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Ebix Short Thesis Undermined by IRS Audit Investigation Resolution

By Deniel Mero | 01/08/15 - 08:37 AM EST

NEW YORK (TheStreet) -- Ebix (EBIX) , a supplier of software and e-commerce services to the insurance industry, saw its shares rise 24% after the company announced a resolution of an Internal Revenue Service audit that many investors thought would cost the company more than $100 million. The real price tag? Only $1.4 million, and that makes what is one of the most shorted stocks a much less attractive target.

The IRS was looking into Ebix's income tax returns for the taxable years 2008 through 2012 as there was speculation that Ebix was booking U.S. revenues to low-tax foreign subsidiaries in India & Singapore. However, as mentioned in the official press release, the IRS' assessment relates solely to non-recurring issues associated with acquisitions and not operating transactions. Thus, the IRS found no money laundering issues.

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Ebix expects that the assessment will result in approximately $1.4 million impact on net income for the fourth-quarter 2014. This resolution includes all issues for the taxable years 2008 through 2012. The company's detractors Ebix in the past had estimated settlements to be as high as $100M.

Ebix is one of the most shorted companies traded on the Nasdaq, with a short interest of 14.9 million shares (or 40% of shares outstanding).

Clean bill of health

Passing the IRS' smell test indicates that the ongoing SEC investigation looking into "revenue recognition issue, internal controls and the accuracy of the company's public statements" has little likelihood of mounting to anything material. Likewise, the same could be said about the Justice Department's investigation into the company.

These regulatory risks were arguably the biggest drawbacks for the company moving forward. With one settled and the two ongoing with SEC & DOJ greatly undermined, the Ebix short thesis is fading.

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The audit resolution caused Ebix stock to touch a 52-week high of $20.50 during intra-day trading. In Ebix's third-quarter 2014 conference call, CEO Robin Raina, historically conservative, gave guidance for fiscal 2015 revenue of between $250 million and $260 million. This would result in a 22% increase over trailing 12-month revenue, growth Ebix hasn't shown since 2012. With regulatory issues seemingly in the rear-view mirror, Ebix will focus on what made the company successful in the first place, growth by acquisition.

Ebix was a target of shareholder activism in late 2014, when Barington Capital wrote an open letter to CEO Robin Raina urging for changes to the board. As a result, Ebix agreed to add two new members to its board of directors.

Due to the regulatory issues Ebix has faced, the company's short interest is 14.9 million shares, or 40% of shares outstanding, making Ebix one of the most shorted companies in the NASDAQ. As the dust settles on the investigations, shorts will be forced to cover their positions. Currently, Ebix sports a price-to-earnings ratio of 12.6 trailing and 11 forward earnings. Ebix shares are trading at a deep discount to comparables, like DealerTrack (TRAK) and LogMeIn (LOGM) which are seeing multiples in the mid-to-high teens -- or higher.

Financial Metrics of Peers

Name	Ticker	Market Cap (M)	Rev Growth (YoY)	Op. Margin	P/E (F)
K12	LRN	390	3.70%	5%	30
DealerTrack	TRAK	2250	87.40%	2.50%	22.9
Blucora	BCOR	550	-7.50%	11%	8.9
CSG Systems	CSGS	770	-0.60%	12%	11.2
LogMeIn	LOGM	1130	35.10%	4.50%	35.8
Epiq Systems	EPIQ	570	-5.40%	3.60%	16.9
Average		*943*	*19%*	*6%*	*20.95*
Ebix	**EBIX**	**740**	**1%**	**33%**	**11**

Management has projected 2015 top line growth to be about 20% in 2015. Operating margins, historically, have been high, hovering around 30%.