



## Why LCBO Should Follow Hydro One Ltd. Down the IPO Path

### Description

Charles Sousa, Ontario's minister of finance, announced July 26 that the Liquor Control Board of Ontario (LCBO) would be introducing an online ordering system, offering free shipping for in-store pickup and \$12 per order when delivered to your home.

Pinch me because I think I might have died and gone to heaven.

First online ordering for grocery stores and now liquor stores. What's next? Marijuana dens right there in the liquor stores? It could happen, providing even more revenue for an Ontario government that's hard up for cash. Not to mention it's another way for the provincial government to pretend it actually cares about voters in Ontario.

No, if the Ontario government truly cares about us, it will take out the template it used to take **Hydro One Ltd.** ([TSX:H](#)) public and do the exact same thing with the LCBO. Investors ate up the Hydro One IPO. Think what they'll do for a piece of one of the province's (nay, the country's) most profitable enterprises.

Can you say cha-ching?

In the past the Ontario government has steadfastly refused to sell or privatize the LCBO because feedback it's gotten from Ontario residents is that we like our government owning a majority of the liquor distribution and retail in the province. I'm not sure how it came to that determination but I'll give them the benefit of the doubt and accept this proclamation as the gospel truth.

But just because we believe the provincial government shouldn't privatize the LCBO, it doesn't mean we can't have a publicly traded LCBO where the Ontario government maintains effective control, as is the case at Hydro One.

Since November 2015, an IPO and a secondary offering have been completed for Hydro One, reducing the province's ownership from 100% down to 70% where it sits today. Ultimately, it will own 40% of the utility with no other single investor allowed more than 10% of its stock, giving Premier Wynne et al. control in perpetuity.

I believe an LCBO IPO makes just as much sense. Here's why.

## **Big dollars**

To date, the Ontario government has generated \$5.2 billion in financial benefits from the Hydro One IPO—\$1.97 billion from the sale of shares, a \$2.2 billion deferred-tax asset benefit, and another \$1 billion from a special dividend and other special payments—with 179 million additional shares to be sold in the future to get it down to the 40% self-prescribed ownership level.

That's another \$4.6 billion, bringing its total potential haul to \$9.8 billion, perhaps more, while the Ontario government retains effective control of a majority of Ontario's electricity transmission and distribution.

While I'm not a lawyer, I would assume the Ontario government could enact legislation as it has with amendments to the Electricity Act to invoke the same 10% restriction on outside ownership. In many respects, the LCBO is also a utility—just a different kind.

How much of a haul would an LCBO IPO represent?

Well, back in 2004 then Finance Minister Greg Corbara considered an IPO that would have valued the liquor retailer at more than \$10 billion, yielding a very healthy 9% distribution to investors. The LCBO remitted a dividend of \$1.04 billion that year to Ontario's provincial coffers. In 2015-2016 (March 31, 2016, year-end), the LCBO remitted \$1.94 billion.

Using a multiple of 10 times the dividend gives us a 2016 valuation of \$19.4 billion. Shed 60% ownership, and Ontario could be looking at \$11.6 billion from an IPO, 20% more than Hydro One will generate.

## **Perhaps more**

At the time of Hydro One's IPO, Ed Clark, chair of Premier Wynne's advisory council on government assets, suggested the government-owned utility saw "extraordinarily strong demand... [Hydro One] was significantly oversubscribed."

The fact is, Canadian investors are hungry for non-resource stocks. An LCBO IPO would generate, in my opinion, even greater demand from retail and institutional investors coast to coast.

If **Loblaw Companies Limited** can get investors to pay \$45 for each dollar of its earnings, I see no reason why the LCBO can get those same people to pay \$17 for each dollar of its earnings—or more.

As IPOs go, the LCBO would rank right up there as one of the biggest in Canadian history. Oh, to dream.

## **CATEGORY**

1. Investing

TICKERS GLOBAL

1. TSX:H (Hydro One Limited)

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