Ebix case study

Business

This article will focus on accounting issues and problems of Ibex, using what we have learned in financial statements analysis combined with financial statements before robber-year to identify Ibex's problems, to verify issues in problem-year and to analyze operational performance.

Our project is made up of Ibises main problem- acquisition and cash flow, financial frauds and aggressive accounting methods, financial ratios analysis and exhibit used to help analyze. Our report will detail: 1) The Game of Acquisition & Its " roll-up" Strategy.

The millions of " value creation" embedded In Ibex's valuation are likely to collapse given the myriad of issues the company currently faces. 2) Consolidated Statement of Cash Flow or No Lasting Cash Flow? Investors have a distorted view of the company's cash flow. " Our cash- generating rate continues to Increase.

The story of Able Is a cash story. " said Robin Rain, the chairman and CEO of Able. If we only focus on Cash flows from operating activities part of Consolidated Statements of Cash Flows, it appears that Ibex has been doing a good job generating cash from its primary business.

But after a careful analysis, we discover the truth is that Ibex has not generated lasting cash flow since 1999. 3) Financial frauds and Aggressive accounting issues.

Apparently, Ibex is good at manipulate financial statements. By using several accounting gimmicks, Ibex can boost up its revenue and show good numbers in margin and growth rate, which caught the eyes of the Impatient investors who don't see the inherent problems of Ibex: declining organic growth rate which shows the downward trend of its profitability and too many obviously overvalued acquisitions. 4) Financial Ratios Analysis.

In this part, we try to analyze operational performance using the ratios calculated, which Including the Liquidity Ratios, Profitability Ratios, Leverage Ratios Analysis, Efficiency Ratios and DuPont Analysis: 1. The Game of Acquisition & Its " roll-up" Strategy 1.

1 Goodwill According to recent annual reports of Ibex, we can calculate the goodwill-to-asset ratios, shown in Exhibit 1 . The company carries a very unhealthy high proportion of goodwill on its balance sheet from 2008 to the problem-year 2011. These years' goodwill-Waste ratios almost double that of 2007, which Is due in part to the strategy of frequent acquisitions.

This accounting Issue Is that if the company Is required to write down goodwill, this will adversely affect future net Income. Balance sheet. This accounting issue is not so simple, looming a big problem of collation Deanna wanly we need to KICK Tort Its accounting Issues Ana trucks Ibex Roll-up Strategy Ibex has been an aggressive acquirer of a variety of companies over the years, many of which focus on the insurance industry.

The company's offering mix is a confusing amalgamation of niche products that all have a " roll-up" strategy.

The $970 million of " value creation" embedded in Ibex's valuation is likely to collapse given the myriad of issues the company currently faces. Ibex current business has been cobbled together from 18 acquisitions, spanning the past seven years. Prior to this acquisition pre, Ibex had no growth, less than $15 million in revenue, and at times in 2003 traded with a NEGATIVE enterprise value ($6. 2 million market cap with $6. 8 million of cash).

Today, the company’s controversial CEO has pulled off one of the most unique acquisition arbitrages in history.

He has turned $276 million of acquisitions (Exhibit 2) and very little starting enterprise value into a company with $1. 2 billion of enterprise value. The $970 million of “ value creation” embedded in Ibex’s valuation is likely to collapse given the myriad of issues the company currently faces. According to Exhibit 2, the economics of the company’s acquisition strategy is relatively simple: manipulation of tax and dramatic cost cuts (headcount reductions and offspring to India). This strategy has avoided criticism and scrutiny by Wall Street analysts, a fact that will likely change when Ibex begins missing stock price.

What’s more, with the help of acquisition, company can recognize acquired firm’s revenue to increase revenue and to inflate goodwill of assets. Also, company can improperly adjust acquisition expense to make a big-bath or to cut down expense. 1. 3 Tricks in Revenue First, we can use an instance in the problem-year 2011 to verify the trick in revenue. During the twelve months ended December 31 2011, the total revenue of Ibex increased $36.

8 million or 28%, to $169. 0 million compared to $132. 2 million in 2010.

The increase in revenues is primarily the result of revenue from the acquisition of ADAM since February 2011 and from business acquisitions made during 2010. $23.

1 million of Dam's operating revenues recognized since February 7, 2011 are included in the Company's revenues reported in its consolidated statement of income for the ear ended December 31, 2011. With respect to business acquisitions completed during the fiscal years 2011 and 2010 on a pro formal basis, combined revenues increased 2. 8% for the year 2011 versus full year 2010, whereas there was a 27. 8% increase in reported revenues for the same comparative periods.

The 2.

8% increase in pro formal revenues was associated with a 0. 7% decrease in full year 2011 versus 2010 revenues pertaining to the businesses acquired during the years 2010 and 2011, offset by a 3. 5% increase in revenues associated with legacy operations preceding these business acquisitions. The cause for the difference between the 27. 8% increase in reported 2011 revenue versus 2010 revenue, as compared to the 2. 8% increase in 2011 pro formal versus 2010 pro formal revenue is due to the effect of combining the revenue derived from those businesses acquired during years 2010 and 2011 with the Company's pre-existing operations.

Second, we can calculate the revenue and net income growth rate according to recent annual reports, shown in Exhibit 3. From 2008 to the problem-year 2011, the accounting issue is that the trend of growth rate is decreasing. This decreasing trend makes Ibex have incentive to aka acquisitions to smooth its growth, which also confirms the trick in acquisitions winos problems Drove out In 2011 wants more, getting roll AT ten revenue Trot acquisitions, we can conclude that the core business of Ibex is declining rapidly and goodwill write-off is looming.

So, strategic acquisitions are a key component of the company's growth rate during recent years. For example, in the problem-year 2011 Ibex made two strategic acquisitions: HAS for $18 million in cash, and " ADAM" in a stock-based transaction.

Third, we can use organic growth rate to analyze specifically. Ibex management set its organic growth goal of 10% to 15% for 2010. On its fourth quarter 2010 conference call, management stated that the company's organic growth was 11% in 2010. We believe the company had organic growth that was significantly below this figure.

Instead of confessing, management appears to have " redefined" organic growth to include acquisitions.

If management is willing to manipulate the metrics around growth, what else might management be manipulating? Ibex management is actually recognizing the benefit of a target's growth BEFORE they were acquired by Ibex. Exhibit 4 is the company's calculation of organic growth from the 2010 10-k. According to Exhibit 4, we diagram a hypothetical example of a company growing at 1%, acquires a company that, previous to the acquisition, was growing at 50%.

According to Ibex’s math, this 1% grower had a 24% “ organic” growth rate in 2010. Conversely, if the same target’s revenue declined 50% year over year, this 1% grower would have had a -27% organic growth rate under Ibex’s distorted metric.

It is clear from this example how irrelevant Ibex’s “ definition” of growth has become and that management is trying to hide a collapsing organic growth profile. As the Exhibit 5 shows about, we can certain know that the REAL organic growth over the past two years appears to be relatively minimal.

We caution that this is only an estimate as the company no longer provides enough disclosure, but estimating the contributions of acquired businesses leads to the conclusion that Ibex has no growth. Additionally, foreign exchange was a large benefit to growth given the weakness in the dollar over the past two years. As stated above, management stopped disclosing this impact.

As a result, our organic growth estimates are likely too high. Exhibit 6 suggests organic growth that was negative in 2009 and only 4% in 2010, FAR BELOW management’s goal and insinuations. 1. Tricks in Expense Except for the trick in revenue, acquisition is also fit for expense trick. Take the Confirming acquisition which happened before the problem-year for example.

It cost 30% more according to the India filings than it did according to the SEC filings. How much did Ibex pay for Confirming? Indian subsidiary filings and SEC filings told the same story as far as how much was paid for Confirming in 2008 and 2009. However in 2010, they did not. They differed by at least $5 million, as shown in the Exhibit 7. We are not sure which numbers are correct.

Either the asks are correct, the India filings are correct, or neither.

But according to the different numbers in 2010, we can forecast an amendment in the next years which also corresponds the problem-year 2011. 2. Consolidated Statement of Cash Flow or No Lasting Cash Flow? 2. 1 Ibex has not generated lasting cash flow “ Our cash-generating rate continues to increase. The story of Ibex is a cash story. ” Said Robin Rain, the chairman and CEO of Ibex.

If we only focus on Cash flows from operating activities part of Consolidated Statements of Cash Flows, it appears that

Ibex has been doing a good Job generating cash from its primary business. First, although ten growth rate AT cans mows Trot operating actively NAS Eden cleaning over time due to a plummet in growth rate of net income, we can see that the company has been generating positive cash flow since 2007, according to our research, as showed in Exhibit 8. Second, net income continues to be positive from 2008 to 2011 , and, as illustrated Exhibit 9, gradually becomes a key driver in cash flow generated from operating activities over time.

But after a careful analysis, we discover the truth is that Ibex has not generated lasting cash flow since 1999. Between the years 2006 and 2011, IBEX, as a serial acquirer, has acquired 17 companies (as publicly reported) and has spent nearly $218 million cash in acquisition activities.

Hence, the free cash flow of Ibex is definitely not representative unless cash costs of acquisitions are included. After including cash costs of acquisitions, the figures in Exhibit 10 shows us a different picture.

Cumulative cash flow of Ibex is a negative figure from year 1999 to 2011, indicating the lack in ability to generate lasting cash flow from its primary business and to raise money through internal channel. 2. 2 Distorted Free Cash Flow As we discussed before, although Ibex has generated abundant cash flow from its operating activities, the major part of cash has been used in acquisition activities, instead of in its capital expenditure.

Exhibit 11 uncovers a highly negative correlation between the cash costs of acquisitions and cash flow from operating and financing activities from year 1999 to 2011, which confirms our theory.

In its annual report, Ibex states that by acquisition conducted over the past several years, it will efficiently further expand its reach in the insurance sector and hence efficiently utilize the operating cash generated from its business. However, as we discussed before in acquisition part, Ibex has little or, even worse, negative organic growth in the past years, which is not consistent with the company’s proclaim about the purpose of its acquisitions. Then why Ibex keeps spending cash acquiring other companies instead of reinvesting in itself and spending more in CAPE and research and development in order to improve its organic growth?

Given the fact that many investors tend to use free cash flow to evaluate company, Ibex, we believe, has a strong incentive to artificially increase free cash flow by using some financial statement gimmicks in a rise of acquisitions. 2.

3 Low CAPE As we take a close look at cash flows generated from investing activities, it's quite obvious that Ibex only spent a quite small portion of its cash flow in capital expenditure, while it spent major part of its cash flow in acquisition activities. As we can see from Exhibit 12, the company has been decreasing its CAPE 2008 to 2011.

In 2011, Ibex only spent approximately 2. 8 million in capital expenditure, which accounts for less than 2% of its operating revenue. This trend of cutback in capital expenditure indicates two possible scenarios. First, Ibex may have run out of opportunity to invest in itself, which means that, without increasing demand in its products, the primary business of Ibex is declining, hence there is no need to spend more money in purchasing new plant, property and equipment to produce more.

Second, it's possible that Ibex has no choice but cutback its capital expenditure since it needs cash to acquire other companies.

But we can't ignore the fact that a cutback in necessary capital expenditure over a long period will result in an inevitable decline in core competitiveness of this company. Considering the situations Ibex is facing, we o Delve Tanat ten lack In capital expenditure Is a result Trot ten accommodation AT both factors. 2. 4 Low R&D expense On one hand, we suspect that Ibex failed to invest sufficient money or resources in its own enterprise. As showed in its annual report in 2011, the company spent less only spent $19.

2 million on research and development (approximately 11% of sales).

FORBES magazine ranks IBEX as the 6th fastest growing technology company in America in 2012. As we comparing Ibex with Linked, the fastest growing high tech company ranked by FORBES in 2012, it turns out that CAPE of 1% and product placement costs of 12% of sales is remarkably low, as illustrated in Exhibit 13 and Exhibit 14. Although a series of acquisitions may benefit Ibex in lowering its labor costs by using cheaper oversea labor, we still believe that Ibex has been underinvestment in itself in order to artificially increase net income and as a result, increase its free cash flow as well.

Therefore, we conclude that Ibex will have to do massive reinvestment to avoid large decline in business in the future and will suffer from a plummet in its margins and cash flow.

On the other hand, based on its low search and development costs, we also suspect that Ibex may increase free cash flow artificially by report significantly less cash costs of product development, which are recognized in income statement, as an amortization expense and in cash flow statement, a cost of acquisition.

In this case, the R&D cash flow shows up in the cash flow of investing section of the income statement, not cash flow from operations. In this way, Ibex can roll-up artificially increase free cash flow by hiding some product development costs in acquisition costs. In either way, the low cost in product development is a bad sign for Ibex. 2.

Increase revenue by acquisitions As we discussed before in acquisition part, Ibex mainly increased its revenue by recognizing acquired firm's revenue as its own and was unable to raise money internally.

Then company borrowed money from investors and bondholders, who is much happy to lend money because of favorable sign in increased revenue and cash flow, to further its acquisitions, as demonstrated in Exhibit 15. In this way, Ibex generated no bona fide profit or, in other words, had little organic growth, and simply took the revenue of acquired companies as its own to hide the fact that its primary business is declining. And this is one of the reasons that Ibex needs acquisitions. But we believe this is not sustainable.

Because once investors realize these gimmicks, they will stop lending money to Ibex, and as a result, the house of cards will collapse. 3. Financial frauds and Aggressive accounting issues 3. 1 Financial Frauds According to our analysis of the annual report of Ibex, we found several suspicious questions concerning Ibex's financial reporting. The followings are some facts we found: 1) Ibex's 2010 long-lived assets don't add up. 2) sass's long-lived assets as calculated from the consolidated balance sheet do not equal the total long-lived assets number found in Note 16.

We can see through these two questions one by one.

First, as for the sass's long-lived assets, the difference is shown in Exhibit 16. The sass's long-lived assets are reported in different numbers in 2010 and sass's annual report respectively, which is extremely weird. We highly doubt that these accounting irregularities were made by accident; Ibex has filed 5 amended asks in the last 2 years. In fact, none of the amended asks correct these Irregularities, nor NAS tender Eden an amen Telling Eden released Tort 2 hey wanted to get this right, we believe they would've done so by now, especially given all the extra public scrutiny the company has received in the last 2 years.

The second question is even more obvious, the numbers of 2011 long-lived assets on the balance sheets don't match the numbers in Note 16. Though the variance might not be significant (around $67, 000), we should cast on doubt the rigorousness of the annual report of Ibex. 3. 2 Aggressive Accounting Methods The problematic cash flow and organic growth rate of Ibex are not the only concerns for the investor; Ibex also used several accounting methods which are either suspicious or very rarely used. The first problem comes to our horizon is Ibex's unbilled receivables.

Unbilled Receivables have been used as a classic financial scheme to aggressively recognize revenue, especially when its growth has outpaced overall Accounts Receivable growth and revenue growth.

As for the case of Ibex, the allowance for doubt accounts has actually been trending down, as a percentage of receivables, while unbilled receivables as a percentage of accounts receivables have been rising. This is not a usual accounting phenomenon since these two accounts should be matched in size and should move in the same direction.

Furthermore, Ibex Started including deferred revenue into its accounts receivable account (even though it reported a separate deferred revenue account as a liability) as soon as Cherry Beakers Holland became its auditor in 2008. The amount of deferred revenue Ibex includes within accounts receivable is buried in the notes, making it difficult for most investors who don’t read the notes. The inclusion of deferred revenue within the accounts receivable account is extremely unusual according to accounting principal.