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PUBLIC CHOICE ALTERNATIVES

ICBC: Incredibly Cascading Burgeoning Catastrophe

A VALUATION OF INSURANCE CORPORATION OF BRITISH COLUMBIA

BY IAN MADSEN

FRONTIER CENTRE FOR PUBLIC POLICY

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EXECUTIVE SUMMARY

Insurance Corporation of British Columbia (ICBC) is a provincially owned Crown corporation that has a monopoly on providing motor vehicle insurance to drivers living in British Columbia. ICBC could be worth as much as $15.8B if the province decided to divest it; or, it could be worthless if the province decided to keep it and ICBC was unable to restructure and price its insurance premiums to cover expected accidents and other losses.

As a business, making the very optimistic assumption that it can turn its stated ‘comprehensive income’ into free cash flow, its value, on a fully taxed basis (as a Crown corporation, it pays no corporate income tax), is estimated to be negative, as it has forecasted a loss for the current fiscal year of approximately $1.3B. Using comparable Canadian financial firms, the range is $8.95–$8.99B (this is an accident of the calculation methods; it is not so precise or tight a range in any way). It could realize the maximum if investors or acquirers believe it has truly been restructured to be self-sustaining and capable of generating free cash flow.

INTRODUCTION

Insurance Corporation of British Columbia, 'ICBC', is the monopoly Crown corporation which provides motor vehicle insurance to all drivers in British Columbia, and is wholly owned by the government of that province.

It is not radically different from other general insurance or motor vehicle insurance firms, except that it has a monopoly with no competition allowed for it within British Columbia; it is not taxable; it has the implicit and explicit backing of the provincial government; and has its officers and directors approved by politicians, which has led it into difficulty. The company mispriced its insurance premiums to not fully incorporate the risks and escalating injury and damage award cost of adverse accident claim judgments. Hence, the billion dollar losses noted earlier.

Insurance Corporation of British Columbia, A History

Insurance Corporation of British Columbia, a provincial Crown corporation, was established in 1973. It provides insurance covering all B.C. vehicles and drivers. It also has divisions responsible for road safety programs and driver licensing services.

The mispricing and misallocation of risk premiums to drivers has brought about a financial crisis at ICBC. This has been brewing for years, but the previous government, approaching a tight election, commissioned a study to examine the issues and find possible solutions just prior to the election. The report, by Ernst & Young, came out after the election in 2018, which brought a new, minority government to power. The report documents the escalating costs, particularly of injury awards, and gave three recommendations for changes: changing road safety strategy and practises; re-pricing of insurance premiums to better fully cost risky drivers and related matters; improving efficiency and productivity.[1]

The report brought about the first in what could be a series of realizations of potential underwriting losses: $980M in fiscal 2017 and about $1.3B in fiscal 2018, with no assurance that these will be the last of them.[2]

These estimated losses are incorporated in this valuation study.

VALUATION FACTORS

Encouragingly, ICBC is able to generate free cash flow, a key factor in corporate survival and growth. However, this free cash flow is not sufficient to result in a substantial intrinsic value, which is based on robust and, ideally, growing free cash flow.

This is important for crucial reasons. Companies have floundered when they showed substantial, positive net income, 'profits' in common terms, but were doing so by tallying up revenue which was financed by either short-term or long-term debt of one form or another, or more rarely, by shareholder capital in the form of common equity injections.

ICBC is even worse off, not showing evidence of being able to generate profits, and thence conversion of same into ready cash to pay bills, service debt, or for other purposes. Rather, it is bleeding money, if not fully realized into cash outflow—not yet, but it soon will, according to the studies. Hence, these estimated losses are subtracted from the final values generated for ICBC.

INTRINSIC, DISCOUNTED FREE CASH FLOW VALUE OF EDC

As noted above, ICBC is unable to generate significant free cash flow, and may not be able to for some time. Therefore, its intrinsic value is miniscule; in the millions of dollars, and even less after subtracting the loss projected for the current fiscal year, 2018. Using discounted projected future free cash flows, **the corporation's full taxed value** could range from \$26M to \$181M, with a median value of \$45M and a mean value of \$58B. However, after subtracting the estimated current loss of \$1.3B, all of these figures become negative, indicating that, as a business, ICBC is worse than worthless, at least for now, prior to restructuring and reorienting for profitable operation.

Table 1

Intrinsic Value, Using Discounted Free Cash Flow Method

Valuation Matrix - Presented Value of Discounted Free Cash Flow = Estimated Next Year Free Cash Flow (Required Rate of Return = Growth Rate)

Projected Free Cash Flow for 2017 (\$M): \$ 0.0018

Matrix Values (\$M) g==v; r==>	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%
0.00%	\$ 0.045	\$ 0.036	\$ 0.030	\$ 0.026	\$ 0.023	\$ 0.020	\$ 0.018
1.00%	\$ 0.060	\$ 0.045	\$ 0.036	\$ 0.030	\$ 0.026	\$ 0.023	\$ 0.020
2.00%	\$ 0.091	**\$ 0.060**	**\$ 0.045**	**\$ 0.036**	**\$ 0.030**	**\$ 0.026**	\$ 0.023
3.00%	\$ 0.181	**\$ 0.091**	**\$ 0.060**	**\$ 0.045**	**\$ 0.036**	**\$ 0.030**	\$ 0.026
4.00%	**--**	**\$ 0.181**	**\$ 0.091**	**\$ 0.060**	**\$ 0.045**	**\$ 0.036**	\$ 0.030
5.00%	-\$ 0.181	--	\$ 0.181	\$ 0.091	\$ 0.060	\$ 0.045	\$ 0.036
6.00%	-\$ 0.090	-\$ 0.181	\$ --	\$ 0.181	\$ 0.091	\$ 0.060	\$ 0.045
7.00%	-\$ 0.060	-\$ 0.090	-\$ 0.181	\$ --	\$ 0.181	\$ 0.091	\$ 0.060

	Minimum	Maximum	Median	Mean (Average)
	\$ 0.026	**\$ 0.181**	**\$ 0.045**	**\$ 0.058**
Less Estimated Yr. 2018 Low % of \$ 1.38	**-\$ 1.300**	**-\$ 1.300**	**-\$ 1.300**	**-\$ 1.300**
Final Total(s)	**-\$ 1.274**	**-\$ 1.119**	**-\$ 1.254**	**-\$ 1.242**

MARKET VALUE COMPARISON VALUATION OF ICBC

There are several viable comparison financial firms available for valuing ICBC. There are seven independent publicly listed insurance finance companies in Canada and another twelve diversified financial firms.

Several standard market valuation metrics were initially used, including Trailing Price to Earnings ratio and Forward Price to Earnings ratios (P/E); Price to Sales (P/S) ratio; Price to Book Value (P/BV); Enterprise Value (Market Value plus Debt minus Cash) to Revenue (EV/Rev), Enterprise Value to Earnings Before Interest, Depreciation and Amortization (EV/EBITDA), and Price to Operating and Free Cash Flow (P/CF, P/FCF) (Please consult the accompanying valuation spreadsheet file in Excel for details). **The corporation's estimated fully taxed value** could range from $3B to $17B, with a mean value of $8.95B and a median value of $8.99B.

Some metrics had to be discarded due to insufficient information on either the comparator companies or ICBC, or the inapplicability of the ratio to either the comparators or ICBC, or negative or otherwise anomalous results. Six ratios were ultimately used: P/S (price to sales) and P/BV (Price to Book Value), Enterprise Value to Revenue, Enterprise Value to EBITDA, Price to Operating Cash Flow and Price to Free Cash Flow. The results are in Table 2.

Table 2

Market Comparison Valuation of ICBC

Valuation Metrics applied to ICBC; Market Value of Common Equity. Figures in $B.		Price to Sales	Price to Book	Enterprise Value/Revenue (Subtracting Net Bebt)	Enterprise Value/EBITDA (Subtracting Net Bebt)	Price to Operating Cash Flow	Price to Free Cash Flow
Average Seven Canadian Insurance Holding Companies	**As Is, Fully Taxed**	$ 14.45	$ 3.87	$ 26.78	$ 7.84	$ 3.69	$ 0.97
Average Twelve Canadian Private Equity or Diversified Financial Cos.	**As Is, Fully Taxed**	$ 9.02	$ 2.98	$ 3.49	$ 22.86	$ 9.94	$ 1.34
Average of All the Above	**As Is, Fully Taxed**	$ 21.95	$ 3.31	$ 13.08	$ 17.08	$ 7.51	$ 1.20

Market Value Using ALL Comparable Companies and using Six Valuation Ratios:	Mean	Median	Minimum	Maximum
Preliminary	$ 10.25	$ 10.29	$ 3.31	$ 17.08
Less Estimated FY2018; Loss of $1.3B	-$ 1.30	-$ 1.30	-$ 1.30	-$ 1.30
Free Total(s); $B	$ 8.95	$ 8.99	$ 2.01	$ 15.78

CONCLUSION AND RECOMMENDATIONS

The decision on whether or not to keep or sell off all, most, or part of a Crown corporation is up to the citizens and taxpayers of the province, or, in this case, of all of Canada, usually via their elected representatives in the House of Commons.

When it comes to ICBC, while it currently occupies a central role, it is clear that other companies could easily serve in its capacity in providing motor vehicle insurance. There are several in Canada alone, most are healthily profitable, unlike ICBC. It had a billion dollar loss in the past fiscal year, and now projects a loss of about $1.3B for the current fiscal year.

Only experts in general insurance and legal liability awards are qualified to ascertain whether or not the provincial government and ICBC managers and staff have made the changes required to put the company on a secure footing where it will no longer lose copious amounts of money. As political meddling in its premium pricing and other policies and practises led to this debacle, and the entity remains 'publicly' controlled, i.e. by politicians, it is unknown whether ICBC is fully and completely restructured and no longer a potential cash abyss for British Columbia taxpayers.

Once it is either required to fully spell out its condition and remedial measures in the prospectus for an Initial Public Offering prior to being sold into the stock market, or a 'data room' is opened for qualified corporate and institutional investors to examine its assets and liabilities in detail, then it will become clear what the company could or should be worth to investors with adequate risk appetite.

Whatever the reasons for the creation of ICBC, it appears that it has outlived its usefulness as it is today. It is far better that private investors take on such a risk. The government should initiate a plan to make ICBC a more normal, commercial, cash profit-generating firm, and then optimize its operations further to make it appealing to either private individuals via an initial public offering, sale to institutional investors, shrewd corporate acquirers, or some combination of those. There are many general insurance, property insurance, and motor vehicle insurance companies in North America and around the world that might be interested, at the right price.

APPENDIX 1:

RATIONALE FOR DIVESTITURE OR PRIVATIZATION

While it is up to the people through their elected representatives to decide if a Crown corporation or other government agency or entity should be sold or otherwise privatized and the proceeds used for the benefit of all citizens and taxpayers, there are some established reasons to embark on such a path, some or all of which are cited for divestiture of such enterprises but may not be applicable in any single, specific case.

1. The government has no mandate to own or run a commercial enterprise. The provision of citizens' safety, security and justice is the government's primary role, and its involvement in the economy should generally not extend beyond this.

2. Regulation can usually accomplish any public policy reason for direct involvement in an industry. If regulation is not easily feasible, then a direct contract or subsidy to any affected individuals, entity or entities may be more efficient or effective and less economically disruptive or costly.

3. If a government-controlled or sponsored enterprise has a monopoly position, near-monopoly, or effective monopoly in a line or lines of business or businesses, then opportunities are lost in one or more commercial or potentially commercial sectors for entrepreneurs and investors to try to create and grow businesses to enrich and sustain themselves, employees, suppliers, and others.

4. A monopoly, near-monopoly, or effective monopoly market position by a government-owned or sponsored entity could result in far higher prices for customers, the general public, or a section of the public, than would be the case in a fully competitive marketplace for the industry involved.

5. A government-owned or -sponsored enterprise may compete directly against private sector firms, which are owned by or employ citizens, or against individual citizens, all of whom the government is supposed to serve, not disadvantage.

6. The government-owned or -sponsored enterprise may compete unfairly against its private sector rivals in that it had or has access to lower-cost government-sourced and -guaranteed capital (debt). It may have a much larger debt component in its capital versus that which would be tolerated in the private sector. Thus, it may not have to meet high standards for profit and cost control, allowing it to offer lower than true free market-based competitive pricing.

7. Government-owned firms may not need to pay provincial or federal income taxes. This can allow such firms to supply goods or services more cheaply than the private sector companies they are competing with.

8. Government-owned or -sponsored enterprises may not have any kind of profit orientation or target, may be used as public policy vehicles and may be given preference in their activities or even in their transgressions, such as labour or environmental abuses.

9. Government-owned or -sponsored enterprises, by virtue of being public sector vehicles overseen by bureaucrats and politicians, may be places where favoured individuals find employment, particularly at management levels.

10. Since profit is a secondary goal of a government-owned or -sponsored enterprise, it is difficult to evaluate the effectiveness, efficiency or productivity of the enterprise or its employees. Consequently, these employees and assets may not be very productive or effective.

11. Government-owned or -sponsored enterprises are often creations of certain time-fixed circumstances and outlive whatever use or public policy role their creators may have conceived. Often, advances in technology; the modernization of transport, telecommunication or information technology; the evolution of the economy and available products and services and the increasing standard of living make these enterprises potentially obsolete. In the private sector, firms and individuals must adapt and evolve, or decline.

12. Government-owned or -sponsored enterprises perpetuate their possibly obsolete existences by virtue of the constituencies that build up around them: employees, managers, directors and bureaucrats, customers, suppliers and associated advocates or consultants. They can lobby to keep the enterprise going, despite dysfunction or losses. They are far more motivated to do so than are the taxpayers, whose average cost is much less per person and may be indirect, hidden or difficult to calculate.

13. Because they are not profit-oriented, government-owned or -sponsored enterprises are usually less efficient, and thus they lower the overall efficiency of the entire economy. This can make a whole nation less competitive than its global rivals are, whether nations or individual companies. The effects are worse the greater the government involvement in the economy. When taken to its most extreme, as happened in 20th-century communist nations, the countries were unable to compete against capitalist companies, despite their immense direct and indirect subsidies, government support and the lack of profit requirement.

14. Funds tied up in the capital of government-owned or -sponsored enterprises could be used to reduce government debt or lower taxes on individuals or corporations, which they could then spend or invest as they freely choose, and thus they could inject money back into the economy in more-lucrative and -constructive ways.

15. Governments, generally, have a poor record of picking winners, or creating or owning enterprises that have market-competitive profitability, or attractive returns on assets, equity, or even returns that exceed governments' own cost of debt service. If, rarely, they actually do, it generally turns out that they have been provided unusually good market, operational, regulatory, or other conditions not available to other, investor-owned firms.

16. The greater the number and size of government owned or government sponsored enterprises in an economy, the greater the size and power of the government, which is usually the largest single entity in society, increasing the dangers of abuse of power, including injuring individual citizens, companies, or groups. Effective capacity of opposition or recourse against this power diminishes as the portion of the economy the government occupies increases.

ENDNOTES

1. Insurance Corporation of British Columbia. "Service Plan 2014-2016". February 2014. http://www.icbc.com/about-icbc/company-info/Documents/service_plan_2014-2016.pdf.

2. Insurance Corporation of British Columbia. "Affordable and effective auto insurance- A new road forward for British Columbia". http://www.icbc.com/about-icbc/company-info/Documents/Affordable-and-Effective-AutoInsurance-Report.pdf.

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