

September 8, 2016  
Company Update

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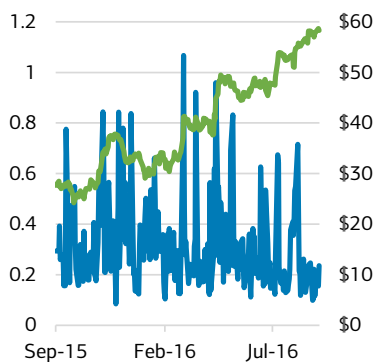
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## Ebix Inc. (EBIX US)

Price	USD 58.31
<b>Rating</b>	<b>SELL</b>
<b>Price Target</b>	<b>USD 13.69</b>
Difference	76.5%
Market Cap	USD 1.89 bln
P/E	22.34x

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



Source: Bloomberg

## Ebix Inc. (EBIX US)

# Ugly Is As Ugly Does

### ► Nowhere left to run

Now that it has run out of accounts to manipulate, Ebix is placing a high-stakes bet on its USD 475 mln acquisition of Patriot National, the biggest acquisition to date—PatNat nearly matches Ebix in total revenues. Corporate governance at Patriot National is as colorful as at Ebix. Patriot National has set a deadline of September 8 for responding to Ebix's revised and improved acquisition offer.

### ► Outdated, outmoded

We have troubling questions about the product's competitiveness and the means of revenue recognition. Technical specs reveal software that is very out of date, and we cannot verify revenue sources for the BPO services, included in the RCS segment.

### ► No more contingent liability earn-outs

Ebix no longer has significant contingent liability earn-outs available to be reversed into earnings. That circumscribes its ability to manage earnings.

### ► Business partners in court

PatNat is embroiled in a breach-of-contract lawsuit pending in Federal District Court in New York as a result of over-pledging his shares as collateral for bank loans.

### ► We reiterate our SELL rating with a price target of USD 13.69

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EBIX has never had organic growth much above 3%

## All the King's Plastic Surgeons...

■ **Melvin Glapion & Susannah Kroeber**

It's that time of year again: back to school, when you get to buy new notebooks and backpacks, meet new friends, and ponder mayhem for new teachers. This week, I found myself feeling slightly nostalgic for my grade school years. That was until a vision of my school's principal, Sister Pat, catapulted me back to reality. My most painful memory of Sister Pat is of her spanking my knuckles with a ruler after I and a few friends had teased someone for being downright ugly. After our spankings, Sister Pat reminded us that no one is ugly because we were all made in God's image and that the only time it would be appropriate to call anyone ugly is if they made themselves that way. Well, Sister Pat, I am calling Ebix Inc. (EBIX US) grotesquely ugly. And you can put that ruler away; the company's ugliness is all of its own doing. Despite the fact that its share price is near a 52-week high, Ebix is no beauty. Ebix is profoundly aware of its ugliness and is engaging in accounting 'plastic surgery' to hide some fundamental flaws.

### Botox—Nothing Like a Bit of Poison to Smooth Away the Wrinkles

Ebix continues to struggle. While the company recorded 2.1% quarter-over-quarter growth between Q1 and Q2 2016, its operating expenses ballooned 5.8%. According to a former employee, "there's never been much organic growth." Top-line growth has bounced around from 3% to 28% but we think organic growth has been 3% or lower. While Exchange has benefited from acquisitions, everything else atrophies.

Ebix appears to be running through the pipeline of existing development projects for customers. Our interviews pointed to real breakage in the company's sales process in 18-24 months.

The sales team collapsed toward the end of 2014, and Ebix has not invested in developing new sales. Over the past six years, the company has also failed to deliver projects on time to existing customers. These factors taken together indicate an organic revenue collapse in the next 18-24 months, given a lead time of up to 36 months for new projects. Consequently, we see a sharp deterioration in late 2017.

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Operating expenses grew dramatically in the last two periods. We believe this is the result of Raina's acquisition strategy. Typically, Raina attempts to lay off as much as many staff as possible after an acquisition, particularly in sales and development. This leads to a short-term ability to eke out a 40% margin but mid-term deterioration through rapid employee turnover; we were told that fewer than 10% of sales staff remain longer than 18 months. This indicates a pattern of rising costs and weakening margins six to nine months after completion of an acquisition.

Churn, recruiting, training, rework and Q&A are all likely resulting in the stubborn operating expenses at Ebix. The only way the company was able to eke out a modest growth in net income in the most recent quarter is thanks to a tax benefit.

**Table 1. Growth Quarter-over-Quarter**

	Q2 2016	Q1 2016	Q4 2015	Q2 2015	Q1 2015
Revenue	2.1%	1.2%	5.1%	3.2%	1.5%
Expenses	5.8%	4.3%	-1.0%	1.3%	2.4%
Profit / (loss) before tax	-10.3%	2.0%	6.9%	9.6%	-2.7%
Profit / (loss) attributable to owners of parent entity	3.8%	1.1%	8.4%	6.3%	3.8%

Source: Company reports

## Cash Seeping Away

Ebix's cash flow generation remains poor. Through Q2 2016, the company has generated by a mere USD 0.68 for every USD 1.00 of reported net income, which suggests that the company's quality of earnings continues to be poor.

**Table 2. Cash Flow from Operations vs. Net Income**

	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015
CFO	30,976.0	10,534.0	48,686.0	25,663.0	10,155.0
Net Income	45,151.0	22,159.0	79,533.0	57,604.0	37,372.0
CFO/Net Income	68.6%	47.5%	61.2%	44.6%	27.2%

Source: Company reports

Ebix is desperately trying to conserve cash by slashing capex spend. Currently Capex spend as a percentage of revenues is ~3%, whereas in Q2 2015, the capex was 15.9% of revenues and around 19% for Q3 and Q4 2015.

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**Table 3. Capex Spending**

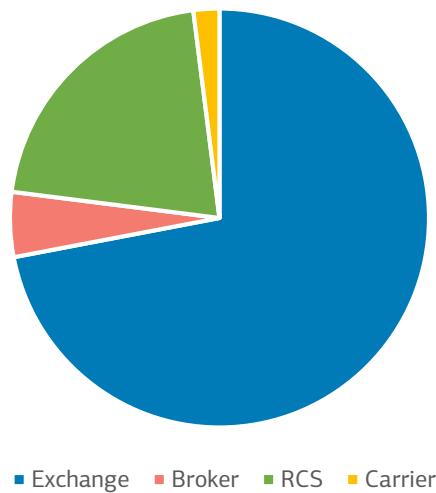
	Q2 2016	Q1 2016	Q4 2015	Q2 2015	Q1 2015
Capex	2,190.0	1,028.0	13,994.0	12,713.0	10,312.0
Capex as % of CY revenue	3.0%	1.4%	19.9%	19.0%	15.9%
Depreciation	5,350.0	2,720.0	10,634.0	7,932.0	5,167.0
Capex to Depreciation-year to year	40.9%	37.8%	131.6%	160.3%	199.6%

Source: Company reports

## A Few Nips and Tucks—The Changing Face of Ebix’s Business

Ebix defines for itself four different product segments that allow us to match products to their revenue numbers broadly: Exchanges, Broker Systems, Risk Compliance Solutions, and Carrier Systems. There is a loose relationship between geographical region of operation and product: P&C exchanges are primarily operated in Australia, New Zealand, the United Kingdom, and Brazil, while life, annuity, and employee health benefit exchanges operate primarily in the United States. Revenue segments are defined slightly differently, making it harder to estimate revenue per category/product (See Appendix A).

**Chart 1. Ebix Revenue Segments**



Source: Company disclosures

Something we note has been the redefinition of the segments. There was a decided change of language in the 2015 10-K and conference call and as well in Q1 2016, where Ebix spoke of reducing the Carrier Systems seg-

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ment (the smallest segment) and focusing on “Exchanges, Healthcare, e-Governance, and e-Learning.” This was also used to justify purchasing previously non-core businesses, like the publisher Oakstone.

## Exchanges

Exchanges account for 72% of Ebix’s revenue and are the company’s primary revenue driver—data exchanges operating independently or integrated into third-party back-end systems to deliver insurance information to a variety of users. The data Ebix is delivering is open-source. (Progressive Insurance pioneered distributing data streams for free as a marketing tool, and that has now become a universal practice in the industry).

Ebix, therefore is not marketing proprietary data, it is marketing and investors should expect an appropriately modest margin. Revenue is derived from:

- ▶ Subscription fees associated with accessing the exchange;
- ▶ Transaction fees charged for each data transaction processed on an Ebix Exchange (a transaction is defined as the exchange of data between any two entities using an exchange).

The second form of revenue appears to be unique for insurance-based data portals. According to the sales manager at competitor EZLynx (based in the U.S., with outsourced staff in India), the typical model is to charge per type of stream you want as part of your subscription. Example:

- ▶ Independent broker subscribes to “Life Insurance Data Exchange.” Pays enterprise fee of USD 200/mo, and USD 50/mo/user for four more users, total cost of USD 400/mo. The enterprise fee is standard, and includes BPO services. Ebix breaks these into separate products and revenue streams.
- ▶ The Exchange comes with three free insurers. For each additional national insurer there is a fee of USD 10/mo, and USD 5/mo for each regional insurer. Typically, additional costs add up to a total package of about USD 425/mo or USD 5,100/yr.
- ▶ Ebix claims that they charge the end user for accessing each record. Given that an independent broker might conduct anywhere from 50-200 searches a day, this would be an additional cost above subscription. We are not aware of other exchanges that charge in this manner.

In the Exchange vertical, Ebix lists a dozen “Business Partners.” Two of these “partners” listed on the website are actually companies that are

Does Ebix have  
real business  
partners?

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wholly owned by Ebix. We spoke with three partners, Morningstar, ADP, and Beacon.

**Table 3. Interviews**

Partner	Notes
ADP Brokerage Services	Pay access fees on per client basis, usually for transactions. Could be used as a transactional portal for brokers, did not disclose relationship with Ebix
Beacon Research	Ebix could have purchased a data license for its annuity rate data. This service is used by large institutions to help fix rates—Ebix or insurance brokers would not fit the typical company profile. Insurers typically subscribe directly.
Communication Intelligence Corporation ("CIC")	
The Depository Trust & Clearing Corporation (DTCC)	
E-Z Data	Acquired 2009
Investigo	
Landmark Technology	
Morningstar, Inc.	Access fees for research, typically data streams on subscription data portals charge USD 500-800,000/yr for single topic, users would have unlimited access to research on that platform.
Vallue Consulting	
VERTEX INC	Acquired 2014
Signix	

Source: J Capital interviews and company websites

**Broker systems**

Broker systems account for 5% of revenue. It is almost exclusively property and casualty. This is primarily an ex-U.S. segment because, Ebix says, margins are better overseas. But we have found that 80% correlation of Indian companies offering BPO services that cover the U.S. also cover Australia—why is this operating in the reverse for Ebix? Revenues are derived from:

- ▶ Subscription license-based revenues from brokers, charged monthly
- ▶ Time & materials-based fees charged to customers on a bespoke basis

According to Ebix, the major cost associated with this derives from inte-

Ebix products seem technically out of date.

gration costs: “all these three products are continually being redesigned, coded and updated to adhere to the most current technologies prevalent today.” We question that given the outdated nature of the products. The company’s main Australian product (as listed in Ebix’s 2015 10-K), WinBEAT 4, was released this year but does not support the last three versions of Windows.

### Figure 1. Ebix's WinBEAT4 Technical Specification

WinBEAT4 Technical Information for your Computer & Networking Consultant

WORKSTATION SPECIFICATION	RECOMMENDED PLATFORMS
<ul style="list-style-type: none"> <li>▪ Dual Core 2GHz processor with 1GB RAM or higher</li> <li>▪ Windows XP Professional - SP 3</li> <li>▪ Windows VISTA Business or Ultimate edition - SP2</li> <li>▪ Windows 7 Professional or Ultimate edition - SP1</li> <li>☒ Windows Home Editions and Windows ME are not supported operating systems</li> <li>▪ Monitor with minimum 1024 x 768 resolution</li> <li>▪ Anti-virus software which is updated regularly</li> <li>▪ Internet Explorer 7.0 or above</li> <li>▪ Adobe Acrobat Reader Version 8 or above</li> <li>▪ Microsoft Office is required when the WinBEAT Export module is activated. We support MS Office 2003 or above</li> </ul>	<p style="text-align: center;"><b>1 - 5 USERS</b></p> <ul style="list-style-type: none"> <li>☑ For a Single User the Workstation Specification applies <b>Peer-To-Peer 100/1000Mb/s network.</b></li> <li>▪ Server - Dual Core 3GHz processor or higher with minimum <b>2GB RAM</b> recommended, using any of the following platforms:               <ul style="list-style-type: none"> <li>- Windows XP Professional - SP3</li> <li>- Windows Vista Business or Ultimate edition - SP2</li> <li>- Windows 7 Professional or Ultimate edition - SP1</li> </ul> </li> <li>▪ Workstation compliance with the workstation specifications shown top left</li> <li>▪ Network must be configured to use only the TCP/IP protocol</li> <li>▪ CD/DVD writer, tape drive, external HDD or other suitable backup device</li> <li>▪ High speed internet connection with Microsoft Internet Explorer 7.0 or above</li> <li>▪ MSDE supplied with WinBEAT for 1 to 10 users</li> <li>☒ <b>WinBEAT is not supported for any other SQL Express versions</b></li> </ul>
<p style="text-align: center;"><b>NETWORK SPECIFICATION</b></p> <p style="text-align: center;"><b>OVERVIEW OF SERVER</b></p> <p>Up to 10 users: The database installation will install and use MSDE, which is a distributable version of the Microsoft SQL database engine.</p> <p>10+ Users or 2GB+ Database:</p>	<p style="text-align: center;"><b>6 TO 10 USERS</b></p>

Source: Company website

### Risk Compliance Solutions (RCS), formerly Business Processing Outsourcing (BPO)

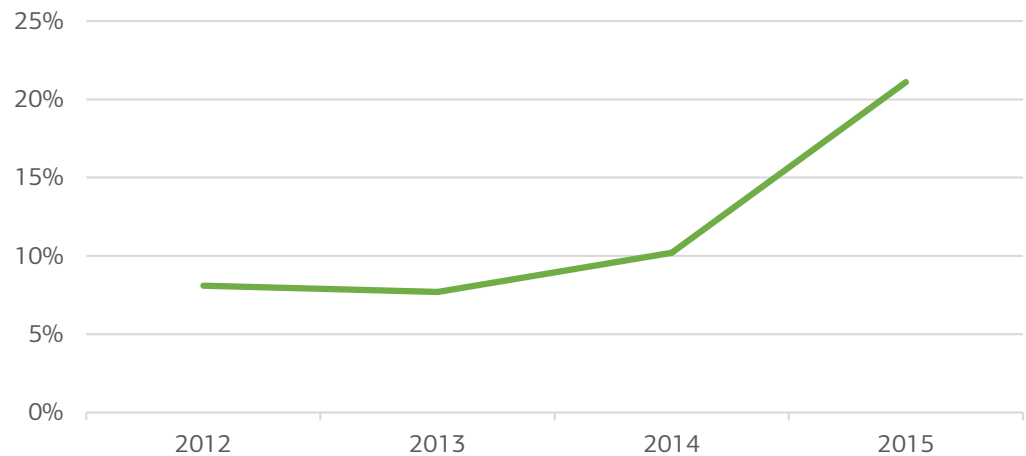
RCS is about 21% of revenue. This segment is a mix of standard BPO services such as CRM, marketing, and insurance-specific BPO, such as call centers and claims support. Ebix does not disclose how any of the revenue from this segment is derived except for certificate tracking:

- ▶ Transaction-based revenues for each certificate created
- ▶ Transaction-based revenue for each certificate tracked

The lack of disclosure on revenue makes us suspicious that “subscription” revenue for the Exchange segment may actually be for low-value BPO business. One of the largest and oldest established facilities was built as a call center in 2002, and the pre-2010 acquisitions were mostly in BPO/call center businesses (eg. JenQuest, 2007). Our best guess is this represents the core of Ebix’s old business before growth took off.

Ebix explains this by pointing to acquisitions that were consolidated in 2015: “Risk Compliance Solutions division revenues increased by USD 34.1 million, or 156%, due primarily to the consulting service revenues generated by the 2015 business acquisition of PB Systems, and the 2014 business acquisitions of i3 and Vertex.”

**Chart 2. RCS (formerly BPO)**



Source: Company reports

It appears that Ebix has no organic revenue growth.

The other main source of revenue growth, in the Exchange segment, was also attributed to acquisitions (“Exchange division revenues increased by USD 21.3 million, or 13%, principally due to new exchange clients, and cross selling of products and services to existing clients as facilitated by the 2014 acquisitions of i3, HealthCare Magic, Oakstone.”) Nowhere does Ebix point to organic growth of revenue in 2015.

**Carrier Systems**

Carrier Systems account for about 2% of revenue and are being phased out as a business segment, likely to be absorbed elsewhere in 2016/2017. Revenues are derived from same sources as brokers:

- ▶ Subscription license-based revenues from P&C insurance carriers, charged monthly
- ▶ Time & materials based fees charged to customers on a bespoke basis.

**Margins**

Ebix has reported gross margins of 73-80% in its consolidated filings since 2012, double the industry average. In the filings we’ve pulled so far from



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the Australian and NZ entities and subsidiaries domiciled in ANZ, gross margins have averaged 37%. This discrepancy persists with net margins (30% vs 19%). These entities account for 9-10% of Ebix's revenue. The local filings may fail to capture important consolidation issues. Our work on this continues.

### Technical issues

Ebix's platforms seem to have surprisingly outdated technology or poor usability compared to peers. A regular feature easily visible on the website is the number of products with outdated technology specs. For example, the U.S.-based broker product, EbixASP, is run on a platform called iTrack. This is a small component of revenue (booked under Broker Services, which is 5.5% of 2015 revenue) but is the main P&C broker solution for the U.S. market. Not only is the website heavy, with a low reliability rating, it isn't search optimized, which is problematic for a data portal. More than half of its traffic comes from India, which is not where its clients (insurance brokers) are ostensibly based. This suggests that either there isn't much traffic, as it isn't a viable platform, or most of the traffic is from technical support based in India, or that this is primarily a BPO primarily used on the back end rather than front end.

### Testimonials

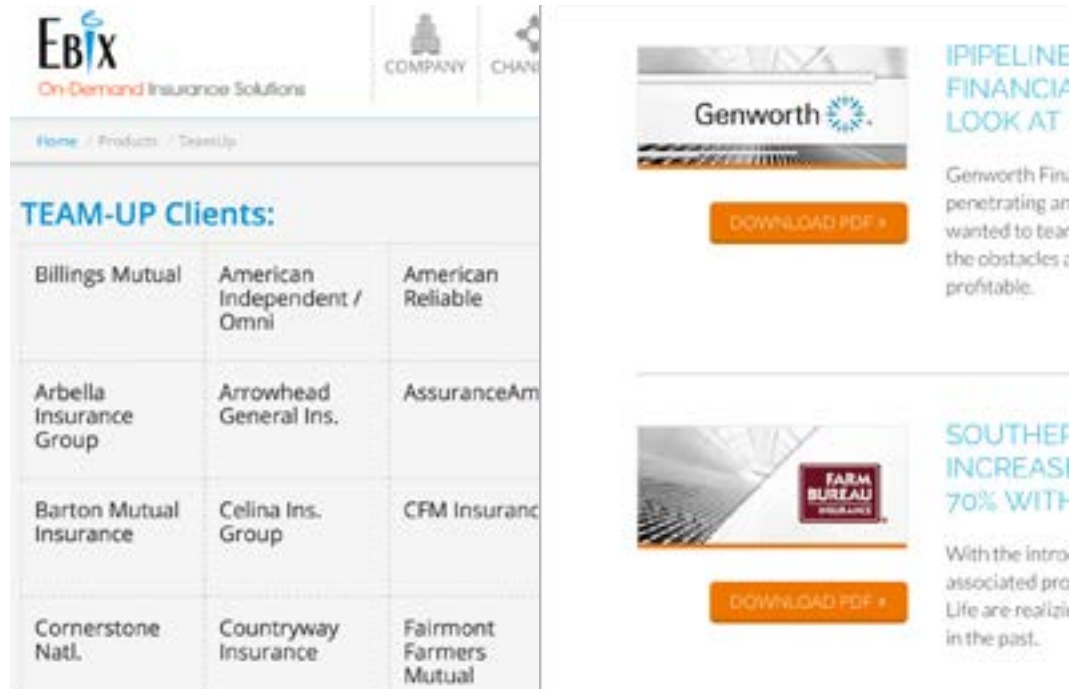
A small point worth mentioning is the non-conformity of the testimonials page. Most are videos from what appears to be a single conference with little accompanying text. Only one video refers to an Ebix out-of-the-box insurance platform. Otherwise, about half the videos either describe platforms that Ebix helped build for specific customers or the BPO services (SmartOffice, CRM). The other half of the videos are about plug-in or other service providers.

We managed to speak to two providers. eSignLive is licensed by Ebix as one of the e-signature solutions—making it an odd testimonial. eSignLive confirmed they are a provider to Ebix and not a customer. The second provider, LaserApp, is an e-form provider for financial services. Ebix also pays LaserApp to license the technology, and they are not a customer. They describe themselves as a “partner to Ebix. Ebix is a customer. We attend their conferences in the role of a partner, and also have overlapping customer bases at times.”

Another oddity is that nowhere are customer logos displayed, despite that being an easy to find feature on EZLynx, iPipeline (Ebix's largest competitor according to disclosures) or any other insurance service provider website regardless of revenue or client base type. The only logos displayed, for

which you would need approval from that company, are for companies that Ebix labels “business partners.”

Figure 2. Ebix vs iPipeline display of customers



Source: Company websites

## Filler—the Critical Importance of the Patriot National Acquisition

CEO Robin Raina has apparently decided that the only way to spruce up his fading glory is to embark on yet another acquisition. Only this time, he has decided to go big. On June 15, 2016, Ebix proposed to acquire 100% of the shares of Patriot National Inc. (PN US) at USD 9.50 a share. With revenues of USD 209 mln in 2015, PN is nearly as large as Ebix. Historically, Ebix has actively acquired companies in the USD 10-50 mln range and offered healthy contingent liability earn-outs, which were rarely ever achieved and were reversed into earnings in later periods.

We think Patriot National offers Ebix a more conventional way to hide its gross underperformance. Patriot National has maintained healthy growth in revenues, 104% and 84% in each of the last two years. While PN seems to recognize positive net income only in odd-numbered years, the company does have modest but steady cash flows from operations.

As Raina rarely seems to structure an acquisition without an earn-out component, PN would likely come with a massive contingent liability to be recorded on Ebix's balance sheet for future earnings drips as and when needed.

**Table 4. Patriot National Annual Revenue and Net Income**

	FY 2015	FY 2014	FY 2013
Revenue	USD 209,764	USD 102,730	USD 55,873
% growth	104%	84%	
Net Income	USD -5,265	USD 10,459	USD -6,268
% of Revenues	-2.5%	10.2%	-11.2%

Source: Company reports

A true sign of ugliness is when even the ugliest of the ball belles refuses your advances. Patriot National refused Ebix's initial offer and announced on August 1, 2016 that it wanted an offer in excess of the proposed USD 9.50 per share. PN later announced that it would consider Ebix's revised offer and after due diligence, PN plans to announce its decision on or before September 8, 2016.

But Raina and Ebix need this deal to keep up the story of a fast-paced, growing, and profitable SAAS-based business. Ebix should have welcomed Patriot's initial rejection, but it can't, despite the fact that Patriot National is financial equivalent of botulinum itself: the massive growth in revenues is primarily due to exponential growth in related-party revenues. In fact, in 2015 and 2014, related-party revenues accounted for 41% and 46% of total reported revenues. The related party is Guarantee Insurance Company, which is owned by Patriot National's largest shareholder, CEO Steven Mariano.

**Table 5. Patriot National Related Party Revenues**

	FY 2015	FY 2014	FY 2013
Related Party Revenue	86,883	46,882	9,387
% growth in RPT	85%	399%	
% Related Party	41.4%	45.6%	16.8%

Source: Company reports

- ▶ PN's cash flow is healthy primarily due to the fact that the company spends even less in capex than Ebix does, 2.8% of revenues in 2015

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and 0.1% in 2013. Ebix spent on average USD 2.5 mln in capex over the last three years, yet its fixed assets are depreciating on average by around USD 8 mln in each of the last three years.

- ▶ In order to complete the deal, Ebix will likely take on over USD 475 mln in additional debt. Currently Ebix's debt to equity ratio stands at 27%. However, given the struggle to eke out net income and cash, it is hard to see how Ebix could generate sufficient cash flows for that amount of long term debt. Ebix has seen its interest expense levels rise markedly over the past eight quarters. In Q2 2015, the company reported interest expense of USD 625,000. That figure had risen to around USD 2.1 mln in Q2 2016. Were Ebix to fund the USD 475 mln acquisition with long-term debt, Ebix would be adding around USD 12 mln in extra interest expense (assuming rate of 2.5% over 5 years). Yet, Patriot National appears to bring an average of only about USD 4.8 mln more in extra cash for debt service—although EBIDTA has been extremely variable.

What makes the request for a better offer even more galling on the part of PN and more stupid on the part of Ebix is that, despite PN's ability to grow via related-party transactions, in the most recent June quarter, Patriot National missed both its revenue and earnings targets by a mile. The company reported revenue of USD 56.5 mln although the market had expected USD 64.2 mln and recorded EPS of USD 0.11 whereas the street had expected double that—USD 0.22. Someone please tell Raina that he's looking desperate.

## Silicone Implants Guarantee-d to Make It Seem Almost Real

Further beautification at Ebix involves selling us the extra support provided by Guarantee Insurance Company (GIC), a specialist in the workmen's compensation insurance space. A.M. Best is a rating agency that focuses on evaluating insurance companies: reputable insurers rely upon A.M. Best ratings as a means of assuring potential customers of their financial stability and viability. According to A.M. Best, Guarantee Insurance Company at present is 'NR-Not Rated'. NR status includes never rated firms as well as firms that had been rated but are currently not rated.

If I were Steven Mariano, I would also opt not to have Guarantee Insurance Company rated. Aside from the multiple reasons for BDO's adverse and qualified opinions on GIC's financial statements for the years 2015 and 2014, the company reports:

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**Figure 3. Guarantee Insurance Audit Letter**

Source: Company website



- ▶ Stagnant gross premiums of USD 288 mln and declining (-43%) net premiums year over year;
- ▶ A modest positive net income in 2015 and large negative net income in 2014;
- ▶ Two successive years of negative cash flow from operations in excess of USD -35 mln;
- ▶ The company's investments over the last two years have lost USD 20 mln in value, while the portfolio consists of both bonds and equities. We believe a material component of the losses in equity are likely due to GIC's holdings in Patriot National stock. PN IPO'd in January 2015 at around USD 15 per share and climbed to about USD 20 over the next eight months. It has drifted downward since and has only slightly recovered in the last several months due to the Ebix offer. Nonetheless, PN's price per share remains below the USD 9.50 per share detailed in the initial offer.
- ▶ GIC details a host of Related Party arrangements, one of which is an outstanding loan of USD 13 mln, which we suspect was made to Steven Mariano.
- ▶ It is possible that Mariano needed the loan to address issues raised in the

lawsuit filed against himself and PN. It seems that Mariano overpledged his PN shares as collateral for loans. Plaintiff Hudson Bay Master Fund states:

"...According to public filings, Mariano now lacks the amount of Shares he needs to deliver to Patriot National and other investors to satisfy his end of the bargain because, in contravention of his contractual commitments, Mariano has pledged too many of his Shares as collateral for personal loans. Thus, Hudson Bay has asserted various claims against Mariano for the contractual breach and tort he committed in what is believed to have been his role in orchestrating the non-delivery of the Shares to Hudson Bay."

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Mariano has lawyered up with four teams of attorneys managing the case. Raina and Mariano, like most plastic surgery devotees, don't think people notice their silicone implants. We see it clearly, in the form of Guarantee Insurance Company and its less than assuring financials.

## A Tummy Tuck with Almost No Scarring

In our previous updates, we demonstrated how Ebix benefitted significantly from reversing contingent liability earn-outs. In fact, in 2014 and 2013, reversals of earn-outs accounted for around USD 0.23 per share each year or 13.2% and 14.6% of reported EPS respectively. This technique was the equivalent of a tummy tuck—unwilling to do the hard work of diet and exercise, simply rip out the unwanted parts and sew the seams back together.

At the end of 2015, Ebix had very low levels of contingent liabilities upon which it could draw to enhance its financial results. As of June 2016, both current and long term contingent liabilities are at low levels and would not be able to materially support Ebix's earnings management scheme.

**Table 6. Contingent Liability Balances**

	2Q 2016	1Q 2016	4Q 2015	3Q 2015	2Q 2015
ST Contingent Liability	2,878	2,143	1,706	1,690	1,887
LT Contingent Liability	0	1599	2571	6323	8193
Total Contingent Liability	2,878	3,742	4,277	8,013	10,080
Basic Shares Outstanding	32,688	33,043	33,678	34,304	35,046
ST CL /share	USD 0.09	USD 0.06	USD 0.05	USD 0.05	USD 0.05
LT CL /share	—	USD 0.05	USD 0.08	USD 0.18	USD 0.23
<b>Total CL/share</b>	<b>USD 0.09</b>	<b>USD 0.11</b>	<b>USD 0.13</b>	<b>USD 0.23</b>	<b>USD 0.29</b>

Source: Company reports

If Ebix needed to manage earnings, it currently has contingent liabilities sufficient to support an uplift of USD 0.09 per share, enough to impact a quarter, but not enough to significantly impact a fiscal year.

We believe that the PN deal is intended to shore up Ebix's contingent liability funds for future use in managing its earnings. However, were PN not to proceed, Ebix is in further dire straits, as it can no longer rely upon an accounting trick that has served it well in the past.

Ebix and the IRS have disagreed more than once about taxes.

## The Increasingly Popular Brazilian Butt-Lift

In attempt to firm up the lower end of its income statement, Ebix has come to rely upon ever more favorable effective tax rates. We pointed out in prior reports that in the past four years, Ebix’s effective tax rate had fluctuated between ~8% and 16%. However, in recent quarters the rate has been averaging around 7%, and in Q2 2016, Ebix reported a tax benefit that allowed the company to increase earnings by USD 1.4 mln.

**Table 7. Effective Tax Rates (in USD mlns)**

	Q2 2016	Q1 2016	Q4 2015	Q2 2015	Q1 2015
Income before taxes	21,625	24,101	23,625	22,109	20,172
Taxes	1,418	-1,750	-1,696	-1,877	-1,136
<b>Effective Tax Rate</b>	<b>6.56%</b>	<b>-7.26%</b>	<b>-7.18%</b>	<b>-8.49%</b>	<b>-5.63%</b>

Source: Company reports

Ebix has endured quite a bit of pain from this procedure—from the U.S. Internal Revenue Service. There have been at least two IRS audits in the past four years, one of which resulted in a substantial penalty. Ebix contends that its work in India and in development zones allows it to report lower effective tax rates. It remains to be seen whether recent further tax ‘enhancements’ catch the eye of the IRS yet again.

Ebix does have USD 33 mln in deferred tax assets that it may attempt to apply to future earnings. However, the extremely low effective tax rate and the modest balance of deferred tax assets suggest that further reliance on lower taxes will not allow Ebix much room for significant earnings management in the near future.

## In the Eyes of this Beholder

Our view is that, regardless of what happens with Patriot National, Ebix is a fading beauty. With Patriot National, Ebix could show improvements in revenues and possible uplifts in cash flow, but the source of the revenues and the sustainability of the cash flows are highly suspect. Moreover, long delayed capex investment will be needed at both Ebix and PN at a time when debt and consequential interest expenses will be accelerating rapidly.

Without Patriot National, Ebix has limited scope for earnings management, at least using the old toolkit. Contingent liabilities have dissipated,

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and effective tax rates can't get much lower than current levels.

The "BIX" is botched. No reality TV show doctors can fix this monstrosity. We reiterate our call for a share price of USD 13.69.

## Catalysts

Potential catalysts include:

- ▶ Ebix remains under investigation by both the SEC and the US DOJ; given that both cases have been open since 2012/2013, the regulators appear to have uncovered some evidence of malfeasance, although timing of any action is difficult to assess.
- ▶ Financial metrics, particularly with respect to cash flows, continue to deteriorate at a time when the company seeks to take on additional long term debt.
- ▶ Patriot National's financial performance recently has deteriorated, which will place further strain on cash strapped Ebix.

## Risks

- ▶ SEC investigation stalls or results in no action;
- ▶ Patriot National is able to extricate itself from a heavy reliance on related party transactions and deliver on synergies.

## Valuation

We believe that Ebix is worth USD 13.69 per share, which represents a downside of 75.9%.



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# Appendix A. Revenue Segment and Product Match Up

Revenue segment	Division	Product	Intended User
Broker Systems	P&C	eGLOBAL	Agents & Brokers
Broker Systems	P&C	WinBeat	Agents & Brokers
Broker Systems	P&C	EbixASP	Agents & Brokers
Broker Systems	P&C	Universal Messaging Gateway	Reinsurance/Lloyds/London Market
Broker Systems	P&C	Lime-St.com	Reinsurance/Lloyds/London Market
Exchange	P&C	EbixAdvantage Web	Insurers
Exchange	P&C	TEAM-UP	Insurers
Exchange	P&C	TEAM-UP Translation Services	Insurers
Exchange	P&C	EbixDM	Agents & Brokers
Exchange	Life Insurance	LifeSpeed	Insurers, Agents & Brokers
Exchange	Life Insurance	The Policy Processor (TPP)	Insurers, Agents & Brokers
Exchange	Life Insurance	PSS	Insurers, Agents & Brokers
Exchange	Life Insurance	WinFlex	Insurers, Agents & Brokers
Exchange	Life Insurance	VitalSales Suite	Insurers, Agents & Brokers
Exchange	Life Insurance	OneOffice	Insurers, Agents & Brokers
Exchange	Life Insurance	Vertex Product Suite	Insurers, Agents & Brokers
Exchange	Annuity	AnnuityNET	Insurers, Agents & Brokers
Exchange	Annuity	Vertex Product Suite	Insurers, Agents & Brokers
Exchange	Risk Management	RiskEnvision	Risk Managers
Exchange	Risk Management	WCIRS	Risk Managers
Exchange	Risk Management	EC Care CM	Risk Managers
Exchange	Health and Employee Benefits	Ebix Enterprise	Insurance Carriers, Health Plans, Hospital Systems, TPAs, and other Health Insurers
Exchange	Health and Employee Benefits	Customer Web Portal	Insurance Carriers, Health Plans, Hospital Systems, TPAs, and other Health Insurers
Exchange	Health and Employee Benefits	A.D.A.M.	Hospitals, Health Plans, Portals

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Revenue segment	Division	Product	Intended User
Exchange	Health and Employee Benefits	Oakstone	Hospitals, Health Plans, Portals
Exchange	Health and Employee Benefits	EbixBenergy	Hospitals, Health Plans, Portals
Exchange	Health and Employee Benefits	LuminX	Hospitals, Health Plans, Portals
RCS	P&C	CertificatesNow	Agents & Brokers
RCS	Certificate Tracking	CertsOnline	All
RCS	Certificate Tracking	TrackCertsNOW	All
RCS	CRM	SmartOffice	All
RCS	Marketing Solutions	Crosstrio Marketing Portal	All
RCS	Marketing Solutions	Crosstrio Media Center	All
RCS	Marketing Solutions	Crosstrio Media Connect	All

Source: Company reports, J Capital

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September 8, 2016

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