Manitoba Public Insurance

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PUBLIC CHOICE ALTERNATIVES

Money, Please, Indefinitely

A VALUATION OF MANITOBA PUBLIC INSURANCE

BY IAN MADSEN

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EXECUTIVE SUMMARY

Manitoba Public Insurance, 'MPI', is the provincial government-owned motor vehicle insurance company in Manitoba. It could be worth as much as $3.24B were it divested; or, it could be worthless, as its chronic loss-making and cash burn make it unattractive.

As a business, its free cash flow is negative, and projected to remain that way. So its value, on a fully taxed basis (as a Crown corporation, it pays no tax, now), is estimated between negative $121M (median in a range of values) and negative—$156M (mean, or simple average of the plausible range of results).

Another method, using comparable Canadian insurance companies and other financial firms, the range is a positive $537M (median of the range of values) to $1.35B (mean, or simple average, of the range of values). It could approach the highest figure if it shows that it has a realistic plan to either boost revenues or lower costs in the near future, and sustainably so.

INTRODUCTION

Manitoba Public Insurance Corporation, 'MPI', a Crown corporation owned entirely by the government of the province of Manitoba, provides automobile insurance for the residents of the province. It has assets and liabilities in the billions of dollars. It has a monopoly position in the vehicle insurance sector in Manitoba, and vehicle insurance is compulsory for all drivers.[1]

Manitoba Public Insurance, A History

MPI was established after public hearings aired complaints about the cost of private sector insurance. Prior to 1971, automobile insurance was not compulsory. The government committee estimated that at least 10 percent of vehicles had no insurance. Insurance companies denied some people coverage. Rates charged in Manitoba seemed not wholly related to claim experience in the province. There was dissatisfaction with the rating system of the insurers. Insurers tried to minimize claim payment.

MPI was created to address these complaints. There was to be a basic minimum level of coverage, all drivers would be covered, administration was to be limited to 15 percent of total revenue, premiums were to be paid in cash at time coverage began, and all funds were to be invested in Manitoba provincial securities.

Manitoba Public Insurance began operations in 1971 to provide the basic, compulsory insurance coverage, called Autopac. Both vehicles and drivers were required to be insured and the insurance was tied to registration so that one was not available without the other.[2] MPI Clients are in the hundreds of thousands; agent offices number over 300.[3]

1. See https://www.mpi.mb.ca/en/About-Us/History/Pages/principles.aspx.
2. See https://www.mpi.mb.ca/en/About-Us/History/Pages/principles.aspx.
3. See https://www.mpi.mb.ca/en/About-Us/History/Pages/history.aspx.

VALUATION FACTORS

For the purpose of this study, the assumption could not be made that MPI can fully convert net income into free cash flow, which is normally a key factor in corporate survival and growth. It is free cash flow negative and net income negative and shows no sign of being able to reverse this status.

Consequently, the Intrinsic, Discounted Free Cash Flow valuation, which used a projection of free cash flow that was negative, may be meaningless, except that it would make the firm as it currently operates unattractive as a business to any potential investor or investors.

INTRINSIC, DISCOUNTED FREE CASH FLOW VALUE OF MPI

An intrinsic value is the value a firm (or an entity equivalent to a firm) has by virtue of generating cash, specifically free cash flow. This is actual cash in the bank after getting cash payment for sales of goods or services and paying for everything in cash (including capital equipment and other long term assets, including intellectual property). As noted above, MPI is unable to generate free cash flow (although its operating cash flow is abundant); it has generally been substantially negative for years, and may continue that way. Therefore, any intrinsic value would be negative, also.

In similar situations, another approach could be taken. However, an optimistic assumption that MPI or new management may be able to convert net income entirely into free cash flow is not possible, as its net income is also substantially in the red.

As a negative value for the company has little use, it does indicate that the company has an important deficiency as it is currently constituted: it cannot easily generate any cash, making it dependent on injections of capital, in the form of debt or equity, ultimately backed by the citizens and taxpayers of Manitoba. Hence, the valuation below using the FDCF method is for illustrative purposes only. The model shows that the company, at best, might be worth negative $69M, and, at worst, negative $486M, with a mean (simple average of a set of plausible values) of negative $156M and a median (middle of the range of plausible values) of negative $121M.

Table 1

Intrinsic Value of Enterprise as Present Value of Projected Future Free Cash Flows

Present Value of Discounted Free Cash Flow = Estimated Next Year Free Cash Flow (Required Rate of Return = Growth Rate)

Free Cash Flow Estimate for Next Fiscal Year ($K): –$ 4,856

Matrix Values ($K) g==v; r==>	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%
0.00%	–$ 121,388	–$ 97,110	–$ 80,925	–$ 69,365	–$ 60,694	–$ 53,950	–$ 48,555
1.00%	–$ 161,851	–$ 121,388	–$ 97,110	–$ 80,925	–$ 69,365	–$ 60,694	–$ 53,950
2.00%	–$ 242,776	**–$ 161,851**	**–$ 121,388**	**–$ 97,110**	**–$ 80,925**	**–$ 69,365**	–$ 60,694
3.00%	–$ 485,552	**–$ 242,776**	**–$ 161,851**	**–$ 121,388**	**–$ 97,110**	**–$ 80,925**	–$ 69,365
4.00%	--	**–$ 485,552**	**–$ 242,776**	**–$ 161,851**	**–$ 121,388**	**–$ 97,110**	–$ 80,925
5.00%	$ 485,552	--	–$ 485,552	–$ 242,776	–$ 161,851	–$ 121,388	–$ 97,110
6.00%	$ 242,776	$ 485,552	$ --	–$ 485,552	–$ 242,776	–$ 161,851	–$ 121,388
7.00%	$ 161,851	$ 242,776	$ 485,552	$ --	–$ 485,552	–$ 242,776	–$ 161,851

	Minimum	Maximum	Median	Mean (Average)
Total(s)	**-$ 485,552**	**-$ 69,365**	**-$ 121,388**	**-$ 156,224**

Source: Valuation model based on trends (and projections of them) in constituent factors in company financial reports.

MARKET VALUE COMPARISON VALUATION OF MPI

There are seven independent Canadian publicly listed insurance companies. There are another twelve diversified financial firms publicly listed in Canada that were used for comparison purposes.

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 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 $272M to $3.24B, with a median value of $537B and a median value of $255M.

Some metrics had to be discarded due to insufficient data on either the comparator companies or MPI, or the inapplicability of the ratio to either the comparators or MPI, or negative or otherwise anomalous results. Four ratios were ultimately used: P/S (Price to Sales), P/BV (Price to Book Value [book value is total assets minus all debt and other liabilities]), Enterprise Value to Revenue (EV/Rev), and Price to Operating Cash Flow (P/CF). Results are in Table 2.

Table 2

Market Value of Firm Using Comparable Publicly Listed Firms and Four Viable Valuation Metrics

Valuation Metrics Applied to MPI, i.e., Market Value of Common Equity (Figures $B)	Price to Sales	Price to Book	Enterprise Value/Revenue (subtracting net debt)	Price to Operating Cash Flow
Average Seven Canadian Insurance Holding Companies	$ 3.29	$ 0.65	$ 7.01	$ 0.27
Average Twelve Canadian Diversified Financial or Asset Management Companies	$ 1.94	$ 0.47	$ 1.05	$ 0.27
Average of All the Above	$ 2.44	$ 0.54	$ 3.25	$ 0.27

Market Value Using Comparable Companies, and Four Viable Valuation Ratios

	Mean (Average)	Median	Minimum	Maximum
Total Market Value ($B)	$ 1.35	$ 0.54	$ 0.27	$ 3.25

Source: Capital IQ via Yahoo!Finance; company annual reports; calculations from consultant.

CONCLUSION

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 territory. Given Manitoba's very challenging fiscal situation, proceeds for such a sale could come in handy at present, and in the near future.

MPI fills a function, but there are many other Canadian and foreign insurance companies capable of providing vehicle insurance, and, demonstrably, at a profit, unlike MPI. At present, MPI is a drain on provincial coffers, whereas it could be a boon to the provincial economy in other hands.

It could be that few other companies, or potential investors in a divested MPI would be able to turn the firm around. However, if Manitoba never lets go of this endless debt-accumulating monopoly entity, it will not only never gain the proceeds of monetizing it, but also never find out if there is, indeed, a better (or maybe more than one) way.

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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