

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

FIRST AMERICAN FINANCIAL CORP
Form 10-Q/A
November 19, 2001

FORM 10-Q/A

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

AMENDMENT NO. 1
to
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2001

THE FIRST AMERICAN CORPORATION

(Exact name of registrant as specified in its charter)

The undersigned registrant hereby amends Item 1 of Part 1 of its Quarterly Report on Form 10-Q for the period ended September 30, 2001, as set forth in the pages attached hereto.

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to be signed on its behalf by the undersigned duly authorized officer.

THE FIRST AMERICAN CORPORATION

(Registrant)

/s/ Thomas A. Klemens

Thomas A. Klemens
Executive Vice President
Chief Financial Officer

/s/ Max O. Valdes

Max O Valdes
Vice President
Chief Accounting Officer

Date: November 15, 2001

Part I: Financial Information

Item 1: Financial Statements

THE FIRST AMERICAN CORPORATION
AND SUBSIDIARY COMPANIES

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

 Condensed Consolidated Balance Sheets

| | September 30, 2001 (unaudited) |
|--|-----------------------------------|
| | ----- |
| Assets | |
| Cash and cash equivalents | \$ 596,733,000 |
| Accounts and accrued income receivable, net | 281,158,000 |
| Income tax receivable | |
| Investments: | |
| Deposits with savings and loan associations and banks | 33,087,000 |
| Debt securities | 253,766,000 |
| Equity securities | 52,162,000 |
| Other long-term investments | 110,423,000 |
| | ----- |
| | 449,438,000 |
| Loans receivable | 105,089,000 |
| Property and equipment, at cost | 750,216,000 |
| Less- accumulated depreciation | (287,734,000) |
| | ----- |
| | 462,482,000 |
| Title plants and other indexes | 303,859,000 |
| Assets acquired in connection with claim settlements (net of valuation reserves of \$1,101,000 and \$1,000,000) | 30,126,000 |
| Deferred income taxes | 16,166,000 |
| Goodwill and other intangibles, net | 431,954,000 |
| Other assets | 102,367,000 |
| | ----- |
| | \$ 2,779,372,000 |
| | ===== |
| Liabilities and Stockholders' Equity | |
| Demand deposits | \$ 92,018,000 |
| Accounts payable and accrued liabilities | 334,508,000 |
| Deferred revenue | 279,112,000 |
| Reserve for known and incurred but not reported claims | 303,864,000 |
| Income taxes payable | 58,383,000 |
| Notes and contracts payable (Note 5) | 422,239,000 |
| Minority interests in consolidated subsidiaries | 126,628,000 |
| | ----- |

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

| | |
|--|------------------|
| Mandatorily redeemable preferred securities of the Company's subsidiary trust whose sole assets are the Company's \$100,000,000 8.5% deferrable interest subordinated notes due 2012 | 100,000,000 |
| <hr/> | |
| Stockholders' equity: | |
| Preferred stock, \$1 par value | |
| Authorized - 500,000 shares; outstanding - none | |
| Common stock, \$1 par value | |
| Authorized - 180,000,000 shares | |
| Outstanding - 68,300,000 and 63,887,000 shares | 68,300,000 |
| Additional paid-in capital | 264,112,000 |
| Retained earnings | 730,500,000 |
| Accumulated other comprehensive income | (292,000) |
| | <hr/> |
| | 1,062,620,000 |
| | <hr/> |
| | \$ 2,779,372,000 |
| | <hr/> |

See notes to condensed consolidated financial statements.

2

THE FIRST AMERICAN CORPORATION
AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Income and Comprehensive Income

(Unaudited)

| | For the Three Months Ended September 30 | | |
|---|--|----------------|--------|
| | 2001 | 2000 | |
| Revenues | | | |
| Operating revenues | \$ 952,776,000 | \$ 730,490,000 | \$ 2,6 |
| Investment and other income | 30,232,000 | 19,770,000 | |
| | <hr/> | <hr/> | <hr/> |
| | 983,008,000 | 750,260,000 | 2,6 |
| Expenses | | | |
| Salaries and other personnel costs | 331,727,000 | 260,250,000 | 9 |
| Premiums retained by agents | 255,384,000 | 192,803,000 | 6 |
| Other operating expenses | 216,854,000 | 176,845,000 | 6 |
| Provision for title losses and other claims | 52,661,000 | 36,764,000 | 1 |
| Depreciation and amortization | 27,820,000 | 22,790,000 | |
| Premium taxes | 6,758,000 | 5,396,000 | |
| Interest | 8,449,000 | 6,655,000 | |
| | <hr/> | <hr/> | <hr/> |
| | 899,653,000 | 701,503,000 | 2,4 |
| Income before income taxes and minority interests | 83,355,000 | 48,757,000 | 2 |
| Income taxes | 30,500,000 | 19,000,000 | |

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

| | | | |
|---|---------------|---------------|------|
| Income before minority interests | 52,855,000 | 29,757,000 | 1 |
| Minority interests | 11,160,000 | 5,358,000 | |
| Net income | 41,695,000 | 24,399,000 | 1 |
| Other comprehensive income, net of tax | | | |
| Unrealized gain (loss) on securities | (4,152,000) | 1,115,000 | |
| Minimum pension liability adjustment | (75,000) | 175,000 | |
| | (4,227,000) | 1,290,000 | |
| Comprehensive income | \$ 37,468,000 | \$ 25,689,000 | \$ 1 |
| Net income per share (Note 2): | | | |
| Basic | \$.61 | \$.38 | \$ |
| Diluted | \$.55 | \$.37 | \$ |
| Cash dividends per share | \$.07 | \$.06 | \$ |
| Weighted average number of shares (Note 2): | | | |
| Basic | 67,844,000 | 63,526,000 | |
| Diluted | 78,872,000 | 66,088,000 | |

See notes to condensed consolidated financial statements.

3

THE FIRST AMERICAN CORPORATION
AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

| | For the Nine Months September 30, 2001 |
|--|---|
| Cash flows from operating activities: | |
| Net income | \$ 114,988,000 |
| Adjustments to reconcile net income to cash provided by operating activities- | |
| Provision for title losses and other claims | 129,676,000 |
| Depreciation and amortization | 77,925,000 |
| Minority interests in net income | 30,697,000 |
| Other, net | (14,189,000) |
| Changes in assets and liabilities excluding effects of company acquisitions and noncash transactions- | |
| Claims paid, including assets acquired, net of recoveries | (113,069,000) |

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

| | |
|---|----------------|
| Net change in income tax accounts | 75,253,000 |
| Increase in accounts and accrued income receivable | (71,788,000) |
| Increase (decrease) in accounts payable and accrued liabilities | 56,561,000 |
| Increase (decrease) in deferred revenue | 15,269,000 |
| Other, net | (19,115,000) |
| | ----- |
| Cash provided by operating activities | 282,208,000 |
| | ----- |
| Cash flows from investing activities: | |
| Net cash effect of company acquisitions/dispositions | (15,407,000) |
| Net increase in deposits with banks | (1,063,000) |
| Net increase in loans receivable | (10,637,000) |
| Purchases of debt and equity securities | (154,974,000) |
| Proceeds from sales of debt and equity securities | 53,397,000 |
| Proceeds from maturities of debt securities | 55,537,000 |
| Net decrease in other investments | 4,560,000 |
| Capital expenditures | (96,311,000) |
| Proceeds from sale of property and equipment | 1,766,000 |
| | ----- |
| Cash used for investing activities | (163,132,000) |
| | ----- |
| Cash flows from financing activities: | |
| Net change in demand deposits | 10,729,000 |
| Proceeds from issuance of debt | 210,000,000 |
| Repayment of debt | (22,357,000) |
| Proceeds from exercise of stock options | 9,173,000 |
| Repurchase of company shares | |
| Distributions to minority shareholders | (17,392,000) |
| Cash dividends | (13,401,000) |
| | ----- |
| Cash provided by (used for) financing activities | 176,752,000 |
| | ----- |
| Net increase (decrease) in cash and cash equivalents | 295,828,000 |
| Cash and cash equivalents - Beginning of year | 300,905,000 |
| | ----- |
| - End of third quarter | \$ 596,733,000 |
| | ===== |
| Supplemental information: | |
| Cash paid during the three quarters for: | |
| Interest | \$ 18,525,000 |
| Premium taxes | \$ 14,353,000 |
| Income taxes | \$ 22,622,000 |
| Noncash investing and financing activities: | |
| Shares issued for stock bonus plan | \$ 225,000 |
| Shares issued for employee savings plan | \$ 8,283,000 |
| Liabilities incurred in connection with company acquisitions | \$ 36,750,000 |
| Purchase of minority interest | \$ 1,203,000 |
| Company acquisitions in exchange for common stock | \$ 78,376,000 |

See notes to condensed consolidated financial statements.

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

Note 1 - Basis of Condensed Consolidated Financial Statements

The condensed consolidated financial information included in this report has been prepared in conformity with the accounting principles and practices reflected in the consolidated financial statements included in the annual report filed with the Securities and Exchange Commission for the preceding calendar year. All adjustments are of a normal recurring nature and are, in the opinion of management, necessary to a fair statement of the consolidated results for the interim periods. This report should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

Note 2 - Earnings Per Share

| | For the Three Months Ended September 30 | | |
|--|--|---------------|-----|
| | 2001 | 2000 | |
| Numerator: | | | |
| Net Income-numerator for basic net income per share | \$ 41,695,000 | \$ 24,399,000 | \$1 |
| Effect of dilutive securities | | | |
| Convertible debt - interest expense (net of tax) | 1,783,000 | -- | |
| Net Income-numerator for dilutive net income per share | \$ 43,478,000 | \$ 24,399,000 | \$1 |
| Denominator | | | |
| Weighted average shares-denominator | | | |
| For basic net income per share | 67,844,000 | 63,526,000 | |
| Effect of dilutive securities: | | | |
| Employee stock options | 2,418,000 | 2,562,000 | |
| Convertible debt | 8,610,000 | -- | |
| Denominator for diluted net income per share | 78,872,000 | 66,088,000 | |
| Basic net income per share | \$ 0.61 | \$ 0.38 | \$ |
| Diluted net income per share | \$ 0.55 | \$ 0.37 | \$ |

For the three and nine months ended September 30, 2001, 4,000,398 and 2,564,285 stock options, respectively, were excluded from the computation of diluted earnings per share due to their antidilutive effect.

Note 3 - Business Combinations

In May 2001, the Company acquired Credit Management Solutions, Inc (CMSI), a provider of credit automation software and services in a stock-for-stock transaction. As a result of the acquisition, CMSI shareholders received 0.2841

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

newly issued shares of the Company's common stock for each CMSI share. The Company issued 2,272,542 shares of common stock and accounted for this transaction under the purchase method of accounting. Goodwill of \$46.9 million was recorded and is being amortized on a straight-line basis over its estimated useful life of 25 years. The Company has included CMSI in its consumer information segment.

Assuming the acquisition had occurred on January 1, 2000, pro forma revenues, net income and net income per diluted share would have been \$2.69 billion, \$112.4 million and \$1.48 respectively for the nine months ended September 30, 2001; and \$2.19 billion, \$47.6 million and \$.70, respectively for the nine months ended September 30, 2000. The pro forma results include amortization of goodwill. The pro forma results exclude certain merger-related costs and are not necessarily indicative of the operating results that would have been obtained had the acquisition occurred at the beginning of the period, nor are they indicative of future operating results.

5

In addition, during the nine months ended September 30, 2001, the Company acquired twelve companies. The purchase method of accounting was used for all of the acquisitions. The twelve acquisitions accounted for under the purchase method of accounting were individually not material and are included in the following business segments: ten in the title insurance segment, one in the real estate information segment and one in the consumer information segment. The aggregate purchase price was \$17.4 million in cash, \$12.5 million in notes payable and forgiven notes receivable and 976,235 shares of the Company's common stock. The purchase price of each was allocated to the assets acquired and liabilities assumed based on estimated fair values and approximately \$44.4 million in goodwill was recorded. Goodwill is being amortized on a straight-line basis over its estimated useful life ranging from 20 to 30 years. The operating results of these acquired entities were included in the Company's consolidated financial statements from their respective acquisition dates.

Assuming all of the current-year acquisitions (including CMSI) had occurred January 1, 2000, pro forma revenues, net income and net income per diluted share would have been \$2.71 billion, \$111.7 million and \$1.46, respectively for the nine months ended September 30, 2001 and \$2.21 billion, \$48.8 million and \$.71, respectively for the nine months ended September 30, 2000. All pro forma results include amortization of goodwill and interest expense on acquisition debt. The pro forma results exclude certain merger-related costs and are not necessarily indicative of the operating results that would have been obtained had the acquisitions occurred at the beginning of the periods presented, nor are they indicative of future operating results.

In February 2001, the Company announced the sale of its subsidiary, Contour Software, Inc., to Ellie Mae(SM), Inc., in exchange for cash, notes and an interest in Ellie Mae. As a result of the transaction, the Company recorded a deferred gain of \$14.2 million. Contour had been included in the Company's real estate information segment.

On July 20, 2001, the Financial Accounting Standards Board ("the FASB") issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"). This statement addresses financial accounting and reporting for business combinations and superseded APB Opinion No. 16, "Business Combinations". All business combinations in the scope of SFAS 141 are to be accounted for using one method, the purchase method. The provisions of SFAS 141 apply to all business combinations initiated or closed after June 30, 2001. Management of the Company anticipates that the adoption of SFAS 141 will not have a significant effect on the Company's earnings or financial position.

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

On July 20, 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). This statement addresses financial accounting and reporting for goodwill and other intangible assets and supersedes APB Opinion No. 17, "Intangible Assets". SFAS 142 addresses how goodwill and other intangible assets should be accounted for in the financial statements. Goodwill and intangible assets that have indefinite useful lives will not be amortized, but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will continue to be amortized over their useful lives, but without the constraint of an arbitrary ceiling. The provisions of SFAS 142 are required to be applied starting with fiscal years beginning after December 15, 2001, and apply to all goodwill and other intangible assets recognized in the financial statements at that date. Goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the nonamortization and amortization provisions of SFAS 142. Management is in the process of assessing the impact of implementing SFAS 142 on the Company's earnings and financial position. Management estimates the adoption of the nonamortization provision of SFAS 142 will increase income before income taxes and minority interests in 2002 by \$18.0 million, or \$.20 per diluted share, excluding the effects of impairment, if any.

Note 4 - Segment Information

The Company's operations include three reportable segments. Selected financial information about the Company's operations by segment is as follows:

Operating revenues:

| | Three Months Ended September 30 | | | | Nine Months September | | |
|-------------------------|------------------------------------|-----|------------|-----|--------------------------|-----|---------|
| | 2001 | | 2000 | | 2001 | | 2000 |
| | (\$000) | % | (\$000) | % | (\$000) | % | (\$000) |
| Title Insurance | 693,235 | 73 | 521,998 | 71 | 1,870,045 | 72 | |
| Real Estate Information | 181,042 | 19 | 141,501 | 20 | 527,736 | 20 | |
| Consumer Information | 78,499 | 8 | 66,991 | 9 | 213,188 | 8 | |
| Total | \$ 952,776 | 100 | \$ 730,490 | 100 | \$ 2,610,969 | 100 | \$ |

6

Income before income taxes and minority interests:

| | Three Months Ended September 30 | | | | Ni | | |
|-----------------|------------------------------------|----|-----------|----|------------|---|---------|
| | 2001 | | 2000 | | 2001 | | 2000 |
| | (\$000) | % | (\$000) | % | (\$000) | % | (\$000) |
| Title Insurance | \$ 38,004 | 38 | \$ 30,543 | 50 | \$ 120,185 | | |

Edgar Filing: FIRST AMERICAN FINANCIAL CORP - Form 10-Q/A

| | | | | | |
|---------------------------------|-----------|-------|-----------|-------|------------|
| Real Estate Information | 50,112 | 51 | 19,915 | 33 | 126,298 |
| Consumer Information | 10,742 | 11 | 10,347 | 17 | 24,278 |
| | ----- | ----- | ----- | ----- | ----- |
| Total before corporate expenses | 98,858 | 100 | 60,805 | 100 | 270,761 |
| | ===== | ===== | ===== | ===== | ===== |
| Corporate expenses | (15,503) | | (12,048) | | (41,876) |
| | ----- | | ----- | | ----- |
| Total | \$ 83,355 | | \$ 48,757 | | \$ 228,885 |
| | ===== | | ===== | | ===== |

Note 5 - Senior Convertible Debentures

On April 24, 2001, the Company sold \$175 million of 4.5% senior convertible debentures due 2008. The Company also sold an additional \$35 million of these debentures in connection with the exercise of an over-allotment option. This transaction was a private placement pursuant to Rule 144A and Regulation S under the Securities Act of 1933. The Company registered the debentures and any common shares issued upon conversion on August 8, 2001. The debentures are convertible into common shares of the Company at \$28 per share. The Company may redeem some or all of the senior convertible debentures at any time on or after April 15, 2004. The net proceeds of the offering will be used to finance acquisitions of businesses, repay outstanding indebtedness, buy out minority interests in existing subsidiaries and for general corporate purposes.