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FAF.N - Q2 2025 First American Financial Corp Earnings Call

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OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Craig Barbero *First American Financial - VP of Investor Relations*

Mark Seaton *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Matthew Wajner *First American Financial Corp - Vice President, Treasurer*

CONFERENCE CALL PARTICIPANTS

Mark DeVries *Deutsche Bank AG - Analyst*

Mark Fedorcik *Deutsche Bank - Analyst*

Maxwell Fritzer *Truist Securities - Analyst*

Terry Ma *Barclays Capital, Inc. - Analyst*

Bose George *KBW - Analyst*

PRESENTATION

Operator

Greetings, and welcome to the First American Financial Corporation Second 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 will be available for replay from the company's investor website and for a short time by dialing (877) 660-6853 or (201) 612-7415 and enter the conference ID 13754701.

We will now turn the call over to Craig Barberio, Vice President, Investor Relations, to make an introductory statement.

Craig Barbero - *First American Financial - VP of Investor Relations*

Good morning, everyone, and welcome to First American's earnings conference call for the second quarter of 2025.

Joining us today on the call will be our Chief Executive Officer, Mark Seaton; and Matt Wajner, 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.

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 yesterday'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 financials, please refer to yesterday's earnings release, which is available on our website at www.firstam.com.

I will now turn the call over to Mark Seaton.

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Thank you, Craig. And thank you to everyone joining our call. Today, I will provide a brief review of our earnings, discuss our market outlook and conclude with some thoughts on capital management.

Today, we announced our second quarter adjusted earnings per share of $1.53. This result includes the impact of $0.12 per share related to executive separation costs. Our earnings were strong despite continued challenges in the U.S. housing market.

Our performance this quarter was highlighted by continued strength in our commercial business. Commercial revenue was up 33%, and we set an all-time record in our National Commercial Services division for fee per file in a quarter. We are seeing broad-based strength in Commercial again this quarter, led by industrial, which includes data center transactions and multifamily. We're also seeing a continued shift toward refinance in commercial.

Historically, our revenue was roughly 30% refinanced but this quarter, it was 46%. The sales, underwriting, closing and operations teams that drive our commercial business are the best in the industry. They deal with complex multisite, multistate, and sometimes, cross-border transactions, while skillfully underwriting risk and providing amazing service and transparency to our clients. Our commercial business also drives much of our escrow deposits, which helped drive investment income.

Investment income grew 17% this quarter. Investment income at our bank, in particular, continues to be a countercyclical earnings driver, while the residential market is at the trough. The residential side of our business continues to navigate through difficult market conditions. Our purchase revenue declined 3%, driven by lower demand for new homes. It's been a tough purchase market for the last 3 years, due primarily to home affordability issues and elevated mortgage rates.

But as purchase volumes return to the trend line, we are very well positioned given our operating leverage and strength with local real estate professionals who drive purchase volumes. Refinance revenue was up 54% this quarter, but it's growing off a low base and represents just 5% of our direct revenue. The opened orders we are seeing in July tell a similar story to what we have experienced so far this year with strong commercial activity outpacing a sluggish residential market. For the first 3 weeks in July, our open purchase orders are down 8%, while our refinance orders are up 29%. Commercial orders are up 13% so far this month, setting us up well for a strong back half of the year.

Our Home Warranty business posted very strong results. Our pretax income was up 35%, driven by a lower loss rate, and we continue to drive revenue growth through our direct-to-consumer channel.

This quarter, we ramped up our share repurchases. And in July, our Board of Directors approved a new $300 million share repurchase authorization. We are at the very beginning of the next cycle. And are poised to outperform given our unique assets and the productivity improvements we expect to achieve related to our investments in data, technology and AI.

Now I would like to turn the call over to Matt for a more detailed review of our financial results.

Matthew Wajner - *First American Financial Corp - Vice President, Treasurer*

Thank you, Mark. This quarter, we generated GAAP earnings of $1.41 per diluted share. Our adjusted earnings, which exclude the impact of net investment losses and purchase-related intangible amortization was $1.53 per diluted share. Both our GAAP and adjusted earnings include a $13 million or $0.12 per diluted share onetime expense related to executive separation costs, which was recorded in the corporate segment.

Revenue in our Title segment was $1.7 billion, up 13% compared with the same quarter of 2024. Commercial revenue was $234 million, a 33% increase over last year. Our closed orders increased 2% from the prior year, and our average revenue per order was up 30% due to continued broad-based strength across both asset class and transaction size. Purchase revenue was down 3% during the quarter, driven by a 6% decline in closed orders, partially offset by a 2% improvement in the average revenue per order.

Refinance revenue was up 54% compared with last year due to a 44% improvement in closed orders and a 7% increase in the average revenue per order. Refinance accounted for just 5% of our direct revenue this quarter and highlights how challenged this market continues to be with mortgage rates hovering between 6.5% and 7%.

In the Agency business, revenue was $717 million, up 16% from last year. Given the reporting lag in agent revenues of approximately 1 quarter these results primarily reflect remittances related to first quarter economic activity. Information and other revenues were $264 million during the quarter up 10% compared with last year, primarily due to our Canadian operations, continuing to see higher refinance activity.

Investment income was $147 million in the second quarter, up $21 million compared with the same quarter of last year, primarily due to higher interest income from the company's investment portfolio and an increase in average interest-bearing deposit balances, partially offset by the Fed cutting rates by 100 basis points in the second half of 2024.

The provision for policy losses and other claims was $39 million in the second quarter or 3.0% of title premiums and escrow fees, unchanged from the prior year. The second quarter rate reflects an ultimate loss rate of 3.75% for the current policy year and a net decrease of $10 million in the loss reserve estimate for prior policy years. Pretax margin in the title segment was 12.6% or 13.2% on an adjusted basis.

Turning to the Home Warranty segment. Total revenue was $110 million this quarter, up 3% compared with last year. The loss ratio was 41%, down from 46% in the second quarter of 2024. The improvement in the loss ratio was driven by lower claim frequency, which was partially offset by higher claims severity. Pretax margin in the Home Warranty segment was 20.2% or 20.7% on an adjusted basis.

The effective tax rate in the quarter was 24.6%, which is slightly above the company's normalized tax rate of 24%. Our debt-to-capital ratio was 32.1%, excluding secured financings payable, our debt-to-capital ratio was 23.1%. In the second quarter, we repurchased 1 million shares for a total of $61 million at an average price of $57.95. So far in July, we repurchased 577,000 shares for $32 million at an average price of $56.19.

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

QUESTIONS AND ANSWERS

Operator

Thank you.

Mark DeVries with Deutsche Bank

Mark DeVries - *Deutsche Bank AG - Analyst*

Could you describe the source of strength in the commercial ARPO that you're seeing and how the transactions that drove you to that outcome compared to what's in your pipeline today?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Yes. Sure thing, Mark. Thanks for the question. The interesting thing is commercial, we definitely look at the order counts and order counts are up, and it's setting us up for good back half of the year. But what matters a lot more is the fee per file.

And when you look at our commercial revenue growth this quarter, our revenue is up 33%. We're closing the same amount of orders we did last year.

Our orders are only up 2%. But the fee per file for commercial is up 30%. So to your point, I mean, we're getting a lot more high-quality and just higher liability transactions. And it's coming from a broad array of asset classes. Our biggest asset class this quarter was industrial.

Our second biggest was multifamily. We're seeing a lot of data center deals. We closed 11 transactions with a premium over $1 million. So we're getting a lot of big deals, but Commercial is also driven by just the smaller commercial deals, and we're seeing a lot of those come through, too.

So I would just say it's hard to pinpoint one thing. It's just real broad-based strength that we're seeing and we're getting a lot of high-quality deals, and we feel really good about our pipeline heading into the second half of the year. And one thing that's going to help us, too, is this one big beautiful bill, I mean, there were certain tax incentives that are going to go away for certain renewable energy credits next year.

And so we think there's going to be kind of acceleration of deals that closed in Q4 to take advantage of those credits. So I think we're pretty positive about the outlook. Now the one thing, too, is the comps are going to get tougher here because we had a really strong back half last year, really strong Q4. But we feel really good about the outlook for commercial for the rest of this year.

Mark DeVries - *Deutsche Bank AG - Analyst*

Okay. Great. And you also referred to kind of an increase in the percentage of commercial that's coming from refi. What's causing that? Is this somewhat of a secular change?

Or is there just some kind of cyclical component to this?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

It's a cyclical component. I mean there's been a lot of -- there was a lot of refinance business back in 2020, 2021, a lot of deals that were happening. And there was talk of this refi wall in commercial, where there was going to be this 18- to 20-month -- 24-month period where there's just a lot of refinance deals we're going to happen in commercial.

And we're seeing that. We're right in the middle of that. So when you look at the long-term trend in commercial, I mean you don't have these 30-year mortgages. You've got 5-, 7-year mortgages, sometimes 10-year mortgages. So it's a little bit lumpier and we're overweight refi now.

But eventually, that will get back to the normalized trend line of 30%.

Mark DeVries - *Deutsche Bank AG - Analyst*

Okay. And that's helpful. Just you mentioned you think we're kind of in the middle of that wall. How much longer do you think it kind of extends before it becomes a bit of a headwind?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Probably another year. It's hard to tell, but we're -- it's been sort of ramping up over the last year, and we think we probably got another year to go. It won't last forever, but we're definitely in the middle of it.

Mark Fedorcik - *Deutsche Bank - Analyst*

Okay, great.

Thank you.

Operator

Maxwell Fritscher with Truist Securities

Maxwell Fritzer - *Truist Securities - Analyst*

On for Mark Hughes. You had pointed to the higher refinance activity in Canada. What is your judgment on the durability there? And maybe could you size the contribution from that quarter?

Matthew Wajner - *First American Financial Corp - Vice President, Treasurer*

Yes. Thanks for the question. This is Matt. We expect the refi business in Canada to be strong for the remainder of the year. So -- the growth that we've seen in info and other is largely driven by Canada and the refi business they're seeing.

And the growth that we saw this quarter is a good proxy for the growth that we expect to see for the full year.

Maxwell Fritzer - *Truist Securities - Analyst*

And then moving to Home Warranty. How do you see the competitive environment there? And then what are your observations around the loss environment? You had called out lower frequency. Was that driven by weather or any other underlying factors you're seeing?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Well, there's a lot of competitors in Home Warranty, but we got a great team, and we continue to grow our business even despite the fact that the real estate markets are challenged. I would say with Home Warranty, they had a really good result this quarter. A lot of things went right. Frequency of claims was down. It's down for a couple of reasons.

One, we did have favorable weather conditions, so that always helps.

And the second thing I would say is we have fewer contracts in force now than we did a year ago just because of -- we've got 2 channels, the real estate channel, the direct-to-consumer channel. The real estate channel is down just like everything else, but the direct-to-consumer channel is growing, but we have fewer contracts. You have fewer contracts, you have fewer claims. So frequency is down. And because frequency is down, we can push our claims to our higher-quality contractors.

And so we're able to kind of hold the line with severity and frequencies down.

And as a result, we have a lower claims ratio. I'd say the other thing that happened is of all the businesses that we have, Home Warranty is the one we were a little bit worried about inflation pressures because we're buying HVAC equipment and different things. And those were going to be subject to inflation. So a year ago, we raised our prices in anticipation of inflation on the cost side of things.

And so -- but we haven't really seen the inflation yet. So we're sort of getting the benefit of the price increases we put in, haven't seen inflation yet on the claims side, but we feel like it's coming. It's lagged. We feel like it's going to kind of come here in the back half of the year. But those are a combination of things that kind of led to really strong loss ratios this quarter.

Maxwell Fritzer - *Truist Securities - Analyst*

Understood. Thank you for taking my questions.

Operator

Terry Ma with Barclays

Terry Ma - *Barclays Capital, Inc. - Analyst*

Hey, thank you, good morning, I wanted to start off on the margin. It obviously came in pretty strong this quarter. I think it was up about 140 basis points year-over-year. I guess, as we kind of look forward to the second half of the year, how sustainable is that, particularly if commercial kind of remain strong?

Matthew Wajner - *First American Financial Corp - Vice President, Treasurer*

Terry, this is Matt. Thanks for the question. Yes, like as you noted, we had a -- we posted a strong margin this year. For the first half of this year, if you compare it to the first half of last year, we're up about 220 basis points in margin year-to-date.

And as Mark mentioned earlier, really the back half, the comparisons are going to get to be a lot more challenging. So we feel like we're -- we believe we're going to finish the full year out with improved margins compared to last year, but I think that gap that you just mentioned is going to start to narrow in the second half of the year.

Terry Ma - *Barclays Capital, Inc. - Analyst*

Got it. That's helpful. Do you have any updates on the technology investments, Sequoia and Endpoint in the sense of kind of like rollouts and success rates?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Yes. Thanks, Terry. We're still making really good progress on both fronts, on both Endpoint and Sequoia. I would just say that we've got great teams. We're really making progress on developing the products.

I think in terms of end point, we're working on implementing the technology throughout our entire branch network. And we're in the very early stages of that. We're going to start piloting the new technology in an office in December, and we're going to start putting it in the hands of our direct operations at some point in the first quarter, and we'll see how it goes.

So the technology, it's working. We think it's going to really improve things on a lot of different fronts. We'll talk more about this when we actually have some data to show. But the national rollout is going to start in Q1, and we'll kind of take it from there.

I think on the Sequoia side, we're making -- we're still making really good progress. We're in 3 markets right now. We've piloted it and it's tough to have instant decisioning for purchase. It's very difficult, but we've been keeping -- every time we get a hurdle, we keep jumping over it. And I think we're going to get there at one point.

So with Sequoia, we're still building out our capabilities to provide instant decisioning for purchase transactions. So we're building out the capabilities. We're laying the groundwork to roll it out through all of California. So we're making those plans now.

And one thing about if you can automate the purchase transaction, you can automate the refinance transaction. So with Sequoia, we're also kind of rolling out our refinance automation in September. So we're making really good progress on both fronts. They're both long term. They're not going to -- we're not going to -- our margin is not going to jump dramatically next quarter or the quarter after that.

But when we look out 2 or 3 years, we feel like these are going to be differentiated solutions relative to the industry, and we're really excited about it. So we'll talk more about it when we have some more tangible progress after we can actually demonstrate what we've done, not really in a lab or in a pilot, but more of a -- in the broader company.

Terry Ma - *Barclays Capital, Inc. - Analyst*

Thank you.

Operator

Bose George with KBW.

Bose George - *KBW - Analyst*

Sorry, guys, I'm on mute. Sorry. Just following up on the question on margins. It makes sense that the gap will narrow in the back half of the year. But just looking at your 13.2% margin you did this quarter.

Is any reason the margin in the third quarter should be lower than that? I mean it just looks like the trends are similar. So could we expect a similar number in the third quarter?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Well, I think a big part of that is it's really going to depend on the strength of the commercial business, right? Again, we set records in Q2. I think that there's a chance it could be higher. I don't think that's our expectation right now. But -- because I think when you look at the typical seasonal trend, Q3 might be on par with Q2.

But we had such a strong Q2 in commercial.

If we have something like that or stronger in Q3, I think there's a chance that we can approach that, but that's not our expectation right now. So it really just -- it's just going to depend on commercial, I think, is going to be the biggest driver, and that's a little bit unknown right now. It's going to be strong. We're just not sure how strong.

Bose George - *KBW - Analyst*

TYes. Okay. No, great. That's helpful. And then just switching to the regulatory front.

Can you just give us any update on the FHFA title pilot? Have you interacted with Bill Pulte, just any color there?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Yes. Thanks, Bose. The pilot is -- it's underway with Fannie. It's very limited in scope and duration. It's only for refinance transaction, and it's only for a subset of refinance transactions.

It's low LTVs, in certain states. The property has to be free and clear of any prior liens and encumbrances. So we're really talking about the lowest risk of all refinance transactions. And we're monitoring the pilot, and we're going to see how things go.

We have been in touch with Director Pulte. We've been in touch with his office. And we're in communication with Fannie and Freddie, too. So we responded to the RFP, not with a title waiver solution. We responded with a title insurance solution.

And that's not the direction they wanted to go at the time. And so we're definitely monitoring the situation. We'll see how things develop.

Bose George - *KBW - Analyst*

Okay, great. And then just in terms of the way -- so just with the pilot, I guess, it's supposed to go to, I guess, later next year. So the way this plays out is FHA presumably waits now for the pilot to be done and then decide at some point in late '26, how to proceed from here?

Mark Seaton - *First American Financial Corp - Chief Financial Officer, Executive Vice President*

Yes. So it goes the rest of this year and through 2026 and it's a pilot, and so they'll evaluate the results and whether it was successful or not and then make a determination at some point after that.

Matthew Wajner - *First American Financial Corp - Vice President, Treasurer*

And I would just say, too, I mean we're not involved in the pilot at this point. But we have -- if this is the way the market decides to go, I mean, we've got very unique assets with our -- just with our data, our title plans, we've got higher coverage than anybody else, and we have our distribution network as -- this is a title waiver pilot, but you still have to close the transaction.

And given our distribution network and our underwriting expertise, I mean, I think we've got real advantages if this is the way the market decides to go.

Operator

Thank you. And there are no additional questions at this time. That 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.
