Ebix Fueling Growth by Going Back To Its Bread and Butter

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Written by Deniel Mero, Posted in Featured Ideas

The last couple of years have been frustrating for Ebix (EBIX) and its shareholders as the company has been the subject of regulatory proceedings and short attacks. During these investigations, the company has allocated most of its resources to defend itself and, as a result, has had its business operations struggle. Though nothing has been determined, it seems the dust is settling and Ebix will come out in one piece. With all these dealings in the rear view, Ebix will go back to its bread and butter to fuel growth.

Missing Component to Slowing Revenue: Acquisition Strategy

Like most software companies, Ebix utilized acquisitions to grow its business (as seen by the growth rates from 2010-2012). However, during 2013 the company moved away from its acquisition strategy due to the legal issues and allegations that it was facing. Ebix made only one acquisition in 2013 as resources were going towards legal fees and obligations to settle class action suit. As a result, operations were affected.

YoY Growth Rates

	2010	2011	2012	2013	1H 2014
Revenue	35%	28%	18%	3%	-0.7%
Earnings	47%	16%	3%	-15%	-6%

Thus far in 2014, Ebix seems to be heading back to what made the company successful. With Healthcare Magic and CurePet acquisitions, Ebix has added two businesses that broaden the pipeline and add to top line. Looking forward, Ebix intends to use the available funds, through generated cash flows and accessible credit, to make accretive acquisitions, both in the short and long term.

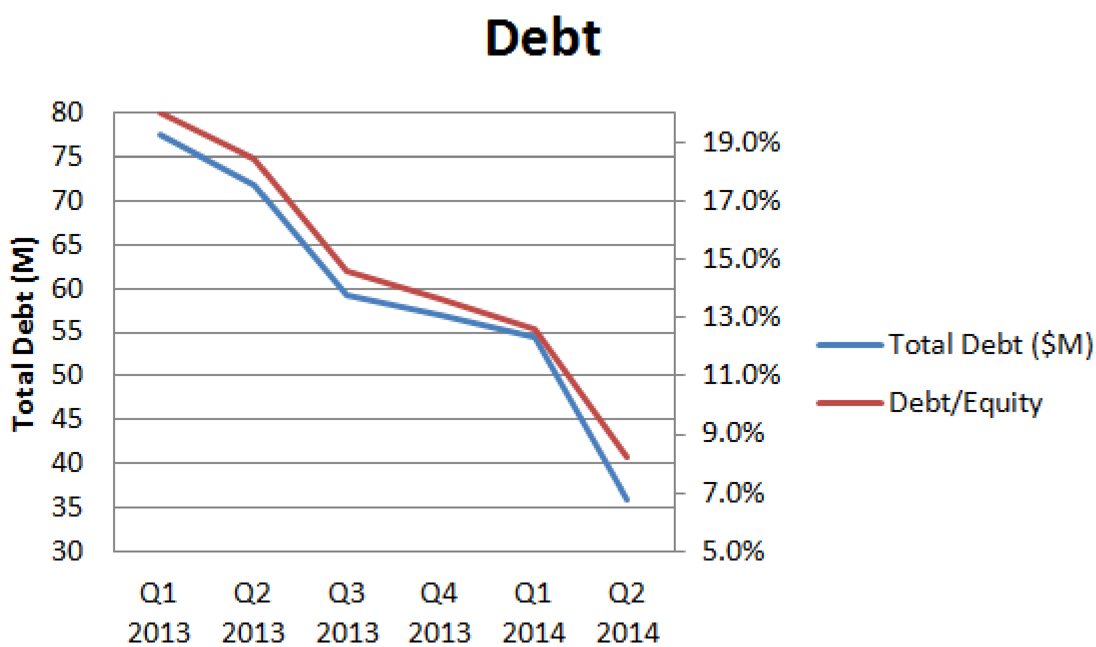
$200M Spending Spree?

Recently, Ebix announced that the company had closed on a $150M credit line (with option to increase to $200M) to fund growth and share repurchase initiative. During the Q2 conference call, Ebix CEO Robin Raina made it clear that the five year revolving credit will be used primarily for stock buybacks and pursuing acquisition targets that will revamp growth.

The fact that a syndicate of banks was willing to commit a revolving credit line of up to $200M to Ebix is validation that some of the prior risks associated with the company have diminished. Obviously, the banks conducted their due diligence, trusted Ebix with their money and thereby dismissing any surrounding allegations. This extended credit line, along with the fact that no additional information has been requested by the SEC or US Attorney Office since 2013 should give investors confidence that the worst is over.

Debt Cycle in Relation To Acquisitions

Due to Ebix's ability to generate strong cash flows each quarter, the company can change its leverage position rather quickly. Throughout 2013, Ebix was paying down the debt incurred from their prior acquisitions that fueled growth during 2010-2012. As seen below, the company has paid off about $20M just in 2014 alone, lowering their D/E to ~8%.



Having gained access to as much as $200M through revolver, Ebix debt levels will likely rise in 2014 to fund acquisitions and, in turn, grow the company. The same process has been done successfully in the past.

Improved Cost Structure

Ebix management has said on several occasions that nonrecurring legal and advisory costs are expected to fall in the future, which in turn should bring operating margins back to the 38% average range and potentially as high as 42%. To hit the higher end of this projection, Ebix has consolidated and purchased real estate in hopes of reducing our ongoing rental and infrastructure expenses. To give investors an idea, below are the comparisons of Ebix's 1H 2014 and how 1H 2015 may look like with the implemented changes.

	1H 2014	% of rev		1H 2015F	% of rev
Revenue	$ 102,880			$ 108,024	
Cost of Service	$ 19,576	19%		$ 20,555	19%
Product Development	$ 13,451	13%		$ 14,124	13%
Sales and Marketing	$ 7,085	7%		$ 8,642	8%
G&A	$ 20,909	20%		$ 17,284	16%
Amort/Depr	$ 4,993	5%		$ 5,243	5%
Total Operating Expenses	$ 66,014	64%		$ 65,847	61%
Operating Income	$ 36,866	36%		$ 42,177	39%

The above assumes revenue grows a conservative 5% in the next year and G&A expenses see a 4% decline due to reduction in legal fees and real estate changes. This would drop G&A expense to ~16% of revenue, what the figure was before Ebix got into the investigations. As a result, these changes would raise operating margins to 39%, the midpoint in Ebix forecast.

Repurchase of Common Stock

Ebix management indicated during the latest conference call that one of the main uses of the $150M revolver will be to repurchase common stock. Obviously, management believes that EBIX shares are currently being undervalued by the market. The company has an approximate $106M repurchase authority, which could repurchase about one fifth of outstanding shares.

Ebix projects that without any repurchases; there will be approximately 38.4M shares outstanding by Q3 2014. Of this, about 34.2M are floating shares and 16.2M are sold short. That results in a 47% of float being short, one of the highest in the market.

On August 8, 2014 Ebix purchased 30,600 shares of its outstanding common stock for at an average rate of $13.18 per share (totaling approx $403K). Repurchases were completed using available cash resources and cash generated from the operating activities. On average, Ebix has allocated $2.5M semiannually the last two years on repurchasing shares.

Stock Repurchase -Sensitivity Table

Price	Millions Allocated: $ 5	$ 10	$ 20	$ 40	$ 60
$ 14.00	357,143	714,286	1,428,571	2,857,143	4,285,714
$ 15.00	333,333	666,667	1,333,333	2,666,667	4,000,000
$ 16.00	312,500	625,000	1,250,000	2,500,000	3,750,000
$ 17.00	294,118	588,235	1,176,471	2,352,941	3,529,412
$ 18.00	277,778	555,556	1,111,111	2,222,222	3,333,333

The table above assumed Ebix allocates $20M for the remainder of 2014 to repurchase a totally of 1.25M shares at an average price of $16. A $20M repurchase figure for 2H 2014 could be seen as conservative, if you take into consideration that the company repurchased $64M worth of common stock back in 2011. Additionally, as shares are repurchased, the price of Ebix stock is expected to rise above current levels which may trigger a short squeeze. This is especially true given the high amount of short interest. Reducing shares outstanding by 1.25M shares would also boost 2H 2014 EPS by an approximate 3%, if all other inputs stayed constant.

Conclusion

The moves that Ebix has made thus far this year indicate that the company is going back to the acquisition strategy that originally prompted growth. The company has completed two acquisitions that are expected to be accretive while also mentioning that they are using the revolver money to initiate growth. This tactic, with the assistance of financial engineering, is expected to add great value to shareholders after the recent tough times the company has gone through.