JCAP

Global
Short Ideas

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Ebix Inc. (EBIX US)

Keep Those Plates Spinning

- **Over the past five years,** Ebix's gross and net margins have consistently and rapidly deteriorated, and the company has relied upon frequent and large accounting tricks to achieve EPS growth. The magnitude of the aggressive accounting has accounted for between 15-18% of EPS in recent years. In the years 2012-2015, consensus EPS would not have been met without the aid of accounting trickery.

- **Ebix is providing low-end services,** not the high-value insurance-management software the company claims to offer. Consequently, profit and revenues are actually eroding despite the aggressive reporting. Organic growth at Ebix is negative.

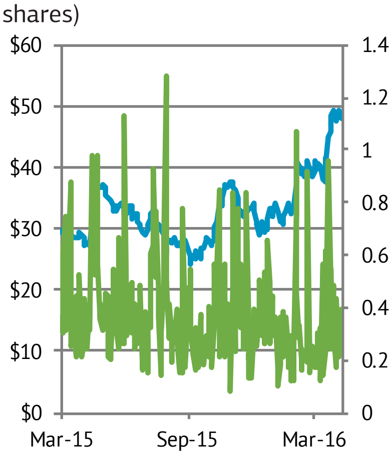
- **The company is using acquisitions** to create the appearance of profit growth by reversing high earn-outs into earnings.

- **The company is under-paying its taxes** and is under investigation by the IRS.

Ebix Corp. (EBIX US)

Price	USD 48.12
Market Cap	USD 1.62B
Rating	SELL
Price Target	**USD 13.69**
Difference	**72%**
Avg. Volume (3m)	317,408
P/E	21.11X

Ebix (EBIX US) last share price in USD (blue) and volume (pink, in mln shares)



Source: Bloomberg

Fact and Fiction

Table 1. EPS Impact

	2015	2014	2013	2012	2011
Consensus EPS	$2.23	$1.64	$1.45	$1.78	$1.71
Reported EPS	$2.29	$1.68	$1.58	$1.91	$1.89
After Tax Impact of Earnout Reversals	$0.04	$0.22	$0.23	$0.02	$0.07
After Tax Impact of Capitalizing Opex	$0.29	$0.08	$0.01	$0.08	$-
After Tax Impact of Valuation Allowance Reduction	$0.06	$-	$-	$-	
Total Aggressive Accounting Benefits	$0.39	$0.30	$0.24	$0.10	$0.07
As % of Reported EPS	17.1%	17.7%	15.2%	5.0%	3.9%
EPS Without Aggressive Accouting	$1.90	$1.38	$1.34	$1.81	$1.82

Source: J Capital Research

I hesitate to summarize for you Ebix's performance as I will spend the next several pages explaining why very little of what is said or reported about the company is actually true. Nonetheless, you deserve some introduction, so allow me to summarize what the company thinks it is and how it has done.

Ebix Inc. sells software solutions and services to clients in the insurance, healthcare, and financial services sectors. Ebix software provides the back-end support which allows, for example, an insurance company to manage agency infrastructure, to match clients with carriers on an insurance exchange, and to monitor employee compliance with regulatory requirements. The software is often licensed to clients for one- to two-year terms. The company also derives revenue from fees associated with implementation, training, project management and business process outsourcing. Ebix claims that nearly 80% of its revenues are derived from returning customers.

Ebix was founded in San Diego, operates out of Atlanta, and is registered in Delaware.

Ebix was founded in San Diego, operates out of Atlanta, and is registered in Delaware. The company trades on the NASDAQ and is currently valued at USD 1.3 billion. In the its most recent 10-K, Ebix highlighted that it had achieved revenues of USD 265.5 mln, a staggering 23.9% increase over prior year revenues. In fact, revenue growth as reported by Ebix has been nothing short of spectacular, vaunting a 12% CAGR for the period 2011 to 2015.

Equally impressive was the company's 17% growth in net income over the prior year. Its EPS has grown at a CAGR of 4.5% in the same five-year period. A quick scan of the financial statements seems to support all of Ebix's claims of outstanding financial performance in its space.

However, a deeper dive into the numbers behind the highlights reveals that Ebix management is furiously spinning plates with a talent seen by only the most experienced of jugglers. How long before all of the plates come crashing down?

- Ebix is a failed and failing business. Its margins and cash flow have deteriorated consistently over the past five years;
- The company has embarked on a roll-up strategy in an effort to hide the fact that organic growth has been declining;
- Cash flow is trending downward and has become increasingly volatile in recent years;
- Ebix has been under investigation by the U.S. Department of Justice and the Securities and Exchange Commission for several years. While it has recently settled issues with the IRS, its reported tax payments suggest further problems;
- Corporate governance is weak, if not non-existent.

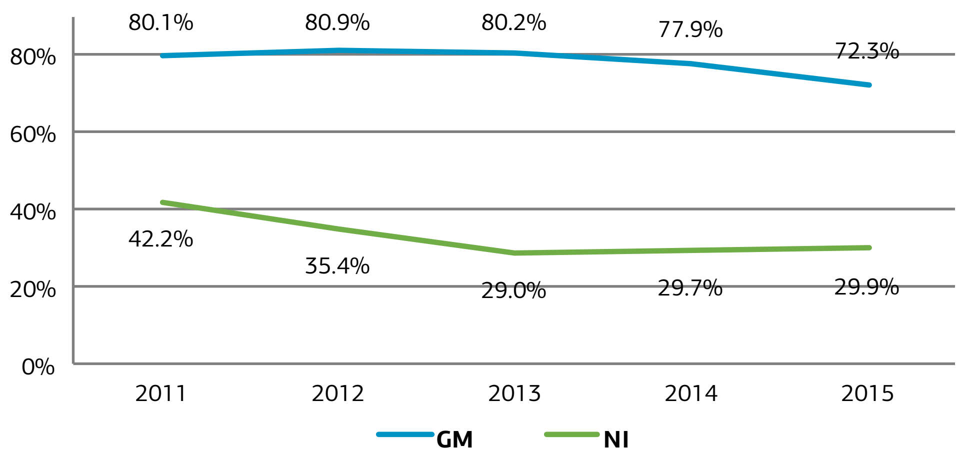
The motor of this apparent strength masking a weakening foundation in acquisition. Ebix has pursued a roll-up acquisition strategy by acquiring small to medium-sized businesses in various domestic and emerging-market locations. The funding for the M&A activity has come both from internally generated cash and a long-standing revolving line-of-credit from a syndicate of banks led by Regions Bank. In late 2015, Ebix took the option of an accordion feature within the revolver to increase the amount available under the revolver to USD 240 million. The acquisitions are dressed up as technology acquisitions so that the company can achieve valuations similar to those of technology and software 'peers.' Then, Ebix typically commits to huge earn-outs so that it can later reverse them into earnings in years to support EPS. Yet despite huge reversals of earn-outs and poor margin performance, the company has not taken a goodwill impairment in years. The company claims that it has cut costs out of the acquired businesses, but a review of its "other assets" reveals that Ebix is just capitalizing these costs onto the balance sheet.

No Matter How You Look at It, Ebix Is Not a Pretty Sight

Over the past five years, Ebix performance has deteriorated considerably across several key metrics.

- Gross Margin has collapsed by 800 basis points.
- Net Income Margin has fallen 1,230 basis points, despite the fact that the company has decreased its effective tax rate (to be discussed later) down to an unbelievable 8.1%.

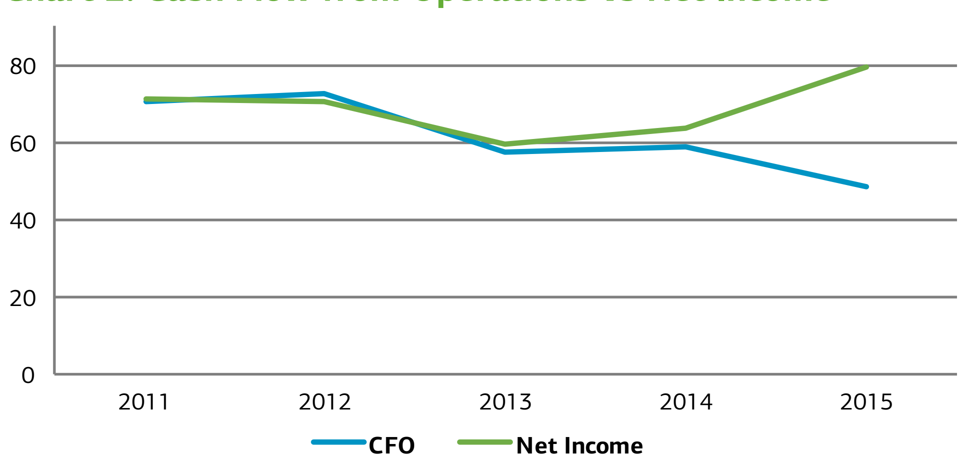
Chart 1. Gross & Net Margin Trend



Source: Company reports, J Capital Research

- The gap between what Ebix reports as Net Income and what translates to Operating Cash Flow has widened every year. As of 2015, the cash conversion ratio (CFO/ NI) is an abysmal 61%.

Chart 2. Cash Flow from Operations vs Net Income



Source: Company reports, J Capital Research

The principal method Ebix has used to hide or minimize the impact of its rapidly and consistently deteriorating financial condition is its aggressive M&A rollup strategy, or as we prefer to call it, the "lipstick on pigs" program.

Putting Lipstick on Acquired Pigs, Part 1: Hiding Declining Revenues

Over the last five years, Ebix has acquired nearly 20 companies for more than USD 200 million. While Chairman and CEO Robin Raina points to the ability of these companies to expand the company's software portfolio and extend its reach into new segments, a central rationale for these acquisitions is to mask the fact that Ebix's core business is experiencing sizable declines in revenue.

Ebix celebrates that fact that its historical revenue trend points to a healthy 12% CAGR for the period 2011 to 2015. For good measure, revenue jumps in 2011 and 2015 exceeded 20%.

Table 2. Reported Revenue Trends

	CAGR 2011-2015	2015	2014	2013	2012	2011
Revenue	12.0%	265.5	214.3	204.7	199.4	169
% Growth		23.9%	4.7%	2.7%	18.0%	27.8%

Source: Company reports

But the reported revenue trend does not provide a breakout of Organic versus Acquired revenues. The company provides limited historical data for its acquired companies, but it does include in Note 4, current year and prior year pro forma results. We have therefore examined pro forma results as provided for the last five years and determined that on a pro forma basis, revenues have actually declined in the last 5 years.

Excluding non-recurring items, revenues are declining

We determined that in 2015 and 2013, pro forma revenues declined by 3.0% and 4.4% respectively. We also noted that in 2014 and 2012, pro forma revenues were flat at 1.0% and 1.2%. The only year of pro forma revenue growth was in 2011, where the company realized a 2.8% increase. Using this data, we then computed a 2011-2015 CAGR for pro forma Revenues [(1.028) * (1.012) * (0.9556) * (1.01) * (0.97)] – 1].

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Table 3. Pro Forma Revenue Trend

Year	Pro Forma Revenues in Reporting Year	Pro Forma Revenues in Prior Reporting Year	% Change
2015	272.2	280.5	-3.0%
2014	262.7	260	1.0%
2013	205.6	215	-4.4%
2012	212.4	209.8	1.2%
2011	179.1	174.3	2.8%
CAGR 2011-2015			**-2.5%**

Source: J Capital Research

Ebix, in fact, on a pro forma basis has recorded pro forma revenue losses over the last five years at a CAGR of (2.5%), which is in sharp contrast to 12% CAGR using revenues as reported.

In fact, if we use 2011 revenue as a starting point and reduce revenues by 2.5% each year until 2015, we see that, of the USD 265.5 million reported in 2015, only USD 153.0 million or 58% was derived from comparable organic sales. The remainder was generated by a string of acquired companies.

Table 4. Organic and Acquisition Revenues

	CAGR 2011-2015	2015	2014	2013	2012	2011
Reported Revenue	12.0%	265.5	214.3	204.7	199.4	169
% Growth		23.9%	4.7%	2.7%	18.0%	27.8%
Growth Profile of Organic Business as Suggested by Pro Formas		-2.5%	-2.5%	-2.5%	-2.5%	-2.5%
Organic Revenues	-2.5%	153.0	156.8	160.8	164.8	169.0
Acquistion Revenues		112.5	57.5	43.9	34.6	-
Organic Revenues as % of Total		57.6%	73.2%	78.5%	82.7%	100.0%

Source: J Capital Research

So while Ebix points to its revenue growth trajectory as one of the reasons it should command a 21x P/E multiple, what it fails to highlight is that its core software business is flagging. The growth is coming from the company's ability to tack on revenues from recently acquired entities.

The acquired companies provided even further support to Ebix's financial statements however.

Putting Lipstick on Pigs, Part 2: Reversing Earn-Outs

Aside from the sheer volume of transactions for a company of its size and the staggering sums paid in purchase prices, considering Ebix itself has assets of USD 680 mln, the common theme throughout Ebix's acquisition history has been the added feature of earn-outs. In fact, in several acquisitions, the agreed earn-outs were many times larger than the initial purchase price.

Table 5. Ebix Acquisitions

Date	Acquired Company	Purchase		Earn-Out	Earnout Period
6/1/2015	PB Systems	$12.4	cash	$8.0	24 months
3/1/2015	Via Media Health	$1.0	cash	$0.4	12 months
12/1/2014	DCM Group (d.b.a. I3 Software)	$2.0	cash	$4.0	24 months
11/3/2014	Vertex Incorporated	$27.3	cash	$2.0	24 months
5/21/2014	HealthCare Magic	$6.0	cash	$12.4	24 months
1/27/2014	CarePet Inc.	$7.7	$6.35M cash/$1.35M forgiven AR	$5.0	36 months
1/1/2014	Oakstone	$23.7	cash		
4/7/2013	Qatarlyst Limited (UK-based)	$5.0	cash	Not disclosed	36 months
6/1/2012	PlanetSoft	$40.0	$35M cash/ $5M instock		
6/1/2012	Fintechnix	$4.7			
4/1/2012	Taimma	$5.0			
3/1/2012	BSI	$1.0			
11/15/2011	Health Connect Solutions	$18.0	cash	$2.0	24 months
2/7/2011	A.D.A.M	$3.5			
9/30/2010	USIX Technologies, SA (Brazil) /PTE Lty ('E-trek') Singapore	$8.5	cash	$6.4	24 months
6/30/2010	Connect Technology Inc. (Houston) /Trades Monitor (Australia)	$4.1	cash	$4.5	24 months
3/31/2010	MCN Techonologies (Brazil)	$3.0	cash	$2.0	24 months

Date	Acquired Company	Purchase		Earn-Out	Earnout Period
10/1/2009	E-Z Data	$50.0	$25M cash/ $25 stock		
		$222.9		**$40.1**	

Source: Company reports

While the earn-outs are agreed to at the point of purchase, there is no guarantee that they will be paid. In fact in over the last several years, the company has not paid out on many of these earn-outs. By not paying out on the earn-outs, Ebix is able, thanks to the accounting for contingent consideration, to reverse the earn-out back into earnings as a reduction to its operating expenses.

PwC explains the concept here:

> "...earnouts and other forms of contingent consideration are recorded at fair value on the acquisition date, regardless of the likelihood of payment. Subsequent changes in the fair value of most contingent consideration arrangements will be recorded in earnings...assume that a buyer agrees to pay the seller additional cash consideration if certain performance targets are met in the three years following the acquisition. Upon acquisition, the buyer records a liability representing the fair value of the obligation to make the additional payment. In each reporting period during the three-year earn-out, the fair value of the obligation is adjusted through earnings until the commitment is settled. As the likelihood of meeting the performance targets increases, the fair value of the contingent consideration also increases, resulting in an additional liability and additional expense. The reverse is also true: Failure to meet the targeted performance milestones under an earn-out will result in income, but may also trigger the need for an impairment analysis of goodwill."

Over the past five years, Ebix has made copious use of reversing earn-outs to beat consensus EPS forecasts. Melissa Davis of Street Sweeper highlighted the impact of earn-out reversals by financial quarter in March 2015. See here.

I conducted a similar analysis by looking at annual EPS as reported and the impact of earn-outs on EPS. I examined Ebix's cash flow statements to determine the amounts that were recorded as reductions of acquisition earn-out contingent liability. See below.

Table 6. Effect of Earn-Out Reversals on Cash Flow Statement

(USD thousands)	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013
Cash Flows from Operating Activities			
Net Income	79,533	63,558	59,274
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities			
Depreciation and Amortization	10,634	9,681	10,107
Provision for Doubtful Accounts	3,111	1,600	1,147
Provision for Deferred Taxes, Net of Acquisitions and Effects of Currency Translation	(10,143)	(1,966)	(10,368)
Unrealized Foreign Exchange (Gain)/ Losses	(1,743)	(741)	(237)
Unrealized Gain on Put Option	—	(296)	(341)
Share-Based Compensation	1,821	1,792	(1,941)
Debt Discount Amortization on Convertible Debt	17	35	42
Reduction of Acquisitions Earn-Out Contingency Liability	(1,533)	(10,237)	(10,253)

Source: Company reports

In order to assess the impact earn-out reversals had on EPS, I added the costs back to the Reported PBT for each year to derive an Adjusted PBT figure. I then applied the reported tax rate to derive and Adjusted after tax Net Income figure. I then divided those figures by average outstanding shares to derive an Adjusted EPS figure.

Table 7. Adjusted EPS—Without Earn-Out Reversals

	2015	2014	2013	2012	2011
Earnouts Reversed into Earnings	1.53	10.237	10.253	0.699	2.847
Reported PBT	86.60	77.50	70.20	78.00	73.50
Adjusted PBT Assuming Reversal of Earnouts	85.07	67.26	59.95	77.30	70.65
Tax Rate as Reported	8.2%	17.9%	15.5%	9.6%	2.9%
Adjusted After Tax NI	78.09	55.20	50.64	69.87	68.63
Adjusted EPS	$2.25	$1.46	$1.35	$1.89	$1.82
Reported EPS	$2.29	$1.68	$1.58	$1.91	$1.89

	2015	2014	2013	2012	2011
Impact of Contingent Liabilities on EPS	$0.04	$0.22	$0.23	$0.02	$0.07
Impact of Contingent Liabilities on EPS as %	1.8%	13.2%	14.6%	0.9%	3.9%

Source: J Capital Research

Over the past five years, earn-out reversals have benefitted EPS from USD 0.02/share in 2012 to USD 0.22/ share or between 0.9% and 14.6% of EPS, respectively. In fact, for the years 2013 and 2014, EPS from earn-out reversals exceeded 13% of reported EPS in each year.

Putting Lipstick on Pigs, Part 3: Don't Take Impairments

You will note in the figure above listing recent acquisitions, Ebix agreed to about USD 40 mln in fair value of earn-out payments. In addition, you will note that in our calculation of Adjusted EPS above, we highlighted as total of USD 25.6 mln of earn-outs that had been reversed into earnings, or 64% of total earn-out value having been reversed in the last five years. In addition, even though Ebix typically sets the earn-out period at 24-36 months, in 2013 and 2014, the company was recording some earn-out reversals within months of the deal having closed.

In the case of Ebix, the accounting only goes one way.

When companies reverse earn-outs, the benefit is that those reversals are allowed to be recorded in earnings as a reduction to operating expenses. However, earn-out reversals are also an indication that an investment has not gone according to plan or expected synergies did not materialize. Typically, those are indications for a company to test for and possibly take the expense of a goodwill impairment. Hence, a company might benefit from a reversal of the earn-out (decrease in expenses) but be forced to record an increase in expenses in the form of a goodwill impairment.

In the case of Ebix, however, the accounting only goes one way. Ebix only records earn-out reversals; in the last five years, the company has not recorded a single impairment to goodwill.

Yet, the company clearly shows signs of having struggled in its acquisitions:

- Large earn-outs often reversed;
- Reversals happening prior to the expiration of the earn-out period, suggesting that Ebix knows very early on that the acquired companies are underperforming;

- Ongoing pressure on gross margin and net income margin.

All of these factors indicate that Ebix should have/ should be evaluating taking impairments against its poorly performing assets.

The company has consistently stated that there is only one “chief operating decision maker” and that all of the businesses are considered under one P&L. This is partly to give the company the ability the claim that underperformance at several businesses is being counterbalanced by other outperforming businesses.

Over the last several years, Goodwill and Intangibles have been between 72% and 80% of total assets. Meanwhile, Goodwill and Intangibles at peers have been considerably lower. At Microsoft and Salesforce, Goodwill and Intangibles accounted for 12% and 42% of total assets respectively, while at smaller SaaS player Veeva, Goodwill and Intangibles recently accounted for 23% of total assets. All of this suggests that the goodwill as recorded on Ebix’s balance sheet is overvalued and should likely be written down by taking a sizable impairment. It is difficult to determine what the amount of the impairment should be, but even a modest impairment would have significant consequences for the company’s reported EPS.

An impairment as small as 5% of existing goodwill would amount to USD 24.5 mln, almost 30% of 2015 reported profit before tax. The longer Ebix delays taking the impairment, the larger it will become.

Every Little Bit Helps

As we highlighted earlier, Ebix’s margins have been in freefall for the past five years. We believe the company is relying upon an old accounting trick to mask the severity of the decline by starting to accelerate the amount of expenses it capitalizes or places on the balance sheet.

In 2013 and 2014, Ebix could use earn-outs as a way of boosting its EPS. At present, at least one short seller has flagged this and at the moment the company have very little in the way of contingent liabilities it is able to reverse. Hence, it cannot rely upon this method any longer.

Ebix has resorted to hiding expenses that should be on its income statement and hiding them in Other Assets.

We common-sized the P&L for the last five years and examined the movements in the various expense items.

Table 8. 5 Year P&L, Common-Sized

	2015	2014	2013	2012	2011
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Costs of Sales	27.7%	22.1%	19.8%	19.1%	19.9%
Gross Margin	72.3%	77.9%	80.2%	80.9%	80.1%
Depreciation & Amortization	4.0%	4.5%	4.9%	4.6%	4.4%
Reasearch & Development	11.6%	12.6%	13.1%	12.4%	11.4%
General & Administrative	18.1%	17.2%	17.8%	16.9%	15.6%
Sales & Marketing	5.6%	6.4%	7.7%	8.4%	8.0%
Operating Expenses	39.3%	40.7%	43.6%	42.3%	39.4%
Operating Income	33.0%	37.1%	36.6%	38.6%	40.7%
Other Expenses/(Income)	0.4%	1.0%	2.3%	-0.5%	-2.8%
Profit Before tax	32.6%	36.2%	34.3%	39.1%	43.5%
Taxes	-2.7%	-6.5%	-5.3%	-3.8%	-1.2%
Net Income	29.9%	29.7%	29.0%	35.4%	42.2%

Source: J Capital Research

While G&A has increased considerably, from 15.6% of revenue in 2011 to 18.1% of revenue in 2015. R&D and depreciation have been volatile. Sales & marketing, however, has been on a steady and sustained downslope from 8% of revenue in 2011 to 5.6% in 2015.

OPEX as a result had increased considerably in 2012 and 2013, rising to 42-44% of sales before coming back down to 39.3% of sales in 2015, nearly equal to the level recorded in 2011. We found this suspicious for a company that has been around for as long as Ebix has and claims to be purchasing companies in the same sector.

We examined the company's balance sheet for the possibility that expenses were being added to the balance sheet, so looked for rapid growth in new or vague line items. We noted that a category named "Other Assets" appears in both the current and long-term assets. In fact, it turns out that the combined "Other Assets" category is one of the fastest growing line items on its balance sheet. Over the past five years, Other Assets grew at a 43.6% CAGR while Total Assets grew at a more modest 13.2% in the same period.

Table 9. Growth in Other Assets

	CAGR 2011-2015	2015	2014	2013	2012	2011
Other Assets (Current and Long Term)	43.6%	23.8	12.7	9.2	8.8	5.6
Total Assets	13.2%	676.0	634.3	553.9	516.9	411.2
Other Assets (Current and Long Term) as % of Total Assets		3.5%	2.0%	1.7%	1.7%	1.4%

Source: Company reports

Our suspicion is that much of what is listed in this category—which the disclosure notes refer to as pre-payments—should be reported as operating expenses. We therefore took the year-on-year changes in Other Assets and analyzed what impact it would have had on the historical P&L had it been included in operating expenses.

Table 10. Putting Other Assets Back into Operating Expenses

	2015	2014	2013	2012	2011
Opex	104.30	87.30	89.20	84.30	66.60
Opex as % of Revenue	39.3%	40.7%	43.6%	42.3%	39.4%
Other Assets as Reported	23.8	12.7	9.2	8.8	5.6
Other Assets Change YoY	11.10	3.50	0.40	3.20	
Opex and Change in Other Assets	115.40	90.80	89.60	87.50	66.60
Opex and Change in Other Assets as % of Revenue	43.5%	42.4%	43.8%	43.9%	39.4%

Source: J Capital Research

We find that, were we to place the changes in Other Assets back into Operating Expenses for each of the relevant years, the figures for Opex as a % of revenue are more uniform. Opex as a % of revenue in 2011 is just under 40% but then settles to between 42.4% and 43.9% for the years 2012 through 2015. We believe that this supports the view that Ebix has lowered its operating expenses considerably in the last two years by placing material amounts of operating expenses onto the balance sheet under the Other Assets line item.

Any valuation of the company should at a minimum add back these

capitalized costs, which in 2015 amounted to USD 11.1 mln.

Taxes Are Only for Little People, Right?

The other way that Ebix keeps its expenses low and boots its reported income is by keeping its taxes a rock-bottom rates. Despite the fact that the company is based in the U.S., Ebix claims that a series of tax holidays, mostly provided by emerging markets countries, allows it to record very lot effective tax rates.

Table 11. Historical Tax Rates

	2015	2014	2013	2012	2011
Effective Tax Rate	8.2%	17.9%	15.5%	9.6%	2.9%

Source: J Capital Research

Ebix pays nowhere near the U.S. statutory rate of 35% in taxes. In fact, in 2011, its effective tax rate barely approached 3%. The company claims to be confident that its tax accounting is correct.

However, historical evidence in the U.S. suggests otherwise.

Ebix recently settled an IRS dispute relating to tax audit of its 2005 to 2012 returns. The company eventually paid USD 25 mln to settle its tax debts. However, in the very next year, an audit of 2013 returns resulted in another payment of USD 400,000. Clearly Ebix has historically not been able to convince the IRS of its understanding of its tax obligations.

Ebix's tax issues could likely come back in future years, as the company continues to record a considerably low effective tax rate of 8.1%. Ebix reveals that much of this is due to the 'Tax Holidays' of nearly 23.5% in non-U.S. locations. Given the company's recent experience with the IRS, we have some concerns as to whether today's tax holidays will result in tomorrow's tax settlements and penalties.

Also last year, Ebix lowered its valuation allowance against deferred tax assets by USD 1.9 mln, which provided additional uplift to 2015 reported earnings. The valuation allowance is often put in place when a company has concerns about its ability to realize some of its deferred tax assets. We believe Ebix lowered the valuation allowance in order to increase its reported EPS; USD 1.9 mln would have given the company and extra USD 0.06 per share in EPS [1.9 mln/34.7 mln]

Tell Everyone Your Acquisitions Are SaaSy

Ebix commands a P/E ratio of 21x primarily because it is considered a rapidly growing company in the software/SaaS space. As we highlighted earlier, the growth is merely as a result of acquisitions. But the acquisitions are not in technology, software, or SaaS despite what the company would have you believe. Ebix has over time become more of a business-process outsourcing company that is bolting on companies in a variety of low-tech sectors.

Consider a number of Ebix recent acquisitions. In 2015, Ebix acquired VIA Media Health Communications for USD 1.0 mln. Ebix's press release referred to the deal as an entrance into Health Communications and Content Exchanges.

Ebix Enters the Health Communications & Content Exchange Market in India by Acquiring Delhi Based Via Media Health

Ebix Press Release | Source: Ebix

In actuality, VIA Media Health Communications is a PR agency. We are not sure how a PR firm would be considered high-tech, but Ebix tries very hard to make it sound sexier.

VIA Media Health Communications | Healthcare Marketing ...
viamediahealth.com/
VIA Media Health, India's leading healthcare PR agency, offers a wide range of healthcare PR services including medical communication & pharma marketing.

VIA Media Health Communications website | Source: Google

How could a PR firm be considered high-tech?

You might think that perhaps this was just a one-off, but actually, this is part of Ebix's modus operandi. In fact, if you look at the key acquisitions the company conducted in 2014, you will see that none of them was related to SAAS or technology:

- Oakstone Publishing, acquired for USD 23.8 mln, is a publisher of continuing education materials for doctors;
- Vertex, Incorporated, acquired for USD 27.5 mln, is a consulting firm;
- HealthcareMagic ,acquired for USD 5.9 mln, is an "Ask a Doctor" consultation service.

Those three acquisitions accounted for nearly USD 60 mln in 2014, and not a single one of them was a technology player. While the bolt-on of random companies is not a crime, the company keeps up this façade of a technology company so that it can convince investors that it deserves the P/E of a technology player.

Even at some of the most basic of key performance metrics, Ebix does not compare to software firms. Here are the revenues per employee recorded at a Ebix as compared to Microsoft and Salesforce.

Table 12. Revenue per Employee Comparison

Microsoft	USD 770,000
Salesforce	USD 395,000
Ebix	USD 98,000

Source: Company reports

In fact, what is more telling is that Ebix's revenue per employee as deteriorated considerably since 2011, offering further proof that recent acquisitions have been in sectors further afield to technology and software.

Table 13. Ebix Trends in Revenue per Employee

	CAGR 2011-2015	2015	2014	2013	2012	2011
Employees	17.4%	2,707	2,343	1,927	1,903	1,426
Average Employee	18.0%	2,525	2,135	1,915	1,665	1,303
Revenue per Employee	-4.6%	$98,079	$91,464	$106,227	$104,782	$118,513
Revenue per Average Employee	-5.1%	$105,149	$100,375	$106,893	$119,796	$129,750

Source: Company reports

We Have Been Here Before

Ebix has likely become accustomed to charges of accounting manipulation and corporate governance failures. In the last few years the company has been investigated by the SEC, DOJ, and the US Internal Revenue Service.

As far as we understand, the SEC and DOJ investigations are ongoing. Ebix has not given any indication that those investigations are going to be settled any time soon. Interestingly, nor has the company provided any of the normal investor confidence-building measures, such as announcing an internal investigation led by a major law firm.

Musical Chairs in Audit, Executives and Board

Chairman and CEO Robin Raina has complete and absolute control over the operations of Ebix. Over the last several years, there have been multiple defections of executives and Board Members. The current board is made up of Raina and four other members. One board member represents a foundation called the Rennes Foundation, based in Lichtenstein. Aside from Ebix, Rennes has invested in only about four companies, all of which since went bankrupt or delisted after having lost more than 80% of their value. Perhaps a bit of bad luck for Rennes, but worth noting.

KPMG served as Ebix's auditors prior to 2004. From 2004 to 2006, BDO Seidman provided audit services. For the years 2007 and 2008, a small firm, Habif Abrogeti & Wynne was Ebix's auditor. However, since 2008, a smaller regional firm, Cherry Bekaert & Holland, conducts the company's audit work. While we are not of the opinion that a Big 4 accounting firm is always best a spotting fraud and manipulation, the numerous changes in audit firm and the trajectory from Big 4, to next tier, to regional players raise a concern that the company may have been shopping for a more malleable auditor. Fees do not seem to have played a major role since in 2006, Ebix paid $586,000 for its total audit and related fees, and in 2014, it paid a still modest $756,000 in total audit and related fees.

We have some key concerns about whether a smaller regional firm can truly conduct an accurate assessment of Ebix's financials given:

- That most of the company's employees and revenues are now outside of the US;
- The large number of global acquisitions conducted over the last several years;
- The level of complexity that earnouts now place on the company's financial performance;
- The speed at which revenue and assets have grown;

Catalysts

Potential catalysts include:

- Cash on hand is at USD 50 mln, and the revolving line of credit has been expanded to USD 240 mln; as of December 2015, Ebix was utilizing just over USD 200 mln, suggesting that going forward, Ebix may have limited capacity to draw on the revolver for ongoing acquisitions as well as share repurchases;
- Continued deterioration in gross and net margins may make it necessary for Ebix to resort to more extreme accounting manipulations to achieve 2016 EPS targets;

- Ebix remains under investigation by both the SEC and the US DOJ; that both cases have been open since 2012/2013 suggests the regulators have uncovered some evidence of malfeasance, although timing of any action is difficult to assess.

Valuation

We believe Ebix is worth USD 13.69 /share, which represents a downside of 72%.

Table 14. Valuation

Profit Before Tax as Reported	86.6
Less Effect of Capitalizing, Valuation, and Earn-Out Reversals	(13.6)
Adjusted PBT	73.03
Tax Rate at US Statutory	35.0%
Profit After Tax	47.4695
Shares Outstanding	34.67
Adjusted EPS	$1.37
PE Ratio for No-Growth Company and Cloud of Investigations	10
Price	$13.69
Downside Risk	72%

Source: Company reports

We have taken 2015 profit before tax as reported and reduced it by USD 11.1 mln, the cost that we think has been kept off of the P&L and hidden on the balance sheet in Other Assets. This represents an adjusted PBT of USD 75.5 mln. We do not believe that the company's extremely low effective tax rate will survive scrutiny from U.S. tax regulators, so we have assumed the U.S. statutory rate of 35%. It should be noted that the IRS has found issues with at least nine years of Ebix's returns. Using the statutory rate of 35% generates profit after tax of USD 49.1 mln or EPS of approximately USD 1.42.

As we have discussed above, Ebix has fooled the market into thinking that it is a technology company in growth mode. Our evidence suggests that Ebix is not growing its core business AND it is not a technology company. As such we believe that the company does not merit its current P/E rate of 21.1x, but a P/E ratio reflective of declining organic sales and the possibility of SEC and OJ investigations in the future. We have therefore assigned a P/E ratio of 10x earnings.

Risks to our thesis:

- The company will announce a series of large M&A deals to further excite investors;
- The company continues with its aggressive share repurchase program, which in 2015 accounted for 8.3% of reported EPS.

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