial intelligence to expand and leverage our extensive data assets.

In November, we launched the first blockchain platform in our industry. We anticipate that, over time, this platform will increase efficiency, reduce risk and improve the title production process. We also achieved a key milestone in 2018 when our bank, First American Trust, took its first deposits from our title agents. Providing banking services to our agents increases their efficiency and reduces risk. In addition, we benefit from increased investment income. We will continue to focus on these innovative efforts and others throughout 2019.

I'm proud of our company's financial and strategic achievements that produced a record year in 2018. Lastly, I'm pleased to announce this morning we've been named to Fortune's 100 Best Places to Work for the fourth year in a row. Our company's vision remains consistent, to be the premier title insurance and settlement service company for our employees, our customers and our shareholders.

I'd now like to turn the call over to Mark for more detailed review of our financial results.

Mark E. Seaton

Chief Financial Officer & Executive Vice President, First American Financial Corp.

Thank you, Dennis. I'll begin by commenting on an accounting change that took effect in the first quarter of 2018 and had a significant impact on our fourth quarter results. Our earnings per share was $0.81 this quarter, which includes net realized losses of $0.47.

Prior to 2018, unrealized changes in the fair value of both equity and debt securities were recorded on the balance sheet and excluded from net income. Generally, changes in fair value were only recorded in the income statement when an equity or debt security was sold.

Beginning in the first quarter of 2018, GAAP required that changes in the fair value of equity securities will be recorded in the income statement, regardless of whether they were sold. This new standard does not apply to fixed income securities. This accounting change will create more volatility in our earnings moving forward.

We believe changes in the value of our investment portfolio are important for investors over the long term. However, in a given quarter or year, they make it more difficult to assess our operating performance. Beginning this quarter, to provide additional disclosure to investors, we have included a table on page 10 of our earnings release, which provides detail on certain key metrics on a GAAP basis along with the reconciliation of these metrics, excluding the impact of net realized gains or losses. We believe these metrics are a more appropriate measure for investors to evaluate our operating performance.

In the title Insurance and Services segment, direct premium and escrow fees were up 1% compared with last year. This increase reflects a 17% increase in the average revenue per order largely offset by a 14% decline in the number of direct title orders closed.

The average revenue per order increased to $2,824, primarily due to the shift in the order mix to higher premium purchase and commercial transactions. The average revenue per order for commercial transactions increased 17% while the average revenue per order for purchase transactions increased 2%. Agent premiums, which are recorded on approximately a one-quarter lag relative to direct premiums, were down 3%. The agent split was 78.6% of agent premiums.

Information and other revenues totaled $183 million, down 3% compared with last year. Higher revenues from recent acquisitions were offset by lower revenues from the company's centralized lender business.

Investment income within the title Insurance and Services segment was $69 million, up 81%. The increase resulted from higher average balances due primarily to strengthen our commercial business and rising short-term interest rates that drove higher interest income in the company's investment portfolio and cash balances.

Higher short-term rates benefit our escrow deposits, operating cash, tax-deferred property exchange business in our bank where we held $4.1 billion in cash and debt securities as of December 31st.

Personnel costs were $426 million, up 3% from the prior year. This increase was primarily driven by severance expense and the impact of recent acquisitions.

Other operating expenses were $199 million, down 4% from last year. The decline was due to an increase in earnings credits, a reduction in discretionary spending and lower production and related cost due to the decline in order volume that was partially offset by a write-off of uncollectable balances and the impact of recent acquisitions.

The provision for title policy losses and other claims is $45 million or 4.0% of title premiums in escrow fees, unchanged relative to the prior year. The current quarter rate reflects an ultimate loss rate of 4.0% for the current policy year with no change in loss reserve estimates for prior policy years.

Pre-tax income for the title Insurance and Services segment was $136 million in the fourth quarter compared to $166 million in the prior year. Pre-tax margin was 10.4% compared with 12.2% last year. Excluding the impact of net realized investment losses, pre-tax margin was 14.2% this quarter compared to 12.4% last year.

Net expenses in the Corporate segment were $18 million, up 5% compared with last year due to lower investment income related to our deferred compensation plan. The effective tax rate for the quarter was 21.6%, lower than our normalized tax rate of 24% due primarily to true-ups of the 2017 estimates we had initially recorded for tax reform. Those benefits totaled $6.8 million for the quarter.

Cash provided by operations was $308 million, up 75% compared with last year. From October through the first week of January, we repurchased $21 million of shares at an average price of $44.20. Of this amount, $19 million occurred in the fourth quarter. Although we have not repurchased shares in February, we will continue to be opportunistic on buybacks moving forward.

Notes and contracts payable on our balance sheet totaled $732 million as of December 31st, which consists of $547 million of senior notes, $160 million on our credit facility, $19 million of trustee notes, and $6 million of other notes and obligations.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question is coming from Mark DeVries of Barclays. Please go ahead.

Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Yeah, thanks. I was hoping to get some additional color on outlook for title trends in 2019. In particular, I think you guys remain kind of cautious on the purchase market. What do you think really was driving the kind of inflection that deceleration in the last couple of months and why are you not optimistic that that kind of reverses course?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.
A

Sure, Mark. This is Dennis. Well if we look at the fourth quarter, our orders were down – orders on purchase were down 4%, been pretty consistent now for a few quarters and consistent going into January.

I think, and I've said it before, I believe that the market's just really in a process of resetting. We've got home price appreciation slowing. We've got the supply going up, days on market going up. So, to me, just it leads us to believe that the markets' in the process of resetting.

So when we look forward into the rest of 2019, we believe the purchase market will be under pressure. We expect it to be down slightly. And that's why we set the business up the way we did in the fourth quarter. We aggressively trimmed our expenses. So, again, our view right now is the purchase market will be down in 2019. If we're wrong on that call, it will be to our benefit. And I'll couple that with we do believe that the commercial market will be another strong year.

Mark C. DeVries
Analyst, Barclays Capital, Inc.
Q

Okay. And then just to follow up on that last comment, Dennis. I think, historically, you've been actually little more guarded around the outlook for the commercial, because it feels like almost every single year we're setting a new record and I think you justifiably assume that this can't continue. But here we are after another record year saying this continues. What are you seeing there that gives you comfort that that continues to be an area of strength?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.
A

I would just add, we had a great fourth quarter. We have a very strong franchise in commercial. Obviously, I'm biased. I think we have the best people and the best operation, but we had a strong, strong fourth quarter. We're up 18%. In the quarter, though, we also had a number of large deals versus a year ago. So large deals are always lumpy to us in any one quarter. But with that said, we were strong against property types, asset types, all deal sizes. We've got a good pipeline going into 2019. So, again, we're optimistic going into 2019. But I'll probably be consistent here. If I were to forecast, and we have, and we believe we'll be down slightly off of 2018's record.

Mark C. DeVries
Analyst, Barclays Capital, Inc.

Q

Okay. Got it. Thank you.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

Yes.

Operator: Thank you. Our next question is coming from Jason Deleeuw of Piper Jaffray. Please go ahead.

Jason S. Deleeuw
Analyst, Piper Jaffray & Co.

Q

Good morning and thanks for taking the question. I just wanted to follow up on the commercial. If you could give us any color in terms of regions of strength that you see. And then when you're looking at the pipeline for 2019, can you talk about the opportunities or what you're seeing in that pipeline for the large deals versus kind of the regular smaller-sized deals?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

Yeah. We were strong against really across the board here on size, type and location. A lot of the large deals are over in the New York area, so that was a strength for us in the fourth quarter. We have a good pipeline of large deals going into 2019. So again – but just to make sure we're clear, large deals are always lumpy and we benefited from large deals in the fourth quarter. But, again, we've got a strong pipeline going into 2019.

Jason S. Deleeuw
Analyst, Piper Jaffray & Co.

Q

Great. And then on the investment income, we had another fed rate hike in December. And can you help us think about any size increase in the investment income kind of from what we saw in the fourth quarter?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Yeah. Hi, Jason, this is Mark. So when the fed raised in December, we got a 25 basis point increase in the average rate that we're getting on our balances. So we got that. So I think everything else being equal, we would expect, as we've talked about in the past, the $15 million annualized benefit based off of that.

One thing that we do look at though is we know what happens with balances. Now, typically, our balances are higher in the fourth quarter, especially on commercial because there's a lot of commercial transactions that we're holding balances for. And balances are a little bit less in the first quarter. So we think investment income is definitely going to rise next year. It'll probably rise from Q1 to Q4 too, but just probably not the same growth rate as we saw from Q4 to Q3.

Jason S. Deleeuw
Analyst, Piper Jaffray & Co.

Q

Great. Thanks for that. Very helpful.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

Thanks, Jason.

Operator: Thank you. Our next question is coming from Mark Hughes of SunTrust Robinson Humphrey. Please go ahead.

Mark Hughes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Yeah. Thank you. The revenue per order on the purchase side went from kind of upper-single digits down to up 2%. Was that part of this resetting process or was there mix shift in there perhaps?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

There's a couple of things happening there. The first thing is it had – the rate of ARPO growth and purchase has been coming down. A lot of that was because we were raising rates two years ago, and now a lot of that has kind of washed out. So that has been reducing our average revenue per order. The other thing is we are – at least in the fourth quarter, we saw a little bit of a mix shift. Obviously, the ARPO in California is higher than other states and we saw a little bit of a mix shift. But the biggest driver is the fact that we're starting to lap the rate increases that we did over a year ago.

Mark Hughes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

And then on the capital management front, you repurchased some shares in the fourth quarter. Can you give us some sense of what you saw in the market? Obviously, the stock was down and more attractive, but whether the dynamic that informed your decision to be active again, does that continue here in February? That's the question.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

So we're pretty selective at the times that we choose to enter the buyback market. What we saw in October was our stock was down quite significantly. Some of that was because of the news that came on the heels of our earnings call, some of it was because we had disclosed our purchase order counts that were down and our stock was down quite significantly because of that.

We just felt like the dislocation in the market was too good to pass up. So, we were buying shares in October through the first week in January, and we feel really good about that. As I mentioned on the call, we're not buying in February, but it's something that we're always looking at, and we feel like it's a good thing for investors and we'll do it.

Mark Hughes
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Thank you.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

Thank you.

Operator: Thank you. Our next question is coming from John Campbell of Stephens Inc. Please go ahead.

John Campbell
Analyst, Stephens, Inc.
Q

Hey, guys. Good morning and congrats on a solid quarter in a pretty tough environment.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.
A

Thank you.

John Campbell
Analyst, Stephens, Inc.
Q

Just on the FNF and Stewart deal, they obviously hit a roadblock in New York. If they're selling or divesting some of the Stewart assets in the state, is that something you guys would look to take advantage of?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.
A

We put out the deal. Potentially, if they are the right assets for us, we'd potentially take a look at it for sure. But with regards to the overall deal, just so you understand how we're looking at it, we're more focused on our own plans not on that deal. We are really focused on innovation in the company to drive greater efficiencies and things of that nature. So, we're very focused on what we've got going on and we're very optimistic looking forward.

John Campbell
Analyst, Stephens, Inc.
Q

Okay. And then one more related to Stewart, I guess. You guys put up very good commercial growth. FNF did the same thing. Stewart's was down. I think it was down 8% year-over-year. Do you feel like you're taking share out there, or is it just kind of the lumpier deals go to you guys?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.
A

I can't comment if we directly took share from Stewart or not. But like I mentioned earlier, we have a very strong commercial franchise, and I think we do very well in that market.

John Campbell
Analyst, Stephens, Inc.
Q

Okay. And then last one for me. Mark, in the title segment on the increase in earnings credits, first, can you kind of size that up for us? And then, what exactly is that? Is that a one-time event?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

Yeah. So, let me just get that number for you. So, with earnings credits, this quarter in the title segment, we had about $9 million of credits. When you look at a year ago, it was about $3 million. And it's really just a function of balances.

As I've talked about, every time the Fed raises rates, we get higher interest rates. Some of that benefit comes through our investment income line item, which is revenue, and some of it in certain states comes as an offset to expenses, which hits like as an offset for other operating expenses. So, we not only see a growth in investment income, but we also see a growth in earnings credits, which we saw this quarter. So, it went up from about $3 million to $9 million this quarter.

John Campbell
Analyst, Stephens, Inc.

Q

Okay. So, that's not technically one-time. As rates rise, you get the benefit on both investment income on the revenue line and then offset the credits or...

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Correct.

John Campbell
Analyst, Stephens, Inc.

Q

... [ph] increase in credits (23:24). Okay.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Correct.

John Campbell
Analyst, Stephens, Inc.

Q

Great. Thanks, guys.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Thank you.

Operator: [Operator Instructions] Our next question is coming from Chris Gamaitoni of Compass Point. Please go ahead.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Thanks for taking my call. First on the buybacks, what's the remaining authorization following the January purchases?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

We have a $162 million available for repurchase as of the end of January.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

And can you quantify? Obviously, you kind of reached levels at the business in the residential side for a lower purchase outlook, what was the severance impact in the fourth quarter?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

It was $9 million in the fourth quarter. Typically, we have a $1 million or $2 million each quarter, so there's always some level. But this quarter was higher, was about $9 million.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Perfect. And relative to the weakness you're seeing in the purchase market, are there any specific geographies that are noticeably weaker or noticeably stronger than others, just thinking about kind of your business mix in your direct business?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

Well, this is Dennis. When we talk about our direct orders, again, we have a bias towards the Western part of the country. But we're definitely seeing the weakness in the Western states. That would probably be the driver right now. But, again, overall, the market, our take right now is slowing and probably will continue to be in the range we're seeing right now.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Okay. And are we at a point where your increased usage of AI for data collection, other opportunities can start to bend the cost curve a little bit? Do you have a sense of relative impact or is it still too early?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

It's definitely early, but we're moving aggressively utilizing AI in our data business to expand our databases and make it more dynamic for us to rendering more efficient title decisions. So I think we're going to start to see those impacts in 2019 and 2020, and we're going to continue to be very, very focused on the innovative efforts across the enterprise right now.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC

Q

Okay. And one last one, what percentage of the information Other is for centralized business at this point? Obviously, refinancings were down a lot last year, while it'll still be low, just the comp year-over-year is a lot easier this year.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

We can get that for you offline, Chris.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC
Q

Yeah.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

I would say it's a minority of it. It's not the majority. If you're just talking about our centralized lender business, I don't have it off-hand, but it's less than half [indiscernible] (26:18), but we can get that for you.

Chris Gamaitoni
Analyst, Compass Point Research & Trading LLC
Q

Thank you so much.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.
A

Thank you.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

Thanks, Chris.

Operator: Thank you. Our next question is coming from Bose George of KBW. Please go ahead.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Hey, guys. Good morning. See, first, just on the investment income, so what's the break-out there between commercial versus residential in terms of the escrow?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

Bose, are you talking about investment income?

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Yeah, for investment income, right.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.
A

Well, it's difficult to break out because when we look at investment income, we don't really track it by business. It's more by fixed income and escrow deposits and the earnings we get from the bank. But one of the things that we do track is just balances and what percentage of our escrow balances come from commercial. And it's about 70% of our escrow balances are commercial. Now, there is more investment income than we get than just from our escrow balances, right? There's our general account portfolio. But about 70% of our escrow balances are commercial.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, great. That's helpful. And then, actually just going back to the tax rate, so going forward, is 24% the number we should use for 2019 onwards?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Yes, I think that's still our normalized tax rate. Now, when you look over the last couple years, it's been – well, certainly, we've been coming in below what we've disclosed as our normalized tax rate because we seem to get benefits. We got $6.8 million of benefits this quarter. So I think 24% is the normalized rate. I think in 2019, I would expect that we would get some more discrete benefits that would cause the rate to be lower than that. But on a normalized basis, I think 24% is the right number.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. But just for modeling, probably use something slightly lower for 2019?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

I think so, yes.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thanks. And the next...

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Bose, it could be 22% or 23% for 2019 just because we do expect to get a few more discrete benefits. But on a normalized basis after that, 24%.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, great. That's helpful. And then just actually in the Corporate segment, it looked like there was a loss in investment income and sort of an offset in the personnel. Was there just some noise there?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Yeah, that's really our deferred compensation plan. And so, what we saw in the fourth quarter was the equity markets really fell off. I think the S&P, off the top of my head, was down 14%. And so, when we see that, we'll see a decline in our investment income and we'll see a completely offsetting decline in our personnel costs. And the same thing will happen when the market rebounds as it has in January. So those two move [indiscernible] (29:03), but our pre-tax earnings shouldn't be affected by that.

Bose George
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, great. Thanks.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Thanks, Bose.

Operator: Thank you. Our next question is coming from Geoffrey Dunn of Dowling & Partners. Please go ahead.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Thanks. I wanted to revisit the commercial market. Understanding that you can have lumpiness in the large deals, it still looks like there's been pretty consistent deal size inflation over the last several years. So I was curious, Dennis, what's your expectation? Just in terms of deal pricing inflation, as you look out on 2019 and 2020, it doesn't seem like that's being checked at all and that the average fee profile could potentially continue to grow?

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

I think it can. And again, a lot of that is going to be driven by the size of the deal though. But I think it could grow again in 2019.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. I mean, I understand fourth quarter was affected. But if you look at any of the last several years, it just seems a general trend of strength. So it would seem that unless something is jumping out at you to change that that we probably are continuing to look at growth.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

I think that's correct. I think it will continue to grow.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. And then do you have your 1031, as well as your escrow balances at year-end? Mark, was that the $4.1 billion? Was that comparable to the $4.4 billion last quarter?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Give me a second, Geoff. At year-end, what I have in front of me is average balances, which is a little bit different than year-end. I think the easiest thing is when we file the K next week, we can have our 1031 balances there.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

On an average basis in Q4, our 1031 was $2.3 billion, but that's on average. At the end of the year, it was $2.7 billion for 1031. On escrow, our escrow balances at year-end were $3.6 billion.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

$3.6 billion, okay. And then last question. Obviously, you have the benefit of investment income, you have the headwind from purchase volume. Looking at Q1 2019, put that all together, can you outdo Q1 2017 on both an EPS and margin basis?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Q1 2017?

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

I'm sorry, Q1 2018? It's a year-over-year, given purchase headwinds, which we really haven't seen for a while.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

Let me start that answer.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

I'm curious how the first quarter might shape up for you.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

Let's start that answer more on a whole year basis right now. I mean yeah, we think there will be headwinds in the purchase market. We've sized the business accordingly for that headwind.

We've also think we'll get strength, a continued strength for the year in commercial and in investment income, and a lot of the innovative issues we're attacking right now. So overall, Geoff, we think that there'll be revenue pressure but we think we'll still hit our long-term pre-tax margins of 11% to 13% for the company.

Now, if Mark wants to comment on the quarter itself?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Similar comments in terms of the Q1 2019 versus Q1 2018. I mean, again, we're seeing decline in purchase, decline in refi offset by an increase in investment income. I think we should see a quarter of Q1 2019 is very, very similar to Q1 of 2018.

Geoffrey Murray Dunn
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thanks.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Thanks, Geoff.

Operator: Thank you. Our next question is coming from John Campbell of Stephens. Please go ahead.

John Campbell
Analyst, Stephens, Inc.

Q

Hey, guys, one more from me. On the accounting change, that's obviously pretty noisy right now. Mark, I appreciate all the details in the back of the report. I think that's very helpful.

But just curious, have you guys considered just reporting on a GAAP EPS number and then also an adjusted number that backs all of that out? Are you guys just, I guess, continue to call it out just on the headlines like you've done in this report?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Well, I think that what we've tried to do, John, in the headline of our EPS with GAAP was $0.81 in the headline of our release. We talked about $1.27. Are you talking about doing something in addition to that?

John Campbell
Analyst, Stephens, Inc.

Q

Yeah. Just maybe just an alternative EPS report out where, I mean, you will have consensus and it'll provide an apples to apples. I mean, we can do all the work, it's just a little noisy. I mean there was a 60% swing between your GAAP number and what the actual core business did, right?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Yeah, we can take that into consideration, John. I think, unfortunately, we're going to have this volatility in our GAAP earnings because of this, and it really didn't affect us Q1, Q2, Q3 because there wasn't a big difference between our GAAP and adjusted number, but it was so significant in the fourth quarter, we felt like we had to make these additional disclosures. But we'll take your thought into consideration.

John Campbell
Analyst, Stephens, Inc.

Q

Great. Thanks, guys.

Dennis J. Gilmore
Chief Executive Officer & Inside Director, First American Financial Corp.

A

Thank you.

Operator: Thank you. Our next question is coming from Mark Hughes of SunTrust Robinson Humphrey. Please go ahead.

Mark Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Mark, you had mentioned a write-off of uncollectible balances. Was that much different than the normal this quarter?

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

I would say that item was. So, we had basically a $7 million write-off of a receivable, we just didn't feel like we could collect, as I mentioned. In terms of other one-time items this quarter, I mentioned the severance of $9 million. But we also had tax benefits of $6.8 million. So everything kind of washed out for the quarter. But, yes, we did have that unusual write-off of a receivable.

Mark Hughes
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you.

Mark E. Seaton
Chief Financial Officer & Executive Vice President, First American Financial Corp.

A

Thank you.

Operator: Thank you. This brings us to the end of our question-and-answer session. We'd like to thank everyone for their participation today. You may disconnect your lines at this time, and have a wonderful day.