

Australian Equity Research

17 June 2015

SPECULATIVE BUY

unchanged

PRICE TARGET A\$1.80↑

from A\$1.63

Price (17-Jun) A\$0.94

Ticker YOW-ASX

52-Week Range (A\$):	0.45 - 0.82
Avg Daily Vol (000s) :	500.0
Avg Daily Vol (M) :	0.5
Shares Out. (M) :	139.1
Market Cap (A\$M):	106
Enterprise Value (A\$M):	96.7
Last Reported Quarter:	March 2015
ADR Ticker:	YWRPY

FYE Jun	2015E	2016E	2017E
Sales (A\$M)	2.9	61.3↑	179.4
Previous	2.9	58.8	179.4
EBITDA (A\$M)	(3.7)	3.8↑	32.8
Previous	(3.7)	3.3	32.8
Net Income Adj (A\$M)	(3.4)	3.4↑	22.6
Previous	(3.4)	2.9	22.6
EPS Adj&Dil (AUc)	(0.03)	0.02	0.13
DPS (AUc)	0.00	0.00	0.08
EV/EBITDA (x)	(31.6)	32.5	3.2
P/E (x)	(34.4)	46.7	6.9
Div. Yield (%)	0.0	0.0	8.7



Yowie Group Ltd is a brand marketing company. The company sells a chocolate confectionery product called a Yowie, under exclusive patent protection in the USA. It is the only collectible toy inside a chocolate animal outer shell legally allowed to be sold in the USA until 2018.

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Raising Target Price

Walmart confirms full scale US roll-out

The company announced today that Walmart has agreed to a full scale roll out of Yowie to all 4,300 of their USA based stores. The announcement confirms that the previously announced second stage trial in 1,505 stores has been successful and that Walmart believes the product will continue to sell well across all of their stores.

Our initiation thesis had assumed that in order to deliver into a Xmas scaled up roll-out window, Walmart would likely need to place purchase orders at the end of May or early in June and thus those orders could be pending. This announcement comes as a surprise, as Walmart has requested delivery of the product for an August in-store date, well in advance of our estimated Nov/Dec assumption.

1H16 volume and revenue estimates increased

As a result of the earlier than expected delivery window, we have adjusted 1H16 unit forecast by 2.0m units, from 5.3m units to 7.3m units and our 1H16 revenue estimate has increased from \$13.1m to \$17.1m (FY16 revenue estimate increases from \$56.8m to \$61.3m). We have left our future year forecasts unchanged at this time.

How significant can Walmart be for Yowie?

Using an assumption that each Walmart store could sell 614 units per month (12 units per checkout, per week at 12 checkouts per store), the all store roll-out could see Yowie sales reach an annualised rate of 31.6m units per annum or 2.6m units per month by the end of calendar 2015. This could equate to estimated monthly revenue run rate of U \$4.5m per month or U\$54m annualized (A\$71m) which is in excess of our FY16 full year revenue estimate.

Walmart is a billboard for the rest of the industry to follow

It's worth noting that when Walmart commits to a product as it has with Yowie in the highly visible checkout locations, other retailers will take notice and are likely to see Yowie as a "must have" item. This could be the tipping point for Yowie in the USA market. We highlight again that it has US patent protection over "chocolates with a toy inside", for another 3 years.

Cheap on our FY17 EV/EBITDA estimates

Our EBITDA estimate for FY17 remains unchanged at \$32.8m. In our view, despite today's share price increase, the stock remains relatively cheap on 3.2x FY17 EV/EBITDA.

Valuation de-risked: price target increased to \$1.80/sh

In our initiation, we suggested an all store roll-out to Walmart would de-risk our risk weighted valuation and could lead to a price target increase. As a result, we reduced our weighting for the "slow customer conversion" and the combined "production problems and slow customer conversion" and increased our base case, which has increased our valuation and price target by 10.4% from \$1.63/share to \$1.80/share.

Figure 1: Risk weighted valuation adjusted higher

Blended Valuation - FY17 EV/EBITDA	Raw Val'n	% Weight	Weighted Val
Base case	\$2.79	35.0%	\$0.98
Production problems	\$1.58	25.0%	\$0.39
Slow customer conversion	\$1.48	20.0%	\$0.30
Production & slow cust conversion	\$0.67	20.0%	\$0.13
Blended Valuation & Price Target			\$1.80

Source: Canaccord Genuity Estimates

The market may be pricing in Walmart, but not Yowie's other major US customers or the rest of the world

In our initiation report, we analysed what level of sales and EBITDA we estimated the market was pricing in. Our conclusion at \$0.76 share price was the market had priced in \$10.5m of EBITDA (using 11.7x EV/EBITDA multiple) or 25m units pa. We translated this to selling 614 units per store, per month, through 3,394 Walmart stores out of a possible 4,300 US based stores.

Following today's announcement and using a share price of \$0.94, we estimate the market is now pricing in \$13.0m of EBITDA or 31.1m units pa, which is the equivalent of 4,220 Walmart stores of the possible 4,300 stores.

On this basis, we estimate that the market may be effectively pricing in Walmart, but does not appear to be attributing any value to the other US customers that Yowie is already dealing with (including Safeway, CVS, Walgreens, 7-Eleven) or other international customers outside of the USA. This appears conservative in our view.

Figure 2: What is being priced in today?

What is the market pricing in today?	
Price	\$0.94
Enterprise Value (incl options converted in 2015)	\$152.6
EBITDA multiple	11.7x
EBITDA priced in	\$13.0
Per unit EBITDA margin (A\$/unit - long term avg)	\$0.42
Units per annum priced in (m)	31.1
Per month, per store (avg for Tier 1, 2 & 3 accts)	322
Average stores required (all tier levels)	8,045
Walmart - Tier 1 stores priced in	
Per month, per store in Walmart	614
Average Walmart stores required	4,220

Source: Canaccord Genuity Estimates

Existing inventory drawn on to hit delivery window

Yowie has approximately 6.5m units in inventory, which will be drawn upon to fulfill the early delivery date. With current installed capacity of 20m pa, or 1.6m per month, we do not see any risk to them delivering this order, or scaling up for Walmart's potential short term future demand. We do however expect the production capacity expansion to 40m units pa to become a priority, as other customers could put pressure on the manufacturing capacity in our opinion.

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Target Price / Valuation Methodology:

Yowie Group Ltd. - YOW

Our price target of A\$1.63/share is derived using a blended EV/EBITDA method based on FY17 forecasts (2 years fwd). The 11.7x multiple has been derived using comparable global peers.

Risks to achieving Target Price / Valuation:

Yowie Group Ltd. - YOW

Risks to achieving our price target include; slower than expected customer volume ramp up, the company having production issues meaning they are unable to deliver product on time, inadequate funding for a larger than expected volume ramp up, overwhelming competition once the US patent expires in April 2018, the inability for Yowie to expand beyond the USA market effectively and margins being squeezed as volumes increase.

Distribution of Ratings:

Global Stock Ratings (as of 06/17/15)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	588	58.92%	32.99%
Hold	323	32.36%	15.48%
Sell	40	4.01%	5.00%
Speculative Buy	47	4.71%	55.32%
	998*	100.0%	

*Total includes stocks that are Under Review

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Yowie Group Ltd. Rating History as of 06/15/2015

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