



Ebix's CEO Chats With the Fool

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A provider of software to insurance companies, **Ebix** (Nasdaq: [EBIX](#)) has been one of *Fortune* magazine's fastest-growing companies for several years running. But it's also a controversial stock where some on Wall Street are concerned. A target of short-sellers and class action lawsuits, Ebix has been accused of everything from unsustainable tax rates to lackluster organic growth.

The stock is a *Motley Fool Rule Breakers* recommendation and, separately, a holding in the *Motley Fool Pro* portfolio. Recently, *Pro* had to chance to talk with Ebix's CEO, Robin Raina, and used the occasion to allow members from these two Fool services to ask questions. Raina is the man responsible for turning Ebix from a money-losing enterprise into a strong generator of free cash flow several years running. The following is Raina, uncut and unedited -- just as Ebix wanted it -- answering questions from *Motley Fool Pro* and *Motley Fool Rule Breakers* members.

Questions and answers

Rule Breakers senior analyst TMFSysun (Sean Sun) asks:

Unfairly or not, Ebix is in the bear's spotlight -- a position where it absolutely cannot afford to make *any* mistakes. How does Ebix plan on trying to become more like Caesar's wife -- beyond suspicion entirely? How is Ebix improving its internal financial and governance controls?

Robin Raina:

I am not sure whether Ebix is in the bear or bull spotlight, but I'm sure that it is getting some attention at present. Leadership and management are about doing things in the most efficient manner that you can. Caesar's wife must be above suspicion, but then, suspicion lies in the eyes and minds of the beholder. Companies need to do things the right way because that is simply the right thing to do, not just because the company is being closely watched.

As long as a management team tries to put in its best at all times, in a transparent, honest & sincere manner, that is good enough in my book. To quote GB Shaw, "A life spent making mistakes is not only more honorable, but more useful than a life spent doing nothing." As long as we make mistakes that we learn from, and we do not keep repeating our mistakes, I would think that is OK. We are focused on execution and performance, while ensuring that we do it with utmost integrity and efficiency. We are not trying to follow another blue-chip company -- we are trying to create hopefully an example that others can emulate in the future.

Somebody recently wrote about BDO raising a concern about our controls in the year 2003. That was the first year of their audit, and SOX was the last thing on Ebix's mind at that time, since Ebix was a tiny company fighting to simply survive. What was not given any attention was the fact that BDO did not cite those deficiencies in subsequent years of their audit, clearly telling you that BDO did not have any control issues after their first audit.

Ebix has some of the best internal financial and governance controls that any company in the world can aspire for. It is not just because SOX mandates you to do that -- it is because that makes our business efficient, cost-effective and better than others.

Ebix runs all its operations and processes over the Internet, using internally built systems with checks, controls, and balances in it. Our entire business is run using an internally built enterprise tool, "iemployee," that is accessible in an anytime, anywhere, anyplace basis over iPads, Droids, iPhones, BlackBerrys, Macs, PCs etc. This was implemented in the year 2007.

All our contract administration is done using that system, our sales management, travel bookings, expense tracking & payment, human resource recruitments, leave tracking, attendance management, payroll, banking, capex management, PO generation, IT management, revenue

tracking, expense forecasting, etc. Everything is done using our "iemployee" system. All processes require multiple approvals, central head office approvals, finance approvals at various levels, tracking of payments, automated PO creation, etc., while an audit trail of every transaction is kept by the system. All this is done over the Internet across six continents in minutes, while ensuring budget sanctity, approval sanctity, and controls that can be trailed back at any time.

We implemented these systems because besides controls, it gave us a better handle on our business -- we can predict things a bit more easily than others, we have better control over all aspects of our business as we have this systematic centralized system to check everything, and also it keeps everybody at all levels in check. To us, it is about efficiency besides checks and balances. If a company aspires to run a 40%-or-more operating margin business, it does not have a choice but to put internal controls and governance controls in place.

We believe that we do extremely well on controls and can teach the best of firms across the world on how to do it in a systematic manner on a large scale, while making their businesses more efficient. We actually plan on launching this new "iemployee" service on an on-demand basis over the cloud, to help companies implement better controls in place. We believe that there is a big market for these kinds of services in the financial world -- we see us selling this on-demand product to large accounting firms besides insurance companies and banks.

Besides that, improving governance and internal controls is an ongoing continued process that can never stop. Like any other company, we keep testing our controls and fixing anything that needs improvement. That will obviously continue.

Fool member ultimatespinach asks:

When the former chief executive and board members of Peak Performance Solutions filed suit, alleging that Ebix wrongfully denied them a \$1.5 million earn-out following the acquisition of Peak, you were quoted by Bloomberg News as saying, "It's a black-and-white issue. They had to hit \$6.5 million. It's pure revenue. Nobody contested anything until the last day. It's in everybody's interest to have as much revenue as possible." Clearly, it was in everybody's interest for Peak-related revenues to blow past the threshold, but assuming they ended up somewhere in the vicinity of the threshold, isn't it true that it is in fact not in the interest of Ebix or its shareholders to pay the earn-out? Doesn't claiming otherwise threaten your credibility?

Raina:

Much has been said about the Peak suit, while the company has kept its answers to itself, since it's a matter being looked at by the courts at present. Let us all reserve our judgment for now, until a court either rejects the Peak accusations or holds Ebix guilty of any wrongdoing.

The suit alleges understatement of revenue, not overstatement, as some people made it out to be. The agreement with Peak shareholders mandates audited GAAP numbers to be used for the earn-out calculation. The audited numbers were a lot lower than \$6.5 million.

If they had a dispute with that number, then the contract mandates that they need to give Ebix a 30-day notice, then submit reasons for dispute on revenue. After all this, it could lead to arbitration, failing which, it would go to a court. The funny fact is that they have not done any of that, including giving us a 30-day notice or taking it to arbitration. One wonders why they were in a hurry to file a suit and report it to the public, when the contract does not even allow them to do that. So, let us hold our thoughts for now and not pass any judgment on Ebix practices or management, based on this suit that alleges a few hundred thousand in understatement.

Till recently, Ebix has been one of the few public companies that have had very few legal disputes in the last decade or so. We must be doing something right to not be the subject of many disputes over the last decade.

Public companies cannot keep cutting checks for fear of avoiding any suits -- we have paid many earnouts over the last decade, and most of the owners, their managements, and at times family members, of businesses bought by us over the last decade still work for us today. Incidentally, that includes Peak, too, even today. We believe that it is in the interest of shareholders that Ebix does the right thing -- pay an earnout when it is due, and not pay it under pressure, when it is not due.

Company credibility is hurt when company does something wrong and that is established as a fact. It might suit some people's interests to exploit an unproven allegation amounting to a few hundred thousand dollars, even if it may not have any basis. But then, the same people are not going to look

very good if that allegation is proven to be a complete fabrication -- so let us hold our judgment for now.

ultimatespinach also asks:

As a company that owes much of its growth to acquisitions, do you believe the dispute with the former Peak executives and board members might make future possible acquisition targets question the good faith of Ebix, and therefore make such acquisitions more difficult?

Raina:

Firstly, Ebix has grown by acquisitions and through organic means both. Let us talk through any acquisition we made, and compare their revenue in the preceding quarter before the acquisition, and say revenue from that service in Q1 of 2011 -- you will immediately discover that Ebix has done a good job of growing the business.

Every time we make an acquisition, we take a haircut on deferred revenues immediately, and that haircut can vary between 3% to 7% of the acquired company's revenues. All growth analysis that I have seen has ignored this 3%-7% hit taken by Ebix immediately post-acquisition, in revenues from the acquired player. Also, this growth has been achieved at a time when the insurance industry was shrinking and having the worst years in a few decades.

As regards any suit impacting future acquisitions, people are a lot smarter than making their judgment based on an unproven exception. We have paid lots of earnouts over the years and still continue to do so. As I said earlier, most of the owners of acquired businesses still work for us, including many family members of the Peak shareholders. Our acquisition pipeline is strong and not affected by any of this. This suit does not get any attention by anybody other than the noise seekers in the investment world, who might have their reasons to do so.

In the investment world today, if the company does not have any bad news, then people become catalysts to creating the bad news -- people sometimes forget that truth always finally prevails. Truth decimates everything that comes in the way -- we are firm believers in the power of truth, integrity and honesty, though we realize that in the short term, repeated chants of "cows can fly" might unfortunately get some followers -- at least for now.

TMFTypeoh asks:

Any thoughts on paying a one-time, special dividend? I would think that would scare some of the shorts away, at least in the short term. It might give some credibility to EBIX as a legit business as well.

Raina:

As regards dividends, at this point nothing is ruled out. Let us wait and watch.

One thing is pretty clear: that the Board has committed to purchasing \$100 million of Ebix stock from the open markets and retiring that stock. Once Ebix has purchased \$75 million or more of its stock, I intend to recommend to the Board to increase the purchase authorization to \$160 million from \$100 million.

We are buying our own stock because we see this as an accretive transaction for our shareholders, and because we see this as buying stock in a company that is producing 40% or more in operating margins, and is still trading at rather low cash multiples. We are not buying the stock because we want to support our stock price or drive the shorts out. That would be knee-jerk, or rather short-term, thinking, and we prefer to think about our shareholders' interests in the long term.

Lastly, after being in existence for 35 years, powering hundreds of thousands of users across the globe, powering hundreds of billions of insurance premiums, or having majority of the blue chip names of the insurance and financial world as customers or having 30 + offices across the world with customers in 69 countries or having one of the highest customer retention rates in the insurance industry or producing 11 years of consistent growth in terms of cash, income, revenues and EPS for a business that a decade back was a \$12 million revenue business with a \$19 million loss; if Ebix still needs a dividend to prove to a particular investor that it is a legit business, then something is wrong with the world we live in today. Dividend payment or non-payment should be a rational decision based on growth strategy and merits, rather than proving anything to anybody.

Fool member SimFool777 asks:

I am wondering if the current short attacks might be related to the EZ Data Puts. Does Ebix know if EZ-Data still holds the put options or if they sold them to someone who might have the financial clout

to implement a short attack? Is the stock buyback intended to try to keep the price above \$15.11. Does Ebix intend to offer put options in future acquisitions?

Raina:

We do not believe that it has anything to do with the EZ Data puts. Those puts anyway run out in October of 2011. We are not buying our stock back to keep the stock above a particular price. We purchase stock because it is an accretive transaction for our shareholders.

Stock puts, constructed properly, have a good upside for the acquired shareholder, and very limited downside for Ebix. When we gave the \$25 million stock put to EZ Data shareholders, it provided for us to pay them \$22.5 million against that \$25 million value in the 25th month. For us, that would be like an interest-free payment after two years, and we get to pay 10% less. For EZ Data owners, it gave them an upside into the future, with a 10% downside cover. That interested them and ultimately got the deal done.

Whether we use it in the future for another acquisition will depend on many metrics associated with that acquisition. I do not rule it out neither can I tell you that we will use it for sure.\

Fool member kcanant asks:

We are interested in your philanthropy; how are things going with the RR Foundation?

Raina:

RRF is committed to helping the underprivileged across the world irrespective of color, religion, sex, caste or creed. We believe that pain feels the same across the world. My belief is that poverty is a religion by itself and it transcends every divide.

RRF supports the education of thousands of kids today, while offering them mid-day meals, clothes, medical care, and hope for a possible future. One of my dreams has been to build 6,000 homes for Delhi slum dwellers that were thrown out of the city by the Govt. of India in the name of cleansing the city, for the 2010 Commonwealth Games. These homes cost around \$2,000 each to build -- we have handed over 1,157 homes as of now, while another 297 homes will be handed over by end of August 2011.

Recently, I produced a documentary film, *Dilli*, to give a voice to these slum dwellers. The film shows these homes [and] also traces the lives of these slum dwellers from Delhi. The response to the film has been rather overwhelming -- as of now, the film has won six film festival awards, besides being selected to the finals of 17 international film festivals.

Recently, NBC's Documentary channel signed an exclusive two-year agreement to telecast the film in the U.S. and West Indies beginning September 2011. All this has served to get the voice of these underprivileged people heard across the world and we feel rather humbled to have played a role in making that happen. You can read more about it on www.dillifilm.com.

I have always believed that a coffin does not have a pocket. Being in charity has given my life a balance, a perspective that keeps my feet on the ground. I realize that materialism is evanescent, while giving & peace of mind are something that nobody can take away from you. Charity is not about giving money -- it is about giving one's time and care for the ones who need it. The blind kids that we educate care less for the money that we provide them; they care a lot more for the warmth of a hand that gives them the sense of belonging and affection. Sometimes people who have no money are more charitable than people who give lots of money.

The foundation is a facilitator in the process of changing lives and imparting hope -- one life at a time. We will keep striving to do so.

Fool member EricLin asks:

Given the amount of cash committed to share buybacks, does this mean the end of acquisitions? If not, how will acquisitions be financed? Via debt or equity?

Raina:

Our business continues to produce good amount of cash. We expect and believe that our cash flow generation abilities will continue to grow over time, as we expand our business and sales force.

We have a strong acquisition pipeline at present. We believe that we have the means to finance these acquisitions. With interest rates being very low and our continual ability to generate strong cash flows, our preferred medium of financing an acquisition is debt. Any company's bankers keep a

close watch on the company's AR, cash & collection record; and they have the best understanding of whether a company deserves that debt. Thus, Bank of America could be a logical choice for us though it will always be a decision made on the best possible interest rate and the best possible flexible terms given by an institution.

Fool member pwil asks:

How does Ebix plan to support its existing U.S. legacy systems in the future?

Raina:

Ebix has continued to support any legacy systems that it inherited from the business that the company had before we reinvented the business as a on-demand SAAS play, a decade or so back. The good news is that the only legacy business we support today accounts for less than 1% of our worldwide revenues.

Supporting a legacy business is like supporting an antique car. You can support it as long as you want, but the spare parts and servicing keeps getting more expensive every year. Ebix intends to follow that rule and support the systems as long as we can, while ensuring that it holds viable economics for Ebix.

Fool member antmark asks:

How does Mr. Raina view EBIX's tax risk exposure stateside, specifically on transfer pricing?

Without robust contemporaneous transfer pricing documentation for Code section 482 purposes, an IRS audit challenging the arm's length nature of payments to India or Singapore affiliates could wipe out a significant part of free cash flow (and impact future taxes).

On a related note, while CB&H may have "decades of experience in audits and tax work with large international accounting firms" (quoting from the Barron's article), does CB&H have (and has it demonstrated) sufficient capability to handle the transfer pricing of services and intangibles? Proof of the pudding will be whether CB&H-prepared documentation (whether for EBIX or other clients) have passed IRS audit scrutiny previously.

Raina:

To put things in perspective, BDO Tax Partners in 2005-2006 put Ebix's tax structure in place. Subsequent to that, it has been reviewed and enhanced by Ernst & Young, with help from other firms like BKD, Frazier Deeter, etc., besides multiple offices of E&Y across the world. Ebix's infrastructure setup of putting development and IP in Singapore & India was put in place much before any tax planning was contemplated. Also, Ebix's inheriting of NOLs in the United States was something that was not planned, but happened since Ebix had lots of losses in the pre-2000 era. Our tax structure worldwide was thus driven by our infrastructure and efficiency needs of putting development & IP in a place, which could give us global economies of scale at the highest levels of efficiency.

Ebix took care not to transfer any IP out of the U.S. and thus does not expect any issues on that account. All our IP centralized in Singapore was either built and funded by Singapore, or directly acquired by Singapore through an acquisition.

Our transfer pricing is not done by CB&H. The transfer pricing, updates and reviews are done by E&Y with help from their various offices, and BKD. That is a continuous exercise and not just a onetime exercise. Every position of the company has a strong documented basis, written by these top quality firms who are rated one of the best in this work worldwide. CB&H is our U.S. auditor who checks all this from an auditor perspective and they have an international tax practice that specializes in this field.

Besides following the advice of the best in the business, the company always has taken conservative positions and built large FIN 48 reserves to offset any adverse transfer pricing rulings. Also our US NOLs in all those periods serve to largely offset the cash impact of any adverse ruling.

As Ebix releases its valuation allowance in Q2 of 2011, a lot of this will become a moot issue with Ebix worldwide effective tax rates going up to 16-20%. Most of those taxes will be in the United States as our international tax rate is primarily driven by Singapore's perpetual tax rate of 10%. India's low tax rate will become a bit irrelevant once all development & IP is centralized in Singapore. At a tax rate of 16-20%, we will be paying a bit more tax than most global software companies in the United States today.

Fool member snafflekid asks:

What prevents another company from buying some **salesforce.com** cloud computing time and

creating an Ebix copycat?

Raina:

Ebix is not just a technology player -- Ebix is an insurance domain expert. That is the biggest barrier to entry to the insurance industry that thrives on regulations that change by state and line of business. In any case, all the businesses that we power do not own any IP for the service that we provide to them. Ebix owns all IP and provides the service on a "right to use" basis. Also, exchanges in the most case require large aggregations to move from one software player to another, which is rather impractical and that is another barrier that is difficult to get over for a competitor.

Pro advisor Jeff Fischer (TMFFischer) asks:

Have any current Ebix customers or potential customers mentioned *Barron's* or any of the short-seller articles as a point of concern?

Raina:

The short answer is no. My guess is that our customers know a lot more about us than any media article can tell them about Ebix.

Thanks!

Thank you to our *Pro* and *Rule Breaker* members for the excellent questions, and to Robin Raina and Ebix for detailed responses. We hope investors of all stripes found this as informative as we have. In *Motley Fool Pro*, we keep in touch with all of the companies we own, giving us another competitive advantage when we make our investment decisions. If you'd like to learn how you can become a member of the Fool's absolute return, market-beating *Motley Fool Pro* service, enter your email address in the box below:

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