JCAP

Global
Short Ideas

July 13, 2017
Closing Coverage

Ebix (EBIX US)
Come Back Next Year

Closing Coverage
Ebix's aggressive accounting tactics, acquisitive strategy, and unexplained high margins warrant skepticism. However, management is also embarking on aggressive share repurchase plan, while the latest acquisition, Itzcash, brings a new growth story to the stock. The SEC recently closed its investigation into the company. We believe the company is ultimately a short, but not until next year.

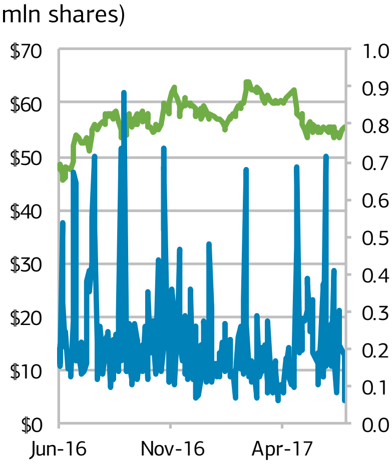
It's Cash
Ebix made its largest acquisition ever, Itzcash, on May 24, 2017, structuring the acquisition with USD 44 mln in contingent earn-outs, a big restock for the Ebix cookie jar. Management will almost undoubtedly use these earn-outs to boost future earnings.

Bottom Line
We believe the quality of earnings at Ebix is low. We are skeptical that Ebix has any core competitive advantage and we cannot be long Ebix. But stock buybacks, an end to an immediate regulatory threat, and an apparent recovery in organic revenues in 2016 make Ebix look like a bad short bet in 2017.

Ebix (EBIX US)

Price	USD 55.35
Market cap	USD 1745.4 mln
Volume	64,180
P/E	18.76x
S/I	25%

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



Source: Bloomberg

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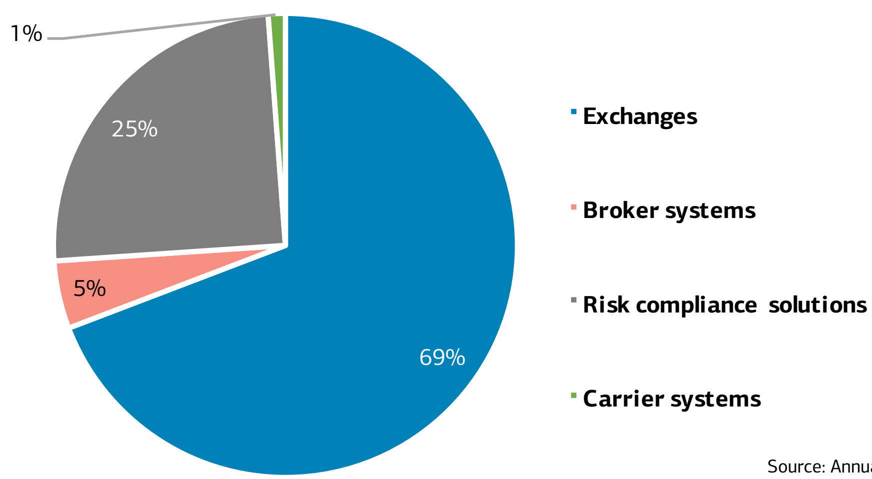
Not Making Sense

We question the sustainability of Ebix's margins and, indeed, whether margins are indeed as high as reported.

Ebix divides its revenue into four categories, Exchange, Broker Systems, Risk Compliance Systems, and Carrier Systems. Of these, the Exchange business is dominant, with ~70% of sales. Risk Compliance Systems is second, at 25% of sales. None of the public comps we examined in these two categories are as profitable as Ebix.

Chart 1. Ebix Sales Composition (2016)



Source: Annual Reports

What is an exchange? Ebix provides the following nebulous definition:

> "... Ebix operates data exchanges in the areas of life insurance, annuities, employee health benefits, risk management, workers compensation, insurance underwriting, and P&C insurance. Each of these exchanges connects multiple entities within the insurance markets enabling the participant to seamlessly and efficiently carry and process data from one end to another... Exchange revenue is derived from two main sources, namely subscription fees associated with accessing the exchange and transaction fees charged for each data transaction processed on an Ebix Exchange, with a transaction being defined as the exchange of data between any two entities using an exchange..."

According to Ebix's definition, an insurance exchange simply involves any exchange of data between two or more parties. We looked through annual reports for companies that compete with Ebix, and found a company called BenefitFocus (BNFT US) that offered a clearer description:

> "... Marketplaces are online shopping environments, sometimes referred to as exchanges that allow customers to select from a variety of benefits plan choices to suit their individual needs. Marketplaces support the shift toward defined contribution benefits plans, which are increasing in popularity. Marketplaces provide consumer centric experiences focused on personalization, and integrate social tools to help drive informed choices while selecting benefits. They also include features to track plans and compare pricing and features across multiple benefit plans..."
>
> Source: BenefitFocus 10-k

What exactly is an "exchange"?

This defines an exchange as an online marketplace giving both brokers and consumers a way to comparison shop insurance offerings. An example of this is the insurance exchange Ebix is building for the London PPL Exchange in order to create a single platform for carriers and brokers.

An exchange might also be a platform where consumers can buy plans and submit claims. From BenefitFocus 10k:

> "... eExchange is a solution that bridges the communication gap between carrier and employer systems, allowing a seamless exchange of data between the two. Our customers use eExchange to integrate data from multiple systems, convert data from one format to another, and manage the flow of employee data between carriers and employers..."
>
> Source: BenefitFocus 10-k

Here is a quick description from iPipeline's CEO, another Ebix competitor, on the advantages of digital exchanges for insurance. iPipeline works with more than 125 life insurance carriers, some 1,200 distributors and financial institutions and links them together for a one-stop database for filling out insurance forms, which differ in regulatory requirements by state.

> "...[Before iPipeline] If I wanted to run you six quotes, I'd have to go to each carrier's website, individually run a quote, aggregate it and bring it to you ... Now I could go out and get five competitive quotes from Genworth, Transamerica, Pacific Life, Met Life and Hartford, and say, 'Here are the differences, here's the price tag, and here's the

> one I'd recommend.' Then the consumer would make the choice..."
> CEO Tim Wallace, iPipeline

Writing insurance policies via software solutions such as iPipeline (and, presumably Ebix) is quicker and more accurate than traditional policies written by hand. According to media reports dated to 2013, iPipeline's CEO estimated that only 10-15% of insurance providers were using digital solutions such as iPipeline, and that the market could grow for the next five years at ~40% annually.

What Is the Exchange Business?

Ebix lumps into the Exchange segment a wide variety of products, some of which have little to do with an actual exchange. For example, the CRM and A.D.A.M., which provides software for medical and health education, are part of "Exchange."

Table 1. Ebix Exchange Business by Division

Division	% Sales of Exchange Segment	Competitors
Health Benefits (Health insurance exchanges and A.D.A.M.)	33%	Trizetto (CTSH US), BenefitFocus (BNFT US), Ultimate Software (ULTI US), Krames Staywell, Red Nucleus, Anatomy One
P&C Exchanges (Ebix Exchange USA/Australia/ NZ, London PPL)	28%	NA
Annuity Exchanges (AnnuityNet, AMP, AN4)	17%	iPipeline
CRM (SmartOffice)	12%	iPipeline, SalesForce (CRM US), Redtail
Life Insurance (Winflex, TPP, Lifespeed)	9%	iPipeline
Risk Mgmt & Workers Comp	1%	NA

Source: 10-k, company presentation

Some of the Mysteries

We attempted to use Ebix's list of competitors to better understand the margin profile of the exchange business. We found that Ebix's competitors generally seem to earn lower margins than what Ebix reports in its financials. Ebix earned 34% operating margins in its FY 2016 and has maintained 30% operating margins as far back as 2007.

Table 2. Margin Profile of Ebix Competitors

Addressable Segment	Competitor	Year	OP Margin	Revenue	Notes
Exchange Competitor	iPipeline	FY 2015	9%	~USD 150 Mln	Private -- unconsolidated data compiled from Orbis. Competes with Ebix in CRM, Life Insurance, and Annuity Exchanges
Exchange Competitor	Trizetto	FY 2007	11%*	USD 360 Mln	Bought by Cognizant in Nov. 2014 for USD 2.6 Bln from Apollo. Cognizant does not disclose the margin profile of Trizetto. Apollo took Trizetto private in 2008
Exchange Competitor	BenefitFocus	FY 2016	-14%	USD 230 Mln	Only public competitor that appears to compete directly with Ebix via an Exchange product offering
Exchange Competitor	Ultimate Software	FY 2016	5%	USD 780 Mln	Seemingly not a direct Ebix competitor. From the annual report it appears Ultimate Software focuses mainly on payroll/HR IT solutions
Exchange Competitor	SalesForce	FY 2017	1%	USD 8.4 Bln	Competes with Ebix in CRM
Carrier P&C Competitor	Xchanging (XCH LN)	FY 2015	13.6%**	GBP 440 Mln	Xchanging bid and lost to Ebix on the London PPL Exchange contract
Carrier P&C Competitor	Guidewire	FY 2016	4%	USD 424 Mln	Competes in Carrier P&C Systems

* For comparison, Ebix booked 40% OP margins in 2008

** 13.6% is for Xchanging's total OP margin. On a segment basis, Xchanging earns 30% OP margins on the insurance segment. However, this excludes corporate expenses and other less profitable segments such as Financial Services. If we were to group all of corporate expense into insurance services, the segment would earn ~24% OP margins. Ebix hasn't reported margins that low since 2006.

Source: Annual Reports,[1] Orbis

1 iPipeline is private and backed by Thoma Bravo, a PE firm that specializes in application and infrastructure software. According to a recent media report, iPipeline's total revenue is approximately USD 150 mln. Our margin data is from Orbis unconsolidated data. Revenue growth at iPipeline has been rapid in recent years, growing from roughly USD 7-8 Mln per year in 2006 to about USD 90 Mln in 2014. It reportedly partners with some 125 life insurance carriers. Their system is described as "a one stop repository for hundreds of thousands of insurance forms."

BenefitFocus—Ebix's Closest Public Comp?

Although Ebix provides numerous examples of public comps to its exchange segment, only one offers a business description that seems to fit the profile of an exchange business. For this reason, we think BenefitFocus is likely the best available public comp to Ebix. Here we provide a screenshot of BenefitFocus' product portfolio:

Table 3. BenefitFocus Product Portfolio

Products and Services for Insurance Carriers	Products and Services for Employers
Marketplaces:	Benefitfocus Marketplace
Large Employer Marketplace	Communication Portal
Small Employer Marketplace	BenefitStore
Individual Marketplace	Core & Advanced Analytics
Retiree Marketplace	Benefits Service Center
eEnrollment	Video
eBilling	ACA Compliance & Reporting
eExchange	eBilling & Payment
eSales	Implementation Services
Core & Advanced Analytics	Benefits Service Center
Integrations	Integrations
Video	Benefitfocus University
Implementation Services	
Benefits Service Center	

Source: 10-k

Like Ebix, BenefitFocus offers exchanges and billing and implementation solutions. Benefitfocus also carries a product called Benefitfocus University (https://www.benefitfocus.com/benefitfocus-university), which appears similar to Ebix's education platform A.D.A.M. Because the scale and description are similar, we thought the two businesses might compare.

Instead, we found the margin profile to be vastly different, with Ebix reporting steady 30% OP margins, and BenefitFocus running an operating loss. Recall that the businesses are roughly similar in scale. In 2016 Ebix did about USD 300 mln in sales, while BenefitFocus achieved USD ~230 mln.

Perhaps most interesting is that Ebix is able to invest a paltry 11% of sales into R&D and still maintain its 30%+ operating margins. Investors might question the sustainability of such a business model when competitors seem to be investing far more aggressively in technology.

Table 4. Margin Profile: Ebix vs. BenefitFocus

	2014	2015	2016
Gross Margin			
Ebix	77.9%	72.7%	71.5%

	2014	2015	2016
BenefitFocus	36.3%	44.4%	48.3%
OP Margin			
Ebix	37.2%	33.4%	33.6%
BenefitFocus	-42.9%	-29.3%	-13.8%
Sales & Marketing (as % sales)			
Ebix	6.5%	5.6%	5.9%
BenefitFocus	35.3%	31.6%	23.8%
R&D (as % sales)			
Ebix	12.5%	11.6%	11.1%
BenefitFocus	30.4%	28.2%	24.3%
G&A (as % of sales)			
Ebix	17.2%	18.1%	17.3%
BenefitFocus	13.6%	13.9%	14.0%

Source: 10-k

Whatever BenefitFocus is doing differently, the strategy is winning business, and doing so organically.

Table 5. BenefitFocus Revenue Growth

	Revenue	% Change
2016	233,335	28%
2015	185,143	31%
2014	137,420	35%
2013	104,752	26%
2012	81,739	

Source: 10-k

By contrast, Ebix sometimes struggles even for single-digit organic growth.

Table 6. Ebix Estimated Organic Growth

Year	Pro Forma Revenues in Reporting Year	Pro Forma Revenues in Prior Reporting Year	% Change
2016	315.8	295.3	6.9%
2015	272.2	280.5	-3.0%

Year	Pro Forma Revenues in Reporting Year	Pro Forma Revenues in Prior Reporting Year	% Change
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%

Source: 10-k

BenefitFocus's revenue growth is all organic. Furthermore, there is clear disclosure around its customer base. In each successive year, BenefitFocus appears to be winning more employers and carriers for its software platform and is gaining operating leverage as economies of scale kick in.

Table 7. BenefitFocus Revenue and Profit

	2014	2015	2016
Revenue by segment			
Employer	62,016	94,842	140,522
Carrier	75,404	90,301	92,813
Total Revenue	137,420	185,143	233,335
Gross profit by segment			
Employer	16,186	33,655	53,031
Carrier	33,764	48,637	59,623
Total Gross Profit	49,950	82,292	112,654
Gross profit per employer*	29,269	46,549	63,663
Gross profit per carrier*	734,000	900,685	1,124,962
Large employer	553	723	833
Carrier	46	54	53

Source: 10-k | Note: *J Capital Analysis

iPipeline has also experienced brisk revenue growth in its exchange business, growing from USD 7-8 mln in 2006 to approximately USD 90 mln in 2014. The CEO further anticipated annual growth of 40% due to low penetration in the industry. If Ebix competes in the same space, why is Ebix struggling to achieve even single-digit growth? And why aren't faster-growing competitors chipping away at Ebix's juicy margins?

Even including growth from acquisitions, Ebix appears to lag behind competitors iPipeline and BenefitFocus.

Table 8. Ebix Exchange Revenue Growth (Including Acquisitions)

Year	Exchange Revenue	YoY Growth
2016	206,427	8%
2015	190,746	13%
2014	169,437	3%
2013	163,925	3%
2012	159,678	

Source: 10-k

RCS Systems—Headcount at Odds with Revenue Growth?

RCS Systems is Ebix's second-largest business segment with 20-25% of sales. According to Ebix's annual report, Risk Compliance Systems is essentially business process outsourcing, including project management, time- and material-based system consulting services, claims adjudication/settlement, and call center/back office support. The division helps clients outsource manpower on an onsite or offshore basis. This division also books revenue with the creation and tracking of certificates of insurance issued in the U.S. and Australia.

Pure-play comps for RCS systems appear non-existent, so estimating the margin structure for this segment is impossible. One oddity, however, is that the employee count for "back-end operations" at Ebix seems to have remained relatively stable in spite of rapid revenue growth in RCS systems. RCS sales are at least partially derived from outsourcing manpower – at least according to Ebix's business description – implying that this business segment should not be overly scalable.

Below is a table of Ebix's employee count breakdown for "back-end operations" and sales for the RCS business segment. We are assuming that the RCS business segment ties to employee headcount in "back-end operations" rather than sales and marketing and/or product development. We think this assumption may be reasonable given that RCS sales engages in consulting, outsourcing business operations and providing manpower (i.e. not developing new products for Ebix).

Table 9. RCS Sales, Back-End Operations Employees

	2013	2013	2014	2015	2016
RCS Sales (USD 000)	16,140	15,678	21,813	55,917	74,196
YoY Increase (USD 000)		-462	6,135	34,104	18,279

	2013	2013	2014	2015	2016
			Employees		
Sales & Marketing	114	121	120	113	138
Product Development	1219	1272	1473	1861	1909
Back-end operations	466	416	608	583	732
Admin, General Management, & Finance	104	118	142	150	209
Total	1903	1927	2343	2707	2988
RCS Revenue per Back-end Operations Employee	34,635	37,688	35,877	95,913	101,361

Source: Annual Reports

Assuming we are correct in this argument, we note that RCS revenue per back-end employee abruptly tripled in 2015. If the reported financials are accurate, one has to believe that the efficiency of Ebix's new sales in 2015 increased by a factor of more than 3x.

We examined the underlying cause in revenue growth in RCS segment over this period. The rapid growth in 2015 was due to the acquisition of PB systems for USD 12.4 Mln in June 2015, as well as the 2014 acquisitions of Vertex for USD 27 mln (October 2014) and i3 for USD 2 mln (December 2014).

The LinkedIn description of Vertex seems to indicate it is an IT consulting business for the insurance industry:

> "... We are a professional services firm providing consulting services to the financial services industry. We focus primarily on Life and Annuities and consult on both the business and IT sides of the house. Our IT specialties include system conversions, modifications, interfaces and development on the insurance carriers back office systems – administration engines, commissions, etc. We offer niche services in the e-commerce space where we support distributors and insurance carriers trying to automate their communications both internally and externally with their trading partners. We are known in the industry as ACORD experts and utilize the ACORD transactions to facilitate these communications..."

The LinkedIn description of PB systems appears similar in that it seems largely an IT consulting business.

> "... Our technology experts offer you full spectrum IT Consulting, Application Services, Systems Integration, Enterprise Marketing Services and E-Commerce Services utilizing our proven Customer Results Approach. PB Systems has domain expertise in E-Commerce, Direct Marketing and Cross-Media Communications...
>
> ...Our mission is to deliver our customer's desired results on time, within budget and at an overall lower cost by providing premier IT services and solutions..."

We are merely pointing this rapid increase employee efficiency out as an oddity. Ultimately, if Ebix books headcount for RCS systems in product development, then our concern would be alleviated.

Itzcash: Restocking to the Cookie Jar

We have previously criticized Ebix for booking generous contingent earn-outs on acquisitions and later writing those back to earnings. Ebix continues to play the same game and made its largest acquisition ever by purchasing 80% of Itzcash on May 24, 2017.

Ebix structured the acquisition by paying cash of USD 76 mln along with up to USD 44 mln in contingent earn-outs. This is the largest amount of contingent earn-outs Ebix has booked on a single acquisition to date. This earn-out provision will provide management with fuel to continue massaging earnings in coming years.

We cannot explain how Ebix's acquisition of Itzcash pertains to its core business.

We cannot explain how Ebix's acquisition of Itzcash pertains to Ebix's core business of insurance exchange – the two businesses of mobile payments in India and back-end insurance software processing appear totally unrelated. We also find Ebix's interest in this unrelated business concerning, given that competitors seem to be achieving healthy revenue growth in Ebix's home market in the United States. Why is Ebix out looking for electronic payments deals in India when competitors are achieving high growth in Ebix's core home market?

Even more concerning is that Ebix is reportedly encouraging Itzcash to make new acquisitions in India:

> "... In last 10 days, we have met about 20 companies in these areas, and we are only going to extend those discussions and go aggressive. One big change, after the Ebix deal, is the inorganic approach to build new businesses and scale it up a lot more faster..."
>
> Naveen Surya, Managing Director, Itzcash

Itzcash is a leader in prepaid cards and bill payments space in India. It claims to be the only profitable company of all its peers, despite that larger competitors such as Paytm have yet to attain profitability, but enjoy larger scale. Itzcash claims to be the largest payment player in domestic travel with 12% share on IRTC, a subsidiary of the Indian Railways that handles catering, tourism, and online ticketing. Itzcash primarily operates through digital wallets and prepaid cards. In the future, Itzcash appears to be moving in the direction of growing its business in SME lending, International remittances, as well as continuing its basic businesses of gift cards, domestic remittances, and payments. Itzcash's business is reportedly growing at 35% CAGR.

We are not experts in Indian payment systems, but comping to some recent transactions in India the valuation paid seems in line. Citrus Pay was purchased by PayU (controlled by Naspers [NPN SJ]) for USD 130 mln in September 2016. Citrus Pay reportedly processes a gross business value of USD 2.2 bln annually, and about 10 mln transactions per month, which appears similar in scale to Itzcash. Like Itzcash, Citrus Pay built its business on mobile prepaid payment system.

Long term, Itzcash probably gets written down to zero.

We think Itzcash is a real company, but it probably has poor long term prospects as it inevitably loses to larger competitors like Paytm. Ebix has likely simply identified a high growth business which it hopes will help boost its top line growth, at least in the short term. Long term we think Itzcash probably gets written down to zero. In the interim period, however, it provides Ebix with much a needed growth engine.

The fintech space in India has captured the attention and imagination of investors since November 2016, when the government moved to ban high value currency notes and limit cash transactions. Google and the Boston Consulting Group recently completed a study estimating that India's digital payments industry is projected to grow 10x in size by 2020 to a USD 500 bln. PriceWaterhouse Coopers has placed this figure closer to USD 1 trn. Either way, the payments system in India is unlikely to slow for a long time to come, and the overall pie is growing fast enough that even smaller competitors like Itzcash are likely to enjoy growing revenue streams.

With a supposed USD 40 mln in revenues for 2016 and growing ~35%, Itzcash is large enough to move Ebix's top line. Ebix shareholders on the long side are likely to accept whatever business metrics are delivered post acquisition—as long as they deliver growth. This leaves the short side with a very real risk of Ebix's stock re-rating to a higher multiple than its current 18x trailing PE.

Closing Coverage

Ebix's aggressive accounting tactics, acquisitive strategy, and high margin structure make us skeptical of the company – or at a very minimum the sustainability of its profits. Competitors seem to be outgrowing Ebix by a mile, making us skeptical of how long the company can sustain its current margins.

At present, however, we think there is substantial risk to shorting the stock. Ebix's board approved an additional USD 150 mln of stock repurchases in February 2017. This ups Ebix's previous repurchase plan from August 2015, when Ebix received approval to spend USD 100 mln buying back stock. Ebix has shown a strong willingness to re-purchase its own stock, spending USD 240 mln in cash on share buybacks over the last three years (from Q1 2014 through Q1 2017).

Furthermore, leverage remains conservative. Ebix held net debt of USD 185 mln as of Q1 2017 and generated EBITDA of 110 mln in 2016. Even using trailing EBITDA, that implies leverage of 1.7 turns. Following the Itzcash acquisition, Ebix will assume an increase in net debt of 74 nln (assuming no inflows from operating cash), but even here Ebix does not appear stretched.

Most importantly, Itzcash brings a new growth story to the stock that long investors may embrace.

The SEC closed out its investigation on Ebix in February 2017 and does not recommend any enforcement action against Ebix.

Lacking a catalyst on the short side, and with near-term risk to the upside, we move to suspend coverage.

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