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PUBLIC CHOICE ALTERNATIVES

SGI: Ripe for Divestment

A VALUATION OF SASKATCHEWAN GOVERNMENT INSURANCE

BY IAN MADSEN

FRONTIER CENTRE FOR PUBLIC POLICY
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EXECUTIVE SUMMARY

Saskatchewan Government Insurance Corporation, 'SGI', is the monopoly Crown corporation that provides motor vehicle insurance to all drivers in Saskatchewan, and wholly owned by the government of that province. Caution: the valuation is highly sensitive to the growth rates and rates of return used in the valuation model. As a business, using a projection of its free cash flow, assuming it can grow at a steady, modest rate, its value, on a fully taxed basis (as a Crown corporation, it pays no tax, now), is estimated to be $2.97B (median) to $3.83B (mean). Using comparable Canadian financial firms, the range is $1.2B (median) to $2.25B (mean). Further, deeper investigation of its operations and finances would need to be undertaken to attain greater confidence in any estimate of the company's value.

INTRODUCTION

Saskatchewan Government Insurance Corporation, 'SGI', is the monopoly Crown corporation that provides motor vehicle insurance to all drivers in Saskatchewan. It is wholly owned by the government of that province. It also has a property and casualty insurance company division.

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 Saskatchewan; it is not taxable; it has the implicit and explicit backing of the provincial government; and has its officers and directors approved by politicians. Absent any revelations about inadequate underwriting of its risks or undisclosed investment losses, it appears to be a viable going concern. The valuation considers only the portion of SGI known as 'Autofund'.

Saskatchewan Government Insurance Corporation (SGI), A History

Saskatchewan Government Insurance Corporation is a provincial Crown corporation established in 1945.[1] At inception, it was not a monopoly in motor vehicle insurance; it acquired that status later.[2]

SGI employs about 2,000 people and is headquartered in Regina. It has two divisions: Autofund, which provides universal auto insurance to Saskatchewan motorists and is also responsible for driver licensing, and vehicle licensing and registration; and SGI Canada, a property and casualty insurance company, which operates in five provinces, and also as Coachman in Ontario.[3]

By virtue of operation in competitive markets, SGI Canada does not have any monopoly rights or privileges.

1. SGI. "Our Business". See https://www.sgi.sk.ca/ourbusiness.
2. See https://en.wikipedia.org/wiki/Saskatchewan_Government_Insurance.
3. SGI. "Our Business". See https://www.sgi.sk.ca/ourbusiness.

VALUATION FACTORS

Encouragingly, SGI is able to generate free cash flow, a key factor in corporate survival and growth. SGI's resultant substantial intrinsic value, which is based on free cash flow, is highly sensitive to the assumptions made about its future growth rate and its cost of capital; the latter is also known as the required rate of return.

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.

INTRINSIC, DISCOUNTED FREE CASH FLOW VALUE OF SGI

SGI's **intrinsic, fully taxed value** could range from $1.7B to $11.9B, with a median value of $2.97M and a mean value of $3.83B. However, this is calculated by extrapolating recent trends in revenues and costs, and using ranges growth rates and required rates of return that may not be realistic, even if, at this time, they are arguably fairly conservative. The results are in Table 1.

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 2018 ($B): $ 0.12

Matrix Values ($M) g==v; r==>	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%
0.00%	$ 2.97	$ 2.38	$ 1.98	$ 1.70	$ 1.49	$ 1.32	$ 1.19
1.00%	$ 3.97	$ 2.97	$ 2.38	$ 1.98	$ 1.70	$ 1.49	$ 1.32
2.00%	$ 5.95	**$ 3.97**	**$ 2.97**	**$ 2.38**	**$ 1.98**	**$ 1.70**	$ 1.49
3.00%	$ 11.90	**$ 5.95**	**$ 3.97**	**$ 2.97**	**$ 2.38**	**$ 1.98**	$ 1.70
4.00%	--	**$ 11.90**	**$ 5.95**	**$ 3.97**	**$ 2.97**	**$ 2.38**	$ 1.98
5.00%	-$ 11.90	--	$ 11.90	$ 5.95	$ 3.97	$ 2.97	$ 2.38
6.00%	-$ 5.95	-$ 11.90	$ --	$ 11.90	$ 5.95	$ 3.97	$ 2.97
7.00%	-$ 3.97	-$ 5.95	-$ 11.90	$ --	$ 11.90	$ 5.95	$ 3.97

	Minimum	**Maximum**	**Median**	**Mean (Average)**
	$ 1.70	**$ 11.90**	**$ 2.97**	**$ 3.83**
Less Estimated Contingency or Other Potential Liability	**$ 0.00**	**$ 0.00**	**$ 0.00**	**$ 0.00**
Final Total(s)	**$ 1.70**	**$ 11.90**	**$ 2.97**	**$ 3.83**

MARKET VALUE COMPARISON VALUATION OF SGI

There are several viable comparison financial firms available for valuing SGI. There are seven independent publicly listed insurance finance companies in Canada. There are also 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 $0.77B to $4.78B, with a median value of $1.2B and a mean value of $2.25B.

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

Table 2

Valuation of SGI Using Comparable Companies' Financial Ratios

Valuation Metrics applied to SGI; Market Value of Common Equity. Figures in $B.		Trailing P/E (Market Value to Net Income)	Forward P/E (Market Value to Estimated Net Income)	Price to Sales	Price to Book Value	Enterprise Value/Revenue (Subtracting Net Debt)	Price to Operating Cash Flow
Average Seven Canadian Insurance Holding Companies	**As Is, Fully Taxed**	$ 2.42	$ 1.24	$ 3.49	$ 0.90	$ 8.09	$ 0.59
Average Twelve Canadian Private Equity or Diversified Financial Cos.	**As Is, Fully Taxed**	$ 4.38	$ 3.76	$ 1.23	$ 0.70	$ 2.46	$ 1.58
Average of All the Above	**As Is, Fully Taxed**	$ 3.64	$ 2.60	$ 3.00	$ 0.77	$ 4.78	$ 1.20

Market Value Using ALL Comparable Companies and using Six Valuation Ratios:	Mean	Median	Minimum	Maximum
Preliminary	$ 3.25	$ 1.20	$ 0.77	$ 4.78
Less Estimated Contingency or Other Potential Liability	-$ 0.00	-$ 0.00	-$ 0.00	-$ 0.00
Free Total(s); $B	$ 3.25	$ 1.20	$ 0.77	$ 4.78

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 SGI, 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. Hence, there seems to be little need for taxpayer money to be locked up in this firm, nor for them to risk losses should there be unforeseen problems, as can happen in any sector.

Once it is either required to fully spell out its condition and remedial measures in the prospectus for an initial public offering (IPO) 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 a risk appetite.

Whatever the reasons for the creation of SGI, it appears that it has outlived its usefulness as it is today. With the potential for political meddling such as was the case in the disastrous Insurance Corporation of British Columbia, it is far better that private investors take on such a risk.

The government should initiate a plan to make SGI 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.

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