

Seeking Alpha α

High Conviction: Stellar Free Cash Flow Growth from This IT Provider

by: Harry Long

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Harry Long is managing partner of [Contrarian Industries](#), a private investment firm that conducts research and development on systematic/algorithmic investment strategies.

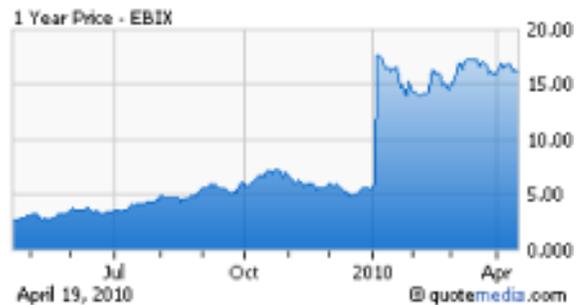
The firm specializes in high-capacity systematic global macro strategies, and is currently researching applying directional strategies to high-yield corporate debt ETFs.

Seeking Alpha recently had the chance to ask Harry about his top stock pick.

What is your highest conviction stock position - long or short?

We are diversified and quantitative/systematic/algorithmic, but if you forced me to choose a highest conviction position at the moment, it would be **Ebix ([EBIX](#))**.

Ebix focuses on insurance IT services, namely Insurance Exchanges, Carrier Systems, Brokers Systems, and Business Process Outsourcing (BPO). Insurance exchanges are the crown jewel, where we have seen high growth, margins, and dominance.



Ebix states in its annual report that “Our goal is to be the leading powerhouse of backend insurance transactions in the world.” What they don't own, they tend to acquire. Going forward, I think you will see them make moves to establish a foothold in the wider space of IT for financial services as a whole. Ebix's record speaks for itself. Since CEO Robin Raina took over at the end of 1999, the company has been one of the U.S.'s premier free cash flow growth stories.

I could wax enthusiastically about the company for an hour, but rather than do that, I would rather just show you a summary of their free cash flow, which speaks for itself.

(in millions)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
FCF	(7.8)	(3.4)	(1.3)	2.8	2.4	5.0	3.6	12.7	26.2	30.8

What do I see when I read those numbers? The guy inherited an awful situation, the company was hemorrhaging cash, he stabilized it, turned it around, and by the skin of his teeth, some brilliance, and pluck, turned it from a money-losing operation into one of the premier U.S. growth stories of the last decade. I take my hat off to Robin Raina.

Can you talk a bit about the industry/sector? How much is Ebix an "industry pick" as opposed to a pure bottom-up pick?

You have to decide where you want to be in the value chain in the IT industry. Robin Raina made the decision that Ebix should be the dominant player in its space, have strong recurring revenues, and be in a high-margin business, and he has delivered on that vision. Totally bottom-up.

Can you describe Ebix's competitive environment? How is the company positioned vis-a-vis its competitors?

In general, insurance exchanges are going to be an area where Ebix can establish, and has established, a very dominant position. Ebix has also had massive growth in BPO, but of course, that space will always be more competitive. The broker systems and carrier systems operations will probably always have serious competitors.

The investment thesis for Ebix is that insurance may be a highly competitive industry, but you can establish a strong position in the value chain by having a monopoly on the IT "picks and shovels." Insurance companies will always compete with each other, but the exchange space could be a place which naturally tends towards the dominance of a handful of firms around the world.

If you had to choose who will be a leader in insurance exchanges, I think the answer would be Ebix.

Can you talk about valuation? How does valuation compare to competitors?

I would estimate that they will generate somewhere between \$40-\$55 million in free cash flow next year. (It's better to be roughly right than precisely wrong.)

That puts the stock at roughly 10-14 times free cash flow. The valuation is ridiculously low. I'm only doing this interview because I think it's one of the great inefficiencies in this market.

There are really only two views you can take on this stock. Either it's one of the best growth stories in the U.S., or the numbers are too good to be true. I've visited Robin Raina at his headquarters in Atlanta, and I think he is one of the most rational people I have ever met. I like him, and I trust him. My money is staked on the notion that the numbers are very real, that he is an excellent manager, and that this company could grow for years.

You're getting a Phil Fisher stock at a Benjamin Graham price. That's the name of the game. I would encourage the institutions to make the trek to Atlanta and to sit down with Robin. I think they will come away impressed.

What is the current sentiment on Ebix? How does your view differ from the consensus?

I think people are totally unfamiliar with their business model. I hope they put out a video with slides, illustrations, diagrams, etc that really explains it step-by-step. Most people have used or seen an iPhone. They have never seen or used an insurance exchange.

Ebix needs to educate investors in a tangible way about what they do and how their business model works, slide by slide, diagram by diagram. Familiarity = Comfort = Acceptance = Investor Support.

What catalysts do you see that could move Ebix's stock?

Every quarter that they report great numbers is another opportunity to prove themselves to the market.

What could go wrong with this stock pick?

If they don't grow revenue/earnings/cash flow regularly, sell it. You buy a stock like this to make a lot of money as it grows. If it doesn't grow, you have to get rid of it.

Thanks for sharing your thesis, Harry.

Disclosure: Contrarian Industries is long [EBIX](#).

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If you are a fund manager and interested in doing an interview with us on your highest conviction stock holding, please [email Rebecca Barnett](#).

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