Value Investors: Check Out This Beaten-Up Former IPO Darling

Description

Most of the time, recent initial public offerings (IPOs) are expensive. Most value investors won't even consider them.

An IPO is carefully managed, with the underwriters waiting until the best possible moment to sell the stock to both institutional and retail investors. If the deal is hot enough, regular Joe investors don't even get a sniff. All the shares are gobbled up by the smart money.

The time to check out a recent IPO isn't right when it starts trading. It's a few months — or even a few years — later, after all the hype has worn off.

That's exactly the situation today with **Freshii** (TSX:FRII), which was one of Canada's hottest IPOs just a couple of years ago. Shares have fallen more than 80% after debuting on the TSX in January 2017.

But I believe shares are quite undervalued today — ripe pickings for enterprising value investors who are willing to wait a few years for a massive potential return. Let's take a closer look.

What happened?

There's no mystery about why Freshii shares have fallen so much since the company's IPO. Growth simply disappeared.

While the company still continues to open new locations — including 50 new restaurants in 2018 and a net seven restaurant openings in its most recent quarter — same-store sales are not very exciting. The company reported same-store sales were down 0.9% in its most recent quarter versus a 1.6% increase in the same quarter last year. Net income fell approximately 75% versus the same quarter last year on higher costs.

Remember, Freshii is just a few months past reporting absolutely dismal same-store sales in the fourth quarter of 2018. That quarter saw same-store sales fall more than 6%.

Another big problem is Freshii is seeing many restaurants close. In its most recent quarter, the company opened 21 new locations and saw 14 close. That's an alarming number of locations being shuttered.

Finally, the company recently lost its chief financial officer who resigned to pursue other opportunities. That was more than two months ago, and the company still hasn't named a replacement.

The opportunity

Investors focused on same-store sales are missing an important point. Freshii is expanding like crazy and has a long runway to continue doing so.

On March 31, 2016, Freshii had 191 locations. Just three years later, the store count has more than doubled, with the company having 446 locations on March 31, 2019. The company has also boosted sales by getting its products on **Air Canada** flights, and it has just booked a deal with **Walmart** to get some of its offerings into some 100 Ontario-based Walmart stores.

Freshii believes this growth will continue at least for the next few years. The company recently reported it has 140 different locations actively working towards opening, with a further 356 locations listed as committed. Investors should note Freshii doesn't list a location as committed until it has a signed franchisee agreement and received at least half of the franchise fee.

The company is focusing on both expanding its footprint in the United States as well as looking at smaller cities. Larger areas have a great deal of restaurant competition, and locations in lower population cities have lower start-up costs.

Finally, value investors will be comfortable knowing Freshii's balance sheet is in good shape, with approximately 40% of the company's market cap in cash and no long-term debt. Remember, Freshii is selling franchises; the restaurant operator is the one supplying the capital here.

The bottom line

Freshii is a fantastic opportunity at today's bargain prices. Same-store sales growth might not be spectacular, but there's potential for the company to open thousands of stores. This growth story might just be beginning.

It isn't often investors see a stock this cheap with such stellar growth potential. It's that simple.

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