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PUBLIC CHOICE ALTERNATIVES

They Aren't Making Real Estate Anymore, Unless, Maybe, They Are

A VALUATION OF CANADA LANDS CORPORATION LIMITED

BY IAN MADSEN

FRONTIER CENTRE FOR PUBLIC POLICY

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EXECUTIVE SUMMARY

Canada Lands Corporation Limited, or CLCL, is the Crown corporation which sells surplus federal land and buildings and also develops various parcels across the country. Using an **intrinsic value method,** and discounting to the present CLCL's projected future free cash flows, as the company is today, fully taxable, the range of estimates is $300M to $2.1B, with a tighter range of a median (midpoint of the array of values) of $520M to a mean (simple average) of $680M.

Under the **market-based valuation system,** CLCL's value is estimated to range from $610M to $2.58B, with a median (midpoint of the array of values) of $920M and a mean (simple average) of $1.18B. Six of eight available valuation metrics were usable.

INTRODUCTION

Canada Lands Corporation Limited, A History

Canada Lands Corporation Limited, or CLCL, is a federal Crown corporation tasked with selling off surplus federal properties and also participating in other property development with other goals, generally with municipal or provincial government involvement, or both. It is unusual, in that it is incorporated under the *Business Corporations Act* and pays full corporate income taxes. Nearly every part of Canada has been affected by its activities, over decades.[1]

To quote the 2017-18 Annual Report, "CLCL works through its subsidiaries to ensure the innovative and commercially sound reintegration of former Government of Canada properties into local communities, as well as holding, investing in and managing certain attractions, while returning the best value to Canadians." The Port of Old Montreal, the redevelopment of the old Canadian Forces Base in Calgary[2] and the CN Tower in Toronto are examples of its projects and holdings.[3]

It is also charged with community redevelopment, with affordable housing and assisting Aboriginal communities (with procurement, employment, training and mentorship), in six developments in four cities.[4]

1. See https://en.clc.ca/files/CLCL%20AR%202017-18%20EN%20(2).pdf p 4.
2. See https://en.clc.ca/files/CLCL%20AR%202017-18%20EN%20(2).pdf p 22.
3. See https://en.clc.ca/files/CLCL%20AR%202017-18%20EN%20(2).pdf p 5.
4. See https://en.clc.ca/files/CLCL%20AR%202017-18%20EN%20(2).pdf p 8.

INTRINSIC VALUE, VALUATION OF CLCL AS A BUSINESS, USING DISCOUNTED FREE CASH FLOW

The intrinsic value model uses a perpetuity with a constant growth rate and constant cost of capital. This is crudely but generally appropriate for a stable company in a slow-growth, mature sector. For the intrinsic value of CLCL, projecting future cash flow growth, and bringing it to a net present value, a relatively conservative approach was taken which could undervalue the company (see Table 1).

Each constituent (eg., revenue, cost of goods sold, interest expense, depreciation and amortization, administrative and sales expense) determining the final free cash flow was projected independently. The company's free cash flow growth rate range was held to a restrained 2 to 4 percent, and the required rate of return or cost of capital range was from 5 to 9 percent. Projecting higher growth in the future could be reasonable, however alcoholic beverage production and sales is a very mature industry, although gambling and cannabis are higher growth, but more uncertain. CLCL's cost of capital, given low expectations and high current valuations in the stock market, could well be lower than the range used (and thus raise its estimated value), although there is also a chance that interest rates and the rate of return investors demand on equity (share) investment could increase. The statutory tax rate used in calculations may be lower in the future, as there is continued global pressure to lower corporate tax rates, exemplified by the 2017 drop in US corporation income tax rates.

The range of estimates is $300M to $2.1B, with a tighter range of a median (midpoint of the array of values) of $520M to a mean (simple average) of $680M.

Using Net Income as a Proxy for Free Cash Flow, more usable results were revealed, see Table 1, below.

Table 1

Intrinsic Value, Using Present Value of Discounted Future Cash Flows

Present Value of Discounted Free Cash Flow = Estimated Next Year Free Cash Flow (Required Rate of Return ['r'] = Growth Rate ['g'])

Projected Fully Taxed Free Cash Flow Estimate for FY2018 ($B): –$ 0.021

Matrix Values ($B) g==v; r==>	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%
0.00%	$ 0.52	$ 0.42	$ 0.35	$ 0.30	$ 0.26	$ 0.23	$ 0.21
1.00%	$ 0.70	$ 0.52	$ 0.42	$ 0.35	$ 0.30	$ 0.26	$ 0.23
2.00%	$ 1.05	**$ 0.70**	**$ 0.52**	**$ 0.42**	**$ 0.35**	**$ 0.30**	$ 0.26
3.00%	$ 2.10	**$ 1.05**	**$ 0.70**	**$ 0.52**	**$ 0.42**	**$ 0.35**	$ 0.30
4.00%	--	**$ 2.10**	**$ 1.05**	**$ 0.70**	**$ 0.52**	**$ 0.42**	$ 0.35
5.00%	–$ 2.10	--	$ 2.10	$ 1.05	$ 0.70	$ 0.52	$ 0.42
6.00%	–$ 8.96	–$ 2.10	$ --	$ 2.10	$ 1.05	$ 0.70	$ 0.52
7.00%	–$ 5.97	–$ 8.96	–$ 2.10	$ --	$ 2.10	$ 1.05	$ 0.70

	Minimum	Maximum	Median	Mean (Average)
Total Market Value ($B)	$ 0.30	$ 2.10	$ 0.52	$ 0.68

Source: Author's calculations based on valuation model formulae using summary versions in annual reports from the company.

MARKET-BASED VALUE: VALUATION OF CLCL USING STOCK MARKET AND FINANCIAL METRICS

As noted in the Executive Summary, the 'as is' current value of the company ranges from $610M to $2.58B, with a median (midpoint of the array of values) of $920M and a mean (simple average) of $1.18B. Six of eight possible valuation metrics (Forward Price to Earnings, 'P/E'; Price to Sales, 'P/S'; Price to Book Value, 'P/BV'; Enterprise Value to Revenue, 'EV/Rev'; Enterprise Value to Earnings Before Interest, Taxes and Depreciation and Amortization, 'EV/EBITDA'; and Price to Operating Cash Flow, 'P/CF') were usable. Please see the details of the models' results in Table 2.

Table 2

Market Valuation Using Financial Metrics from Comparable Companies

Valuation metrics applied to CLCL; Figures in $M.	Forward P/E (Market Value to Estimated Net Income)	Price to Sales	Price to Book Value	Enterprise Value/Revenue (subtracting net debt)	Enterprise Value/EBITDA (subtracting net debt)	Price to Operating Cash Flow
Average Eight Canadian Real Estate Development or Management Companies	$ 0.36	$ 0.85	$ 0.88	$ 1.73	$ 0.76	$ 1.04
Average Twenty-three Canadian Real Estate Investment Trusts	$ 0.86	$ 1.53	$ 0.61	$ 2.87	$ 1.25	$ 0.36
Average of All Above, Evenly Weighted by Company	$ 0.61	$ 1.36	$ 0.68	$ 2.58	$ 1.10	$ 0.73

Market Value Using Comparable Companies and Six Viable Valuation Ratios

	Minimum	Maximum	Median	Mean (Average)
Total Market Value ($B)	$ 0.61	$ 2.58	$ 0.92	$ 1.18

Source: Capital IQ via Yahoo!Finance; additional material from BMO Investorline; valuation model formulas.

CONCLUSION

This study used detailed historical financial statements, but the trends in net income, costs and capital expenditures may not be fully and reliably extrapolated. A more thorough appraisal prior to a proposed floating of CLCL shares on a stock market or before the company would be sold to private investors could and should determine a very different value for the company. As far as is known, the proceeds of such a sale would go to the federal government of Canada, unless Ottawa decides otherwise.

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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