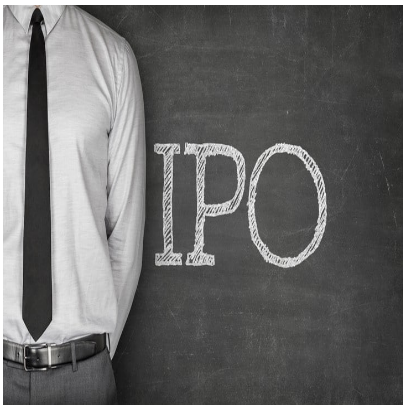

A Retail IPO for the Ages

Description

Roots Corporation (TSX:ROOT) went public October 25 at $12 per share. If you were one of the unlucky ones to have bought shares in the iconic Canadian retailer, I hope for your sake that you've been able to sell them, because in just one week, they lost one-quarter of their value.

You would hardly calls Roots's IPO one for the ages.

When the underwriters dropped the offering price to $12 from a range of $14-16, the writing was on the wall. Historically, IPOs that price below the range tend to underperform, maybe not by 25%, but they don't do well. Add to this a stock valued at 14 times adjusted EBITDA and a retail industry that's not running on all cylinders, and the stock's failure to launch is understandable.

Although it's been a bumper IPO season in 2017, the retail industry just doesn't seem to have what it takes to deliver a winner. However, there is a privately owned retail business that I believe would do well if it were to go public.

For me, Farm Boy Inc. would be a retail IPO for the ages. Here's why.

It's growing across Ontario

The first time I came across the Ottawa-based grocery store chain was two to three years ago when on vacation in Prince Edward County. My wife and I rented a cottage on the island and stopped in at its Kingston location to buy our groceries for the week.

I was immediately struck by the fact it wasn't your typical **Metro, Inc.** (TSX:MRU) or Sobeys, but I couldn't put my finger on what made it different. Since then, I've been to one of its Ottawa locations and I was equally impressed by the presentation.

The grocery store got its start in 1981 in Cornwall, founded by a trio of brothers. Offering a smaller footprint then the usual chain-store location and more of an emphasis on daily shopping for great food, it grew to 13 stores by 2012 when Boston-based private equity firm Berkshire Partners invested in its plans to grow across Ontario and eventually coast to coast.

If you're not familiar with Berkshire Partners, they also invested in **Aritzia Inc.** (TSX:ATZ), taking the specialty retailer public in 2016. Berkshire Partners still owns 51.1% of Aritzia's voting shares and likely won't sell until its share price recovers from $11 where it currently trades — well below its $16 IPO price.

Why is this different?

The typical private equity exit strategy is to invest for three to five years and then sell to a strategic buyer or another private equity firm or take it public.

In the case of Farm Boy, I'm not sure a strategic buyer would be ideal given its smaller size. Another private equity firm is a real possibility, because Berkshire is entering its sixth year of involvement with the grocery store, and it might want to redeploy the capital elsewhere. Certainly, between Farm Boy's expansion in the GTA and out west, it's going to need more capital.

That's where the IPO comes in.

CEO Jeff York, who's been in the top job since 2009, plans to open stores in the GTA suburbs before heading downtown. Forget the rest of Ontario; it's got big plans for the GTA.

"We have 10 to 12 leases either ready to be signed, negotiated or development plans in place in the GTA," York recently told the *Globe and Mail*. "In Ottawa we have 13 stores, so we can do 50 stores into Toronto pretty easily, in the GTA."

I'll grant you that grocery stores don't have the same profit margins as specialty retail, but if done right it can be very profitable.

"In a sense, the timing of the model has finally met up with consumer habits," Sylvain Charlebois, professor of food distribution policy at Dalhousie University, told the *Globe*. "The line between food service and retailing is blurring, and Farm Boy has always been able to strike the right balance for consumers."

The retail IPO that makes sense

With two stores in the GTA — five if you count Brantford, Cambridge, and Kitchener — and a third to open in Etobicoke in 2018, Farm Boy's growth story is a compelling one.

Almost anybody can produce nice sweatpants and sweatshirts, but a well-run grocery store operation is next to impossible to deliver.

Farm Boy can and probably will sometime in 2018.

CATEGORY

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TICKERS GLOBAL

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2. TSX:MRU (Metro Inc.)

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