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Reviewing Ebix's FYE 12/10 Shows a Continuing Attractive Investment Opportunity

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This article reviews the latest financial results from the perspective of performance metrics relevant to fundamental value.

Two points result from this review. First, the estimated fundamental value ($38/sh. - $40/sh.) and the related investment presented in a previous article (here) remain comfortably valid.

Second; financial results coupled with Ebix's (EBIX) strategy, presented in the conference call by Robin Raina, CEO and chairman, substantiate the company's direction and reinforce the low business risk implicit in the business model.

From the perspective of the investor, the risk/reward trade-off continues to point to Ebix as an attractive investment opportunity.

FYE 12/10 Performance

The table shows multiyear metrics related to fundamental value, including FYE 12/10 results (Note: the ADAM acquisition is not included in such results. It closed in 2011).

EBIX Table --Selected Metrics

(Amounts in millions of US$, unless otherwise noted)	**FYE 12/06**	**FYE 12/07**	**FYE 12/08**	**FYE 12/09**	**FYE 12/10**	**5-Yr.Avg. FYE06-10**
Revenues	29.25	42.84	74.75	97.69	132.19	
Revenue Growth (y-o-y)	21%	46%	74%	31%	35%	42%
Revenue per Sh. ($/Sh.)	1.04	1.36	2.03	2.57	3.39	2.08
EBIT	6.71	12.80	29.26	39.26	52.51	
EBIT / Revenues	23%	30%	39%	40%	40%	34%
EBIT per Sh.($/Sh.)	0.24	0.41	0.80	1.03	1.35	0.76
Cash Flow from Ops.	4.15	15.04	26.83	33.88	52.78	
CF f/Ops. / Revenues	14%	35%	36%	35%	40%	32%
CF f/Ops.Growth (y-o-y)	-24%	262%	78%	26%	56%	80%
CF f/Ops.per Sh.($/Sh.)	0.15	0.48	0.73	0.89	1.35	0.72
Free Cash Flow	2.35	12.44	23.52	29.92	46.74	
FCF / Revenues	8%	29%	31%	31%	35%	27%
FCF Growth (y-o-y)	-44%	429%	89%	27%	56%	112%
FCF per Sh.($/Sh.)	0.08	0.39	0.64	0.79	1.20	0.62
Cash & Mkt. net of Debt	-6.93	-12.10	-42.26	-39.30	-6.97	
Cash Growth (y-o-y)	nm	nm	nm	nm	nm	nm
Cash per Sh.($/Sh.)	-0.25	-0.38	-1.15	-1.03	-0.18	-0.60

# Shares	28.26	31.60	36.78	38.01	39.02	
# Shares Growth (y-o-y)	1%	12%	16%	3%	3%	7%

Operating Income (EBIT)

Net Operating Profits after Taxes (NOPAT) = EBIT (1 – Tax Rate)

Operating Capital = NOWC (Net Operating Working Capital) + OLTA (Operating Long Term Assets)

Free Cash Flow = NOPAT - Net Investment in Operating Capital during the period

(As an approximation: FCF = Cash Flow from Operations minus Depreciation and Amortization)
FCF Growth Rate (g)
Weighted Average Cost of Capital (WACC)
Enterprise Value = Present Value of FCF growing at g, discounted at WACC
Equity Value (Fundamental) = Enterprise Value + Cash – Debt
Share Fundamental Value = Equity Value / # Shares

Worth highlighting are the following 12/10 FYE figures and y-o-y growth in parenthesis:

- Revenues --$132.19 million (35%)
- EBIT --$52.51 million (34%); [(NOPAT --$52.51 million (34%)]
- Cash Flow from Operations --$52.78 million (56%)
- FCF --$46.74 million (56%). (FCF = Cash Flow from Operations - Depreciation).

Implicit in the strong FCF generation is the performance of the following components:

- Strong NOPAT margins (NOPAT /Revenue ratio was 37% in FYE 12/10 and 40% in FYE 12/09)
- Efficient management of Operating Capital, even in the face of expansion due to acquisitions (minimal NOWC and $242.52 million in OLTA)
- Resulting from such strong operating cash flow and efficient use of capital is strong ROIC; 20% in FYE 12/10 vs. 17% in FYE 12/09.

These metrics are consistent with the fundamental value of $38/share - $40/share estimated in my previous article (here). In fact, an updated fundamental value estimate based on Q 12/10 and pro-forma ADAM figures results in a marginally higher fundamental value (the acquisition closed early in 2011). For all intents and purposes, we keep the $38/sh. - $40/sh. estimate.

Strategy

During the conference call, Robin Raina, CEO and chairman, did not use the word strategy, but presented eight words to focus on to understand the Ebix story –a quick-reference way to understand what the company is doing and wants to continue to do.

The following is from my notes of the call. It is a combination of paraphrasing, adding, subtracting, interpreting, synthesizing, and commentary (any misses regarding substance are only mine).

1 Convergence

Convergence is the focus on all channels in the insurance industry; from B-to-C, and B-to-B; from back-end to front-end. The goal: To take data across all entities in the industry and across all product lines seamlessly.

2 Airport

Airport service is synonymous with exchange service. Airport is an infrastructure based-served business with relatively little competition. The B-to-B exchange is an infrastructure-based service; non-aligned and neutral in preference. 71% revenues are from B-to-B exchanges.

3 Enterprise

Enterprise is the focus; providing all insurance services and deploying front-end, exchanges, and back-end systems, across all product lines, while taking responsibility for the enterprise-functionality of the end client.

4 Change

Ebix prefers to keep evolving with the times; free to change and agnostic in the use of technology. The preference is to build technology along open architecture standards; to expand functionality and take advantage of latest advancements.

The emphasis is on the ever-moving, cutting-edge and staying years ahead of competition.

R&D emphasis is worthy of note. The company's R&D centers in India have the highest quality rating from Carnegie Mellon. Further, R&D emphasis is evidenced by the highest employee deployment in product development –71% of the number of Ebix's employees worldwide work in product development.

5 On-Demand

Products and services are available on demand, charged on a utility-like fashion.

6 Consistency

Have always focused on consistency, rather than on a flash-in-the pan performance. Consistency is an all around focus; on recurring revenues and overall financial performance, and on how to be seen by stakeholders in general, including clients and shareholders.

Recurring revenues from a diversified client roster is also an important focus, with 75%+ of revenues being recurring. Reflecting consistency is a history of yearly and quarterly improvement. Nothing extraordinary was needed to achieve a good Q 12/10.

Product consistency is important to clients using Ebix globally. Products are deployed in different foreign languages, for example, but keeping the core-base unchanged. So, like in the case of McDonald's (MCD) french fries, the look and feel of the product is consistent wherever accessed.

7 Cash

The focus is on building a solid business where clients pay on an ongoing utility-basis, and where margins and the revenue cash content are robust. Witness $52.78 million in Operating Cash Flow derived from $132.19 million in FYE 12/10 revenues.

8 Humility

Humility is the modesty to keep the vision in proper balance; and the focus on today and tomorrow, and on the fundamentals of the business.

The preference is not to issue guidance but to deliver results; and to exchange information with institutional shareholders on an organized manner through venues such as the analyst day scheduled for 4/1/11.

It is not difficult to understand the rationale for avoiding guidance. Coming after a strong yearly performance, prospective guidance can be lower than the analysts' expectations, and subject to derogatory comment. Result: The price of the stock drops.

Alternatively, guidance can be bullish and beyond analysts' expectations, in which case favorable reviews follow and the price of the stock rises. Going forward, however, elevated guidance becomes the standard measure; the higher the hurdle, the greater emphasis in short term gymnastics to meet guidance and maintain management credibility. Missing guidance causes decreases in the price of the stock.

The real management task is to manage the business and execute on strategy. Arguably, the case can be made that projecting performance more appropriately falls in the realm of business analysis and stock valuation by security analysts.

If in management's opinion providing guidance is not consistent with enhancing shareholder value, then there is no (financial) basis for management to provide it. This view is reinforced by Ebix's story of positive multi-year performance. But this is only a view, better left for a corporate-finance-based discussion on some other occasion.

Low Risk

The strategy outlined and the FYE 12/10 financial results as a total confirm the relatively low risk content in the Ebix business model. The following is worth emphasizing:

- Cash Flow from Operations is robust and steady - Notice the relatively high content of Cash Flow from Operations in Revenues, and the relatively high rate of growth, due to the recurrence of exchange revenues and the concurrent diversification in the client roster.
- Focus is on the exchange business - The strategic focus is on the insurance industry. It is supported by the high level of competency in the business.

- The business model is economically strong --Robust FCF generation based on strong EBIT and effective use of Operating Capital, which promote attractive ROIC.
- Growth is driven by technology - Substantial resource allocation in R&D and product development (see #4, Change)
- Continuing acquisitions (mentioned in the call) connote investment risk uncertainty mitigated by multi-year M&A experience. Strategic acquisitions have strengthened exchange infrastructure and moat. They have added capacity, and to the depth of services that airlines of all sizes need. The result: Bigger airports, better airports, more efficient airports.

Summary

To quote the CEO; “Nothing extraordinary happened in 4Q 2010, and we still had a good quarter. We like it that way”.

This is a real tribute to the strength of the company’s business model.

Like the way a tennis buff refers to Roger Federer, tennis player extraordinaire: “Roger did not play great tennis this tournament; but it was good enough to beat his opponent in the final, in three straight sets”.

Stability in the business model and inherent low risk is reflected in predictable FCF growth. Predictability decreases the cost of capital and effectively enhances fundamental value.

High return in invested capital (ROIC) and high capital efficiency underlie high business returns, a prelude to attractive investment returns. The combination of low business risk and high value/price gap translates into an attractive investment opportunity.

From this perspective, the conference call was very useful; the strategic review was broad in scope and useful in important detail. It contained much more than what is covered in this article.

Management effectiveness gets very high scores for constructing the secular growth story, and for working hard in maintaining it vibrant and alive.

So far, the market response to the Ebix story in only tepid, as witnessed by the estimated value ($38/sh. - $40/sh.) / price (about $28/sh.) gap. On the other hand, from the investor's own perspective, market mis-pricing is the premise that leads to attractive investor return conclusions.

Steadiness in strategy, consistency in performance, and a medium-term horizon, are in my opinion, powerful ingredients that compel closure of the value/price gap.

Disclosure: I am long EBIX.

Additional disclosure: Careful attention has been given to accuracy. Nonetheless, data usage and computation entail a probability of error, which is entirely possible.