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EBIX: Let's Let The Results Do The Talking

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In the vast universe of companies there are only a few that seemingly make the right moves - operationally, financially and strategically speaking. In my opinion Ebix Inc. (EBIX) is one of them.

Going back a-half-dozen years or so, EBIX was acquiring businesses when there was relatively little in the way of free cash flow (FCF). In 2004 annual revenues were less than $20.0 million, FCF less than $2.0 million.

How easy is to make an acquisition under tight financial constraints?

Not too easy. It is much easier now with a history of performance behind, and with more substantial and growing FCF. By way of an order-of-magnitude-comparison with 2004, 2010 revenue was $132.0 million and FCF $47.0 million. Net Operating Profit after Taxes to Revenues (NOPAT/Revenues) grew from 11% to 39%. FYE 12/10 ROIC was in excess of 20%.

What that does this mean?

I would argue that EBIX has accomplished something very difficult. With very limited financial firepower available in the earlier years, the company has strengthened its network (expanding product, geographic reach, and clients) while concurrently creating shareholder value. Strengthening the network entailed making synergistic acquisitions. [For greater detail see here.]

Acquisition actions give rise to accounting consequences: A large amount of intangibles and goodwill in the balance sheet (close to 80% of total assets). This is of concern to investors who focus on tangible assets, or tangible equity, as measures of shareholder value. However, if one changes the measurement yardstick to free cash flow (FCF) --the source of fundamental shareholder value –the accounting concern can transform into an investment opportunity.

I will just briefly mention two points supporting the appropriateness of FCF for purpose of enterprise valuation. First, corporate finance principles; second, Ebix provides specialized and high-margin services to clients, which enable FCF. In other words, the firm is not in the business of selling assets at tangible-asset-value, but of providing valuable solutions.

FCF grew to $47.0 million in 2010 from less than $2.0 million in 2004. 2010 ROIC was 20%, and close to 19% for Q 6/11 annualized, well in excess of the cost of capital, conservatively estimated at 10%. From the perspective of shareholder value creation, equity holders should pay attention to these returns and the concurrent rapid growth.

Risk-taking is contained and well within acceptable boundaries. The strategic nature of the acquisitions (to strengthen the network) and focus on insurance industry align with management expertise and serve to maintain risk well within management competence.

EBIX recently announced the addition of expertise to focus on organic growth. Notwithstanding the achievements of the growth-by-acquisition-strategy the announcement underpins welcomed emphasis in organic growth. The network is now robust and exhibits substantive value that can be realized through sales. The expansion of sales capability enhances the lever for internally generated action as a complement to externally-dependent acquisitions. This announcement is consistent with previous communications in terms of financial progress and strategic direction.

Financial management is particularly astute. Stock repurchases and dividends come to mind. Current stock market prices at a level significantly below fundamental value ($35/share) and growing FCF support financial management.

Stock repurchases are well balanced among prospective uses of FCF. At $0.16 dividend per share, annual dividend outflow is less than $7.0 million, equivalent to 10% of estimated annual FCF of $70.0 million. After subtracting dividends ($7.0 million) and ongoing maintenance CAPEX ($4.0 million) annual FCF is $59.0 million. This amount is sizeable relative to modest debt repayment. (Uses of Net Operating Working Capital are minor –On Q6/11 NOWC requirements amounted to a modest 2% of revenues). The point is that FCF generation is very strong, and easily able to support current dividend payments and growth. I would venture to say, at this early stage of dividend-paying history, that dividend increases are not only possible but likely going forward in 2012 and years to come.

This week's announcement is in line with the views expressed above and reinforces the notion that FCF is sizable --pays for acquisitions, reduces debt and common stock outstanding. The specific numbers cited (the cash on hand figure is not available I the announcement) suggest that Operating Cash Flow in the third quarter of this year, to be yet formally reported, continues to accelerate.

In my opinion, EBIX has a strong track record in ROIC and in growing shareholder value. This reflects effective business operations, adept financial management, and a strategic vision grounded on a clear view of the environment and the opportunities within reach. Results include an increasingly relevant and important franchise within the insurance industry.

There seems to be little in the way of surprises with performance; it is on a steady upswing and not dependent upon any one make-it-or-break-it event. Risk, in turn, is contained by industry expertise and the relentless focus on the value of the network.

Disclosure: I am long EBIX.

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