

First Advantage Corporation

Tough 4Q & guide; potential M&A screens accretive

Reiterate Rating: NEUTRAL | PO: 17.00 USD | Price: 15.81 USD

EPS & guide falls short; merger announced

FA's 4Q23 EPS missed on sales and margins amid a still tough labor market. 2024 guidance was also lackluster. FA announced an agreement to acquire Sterling Check (STER), a background screening competitor, for \$2.2bn. The deal implies a 12x LTM EBITDA multiple, compared to HireRight's 9.3x take-out multiple. FA targets a 3Q24 close. We like that the potential deal will provide FA with more diversification, scale, synergies and additional employment and income records data. However, the deal will leave FA with much higher leverage and there's always some execution risk with M&A. We reiterate our Neutral rating. We think valuation factors in its sluggish sales due to the tougher labor market, offset by up-sell/cross sell momentum and strong cost control.

4Q EPS missed expectation under challenging macro

4Q's \$0.29 EPS was below our/the Street's \$0.31/0.30. The miss was driven by lower sales (organic (6.1)% vs. our/the Street's (2.5)/(4.6)%E) and EBITDA margins (33.7% vs. our/the Street's 34.3%/33.9%E). FA introduced \$0.88-0.98 2024 EPS guide on (2)-5% sales and 30.4-31.0% EBITDA margins. The Street's was at +6.4%E and 32.0%E. The guide excludes the pending acquisition of STER. We reduce our 2024 EPS by 10c to \$0.96 on a lower sales outlook. We roll forward our valuation to 2025 estimates and raise our PO to \$17 on a higher multiple (11x vs. 10x prior). We apply a higher multiple to give FA credit for its ongoing strong cost control in a tough environment.

Merger accretive, but raises leverage

STER plans to fund the deal with 27.15mn shares and a \$1.8bn loan. Post-deal, FA's net leverage will be ~4x (vs. 4Q's 1.5x) and management plans to focus on delevering post-deal (2-3x net leverage target). FA guided to \$50mn of cost synergies (11% upside to combined EBITDA) w/in 18-24 mos. with room for upside. We estimate the deal would be ~7/18% accretive in yrs 1/2 assuming synergies are realized over 18 months. We were pleased to hear that FA will take a cautious approach to integration to avoid customer attrition.

Seeing early green shoots in APAC/India

FA's sales miss was largely due to peak Americas hiring season ending earlier than mgmt expected. On a positive note, cross/upsell and new customer growth remained strong. Management has called out early signs of stabilizations in India/APAC in 4Q.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.03	1.00	0.96	1.05	1.22
GAAP EPS	0.43	0.26	0.42	0.69	0.87
EPS Change (YoY)	2.0%	-2.9%	-4.0%	9.4%	16.2%
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	15.3x	15.8x	16.5x	15.1x	13.0x
GAAP P/E	36.8x	60.8x	37.6x	22.9x	18.2x
EV / EBITDA*	10.3x	10.8x	10.5x	9.8x	9.0x
Free Cash Flow Yield*	8.0%	5.9%	6.9%	9.2%	8.1%

* For full definitions of *IQmethod*SM measures, see page 4.

04 March 2024

Equity

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Stock Data

Price	15.81 USD
Price Objective	17.00 USD
Date Established	4-Mar-2024
Investment Opinion	B-2-9
52-Week Range	10.90 USD - 17.49 USD
Mrkt Val (mn) / Shares Out (mn)	2,292 USD / 145.0
Free Float	34.6%
Average Daily Value (mn)	5.25 USD
BofA Ticker / Exchange	FA / NAS
Bloomberg / Reuters	FA US / FA.OQ
ROE (2024E)	14.6%
Net Dbt to Eqty (Dec-2023A)	38.4%
ESGMeter™	NLA

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Timestamp: 04 March 2024 12:36AM EST

iQprofileSM First Advantage Corporation

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	10.5%	9.9%	10.5%	10.1%	10.4%
Return on Equity	13.9%	14.3%	14.6%	14.6%	15.0%
Operating Margin	11.6%	10.7%	14.2%	19.0%	20.8%
Free Cash Flow	184	135	158	211	186

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.4x	1.1x	1.4x	1.4x	1.2x
Asset Replacement Ratio	0.2x	0.2x	0.3x	0.1x	0.4x
Tax Rate	24.1%	23.1%	23.1%	23.1%	23.1%
Net Debt-to-Equity Ratio	14.6%	38.4%	19.6%	1.0%	-13.7%
Interest Cover	4.4x	2.9x	3.6x	5.8x	8.7x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	810	764	775	825	891
% Change	13.7%	-5.7%	1.4%	6.5%	8.0%
Gross Profit	401	377	381	407	440
% Change	11.4%	-6.0%	1.1%	6.7%	8.2%
EBITDA	249	238	244	262	285
% Change	10.0%	-4.6%	2.6%	7.3%	8.9%
Net Interest & Other Income	(1)	(18)	(10)	(6)	2
Net Income (Adjusted)	156	146	139	153	177
% Change	9.9%	-6.8%	-5.0%	10.3%	15.8%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	65	37	61	99	126
Depreciation & Amortization	138	129	114	84	76
Change in Working Capital	7	(3)	(1)	17	(5)
Deferred Taxation Charge	5	(19)	0	0	0
Other Adjustments, Net	(1)	19	14	16	18
Capital Expenditure	(29)	(28)	(31)	(5)	(29)
Free Cash Flow	184	135	158	211	186
% Change	47.5%	-26.7%	16.8%	33.8%	-11.9%
Share / Issue Repurchase	(61)	(54)	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	(1)	0	(1)	(3)	(1)

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	392	214	371	552	737
Trade Receivables	144	143	145	170	183
Other Current Assets	31	17	17	23	25
Property, Plant & Equipment	114	79	52	49	47
Other Non-Current Assets	1,206	1,177	1,121	1,072	1,027
Total Assets	1,886	1,631	1,706	1,866	2,019
Short-Term Debt	0	3	3	0	0
Other Current Liabilities	101	82	83	130	140
Long-Term Debt	557	558	560	564	566
Other Non-Current Liabilities	102	80	72	64	56
Total Liabilities	759	724	719	758	762
Total Equity	1,127	907	987	1,108	1,257
Total Equity & Liabilities	1,886	1,631	1,706	1,866	2,019

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Business Services

Company Description

First Advantage is a leading global provider of technology solutions for background screening, verifications, safety, and compliance related to human capital. Revenue is primarily transactional in nature, with the majority coming from pre-employment background checks.

Investment Rationale

We have a Neutral rating. We think FA has an attractive longer-term growth story given secular trends, its focus on high-growth customer verticals, and the potential for further industry consolidation. However, we expect sales to remain sluggish in a slowing labor market.

Stock Data

Average Daily Volume

332,031

Quarterly Earnings Estimates

	2023	2024
Q1	0.19A	0.16E
Q2	0.24A	0.21E
Q3	0.28A	0.27E
Q4	0.29A	0.31E

Price objective basis & risk

First Advantage Corporation (FA)

Our \$17 price objective is based on 11.0x 2024E EV/EBITDA (vs. 10.0x 2024E EV/EBITDA prior). This is a 0.5x premium to its current multiple, as well as peers. We see valuation upside on earnings beats, but we think it will be limited given sales pressures from more challenging labor market trends. We also think a premium to peers is warranted given FA's higher margins and stronger balance sheet.

Downside risks to our PO: 1) economic cyclicality, 2) risks related to the company's data (reliance on third parties, data security), 3) high sponsor ownership that limits the float, 4) limited M&A track record, 5) potential need for increased investment, 6) more stringent regulatory environment, 7) moderate customer concentration, and 8) post-employment monitoring not gaining traction.

Analyst Certification

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US - Business, Education & Professional Services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Alight Inc	ALIT	ALIT US	Heather Balsky
	APi Group	APG	APG US	Heather Balsky
	Aramark	ARMK	ARMK US	Heather Balsky
	Cintas	CTAS	CTAS US	Heather Balsky
	CoStar Group	CSGP	CSGP US	Heather Balsky
	Dun & Bradstreet Holdings, Inc.	DNB	DNB US	Heather Balsky
	Equifax	EFX	EFX US	Heather Balsky
	Gartner	IT	IT US	Heather Balsky
	Moody's Corp.	MCO	MCO US	Heather Balsky
	S&P Global	SPGI	SPGI US	Heather Balsky
	Strategic Education	STRA	STRA US	Heather Balsky
	Thomson Reuters	YTRI	TRI CN	Heather Balsky
	Thomson Reuters	TRI	TRI US	Heather Balsky
NEUTRAL				
	FactSet Research Systems Inc	FDS	FDS US	Heather Balsky
	First Advantage Corporation	FA	FA US	Heather Balsky
	Verisk Analytics	VRSK	VRSK US	Heather Balsky
UNDERPERFORM				
	ASGN Inc.	ASGN	ASGN US	Heather Balsky
	Clarivate PLC	CLVT	CLVT US	Heather Balsky
	ManpowerGroup	MAN	MAN US	Heather Balsky
	MSCI Inc	MSCI	MSCI US	Heather Balsky
	Robert Half	RHI	RHI US	Heather Balsky
	TransUnion	TRU	TRU US	Heather Balsky



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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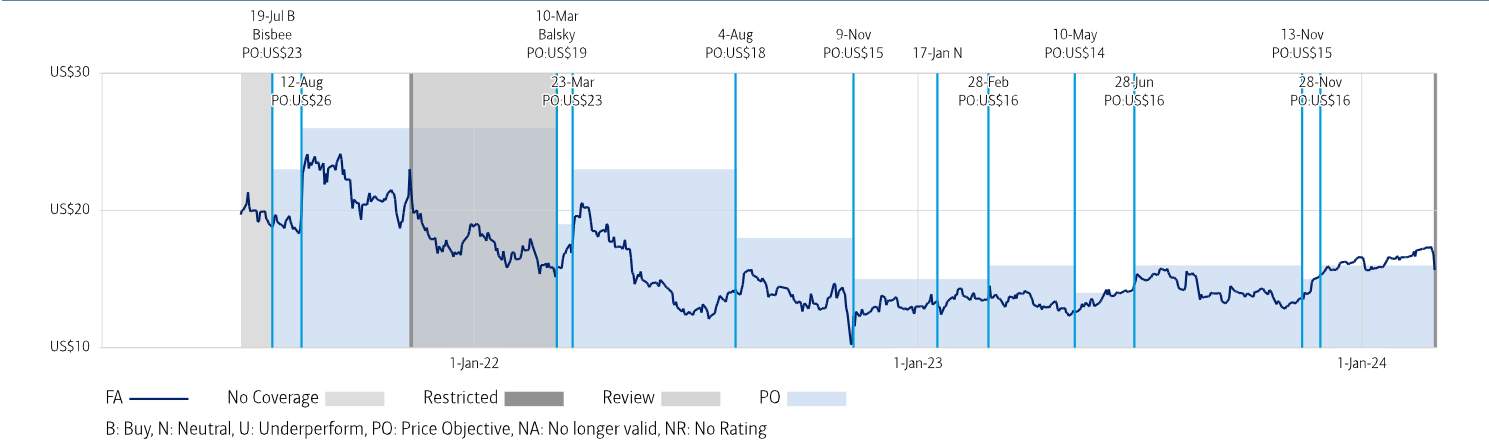
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First Advantage Corp (FA) Price Chart



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Equity Investment Rating Distribution: Business Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	26	55.32%	Buy	17	65.38%
Hold	8	17.02%	Hold	3	37.50%
Sell	13	27.66%	Sell	11	84.62%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Underperform	N/A	≥ 20%

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