EDISON

ADR research

Yowie Group

Results update

Walmart rollout leads to record sales

Food & beverages

Yowie Group's retail revenues doubled on a sequential basis in the September quarter to an estimated US$4.8m as the company expands its rollout from 1,500 to 4,300 Walmart stores in the US. With the Walmart rollout nearly complete, inventory-related working capital needs are declining, improving operating cash flow trends. Based on these early results, we believe there may be upside to our fiscal 2016 base case outlook. However, we are maintaining our estimates for now as the September quarter numbers reflect both retail and stock-building sales.

Year end	Revenue ($m)	PTP* ($m)	EPADR ($)	DPADR ($)	P/E (x)	Gross yield (%)
06/14	0.0	(3.2)	(0.35)	0.0	N/A	N/A
06/15	1.9	(2.4)	(0.19)	0.0	N/A	N/A
06/16e	15.5	(0.7)	(0.04)	0.0	N/A	N/A
06/17e	33.5	4.1	0.27	0.0	30.9	N/A

Note: *PTP and EPADR are normalised, excluding intangible amortization, exceptional items and share-based payments. Converted at A$/US$0.725. Investors should consult their tax advisor regarding the application of any domestic and foreign tax laws.

Quarterly sales at retail approach US$5m

Yowie Group reported record sales in the September quarter. An estimated US$4.8 million of retail sales value was achieved, which management indicates is more than double the retail sales value in the June quarter. As of 30 September, Yowies are in 3,700 Walmart stores, and the rollout to all 4,300 stores is on track to be finished by late fall 2015.

Moving towards positive operating cash flow

With the Walmart rollout largely complete, Yowie is working down its inventory, moving towards positive operating cash flow and freeing up cash for other uses. Inventory at the end of September was $5m, down from $6.9m at the end of June, prior to the start of the rollout. Working capital used for raw materials and manufacturing costs was $0.7m, down from $1.0m in the June quarter. Net operating cash flow in the quarter improved to ($0.7m) from ($1.2m) in June.

Valuation: Reverse DCF largely unchanged

Yowie ADRs have held steady since our initiation in September, however, the ADR count has increased c 4% to 15.4m from 14.8m due to option exercises. As a result, a reverse DCF at the current price with a WACC of 10% continues to imply compound average revenue growth from FY16 to FY18 of 70% fading to terminal growth of 2%, though with a terminal EBIT margin of 23% (previously 22%). There is nothing in our forecasts for rollout to other geographies, which would present upside. We believe that there is a real opportunity for investors as Yowie demonstrates that it can move beyond confectionery into licensing the brand for other products.

6 November 2015

Price	**$8.34***
Market cap	**$128m**

*Calculated ADR/Ord conversion ratio 1:10
A$/U$0.725

Net cash ($m) at 30 September 2015	8.3
ADRs in issue	15.4m
ADR Code	YWRPY
ADR exchange	OTC
Underlying exchange	ASX
Depository	BNY

Business description

Yowie Group, listed in Australia, is engaged in brand development of the Yowie chocolate confectionery product, digital platform, and licensed consumer products. The company's brand vision includes distribution in North America, with further expansion planned into Australia, New Zealand and Asia, where the Yowie brand's equity remains strong. Expansions into Europe and the Middle East are key strategic priorities for a second-stage brand rollout.

Next events

H116 results	February 2016
Q316 results	May 2016

Analysts

Beth Senko, CFA	+1 646 562 7033
Paul Hickman	+44 (0)20 3681 5201

consumer@edisongroup.com

Edison profile page

Update: Yowies invade America

Yowie Group is an emerging growth, brand development and marketing company. It is launching a unique and patented chocolate/toy novelty in the US market as the first step in reviving a highly successful Australian children's brand that teaches environmental awareness and conservation through whimsical cartoon characters and stories.

In many ways, Yowie Group has achieved the Holy Grail for new consumer products. Without any real sales track record in the US, Walmart came on as a beachhead customer in 2014, based on what Walmart's buyers see as strong potential for Yowie's chocolate encapsulated/toy product in their stores. Due to a successful trial in 50 stores in fall 2014, followed by a preliminary rollout to 1,500 stores in early 2015, Yowies are currently available in over 3,700 Walmart stores and are expected to be in all 4,300 Walmart outlets in the US by late fall 2015.

Recent trends early but encouraging

According to the company's press release, Yowie Group reported record sales in the September quarter. An estimated US$4.8 million of retail sales value was achieved, which is more than double the previous quarter. Consistent with ASX practices, Yowie Group does not file an income statement on a quarterly basis, so we have to infer unit sales from management's comments and its 4C filing.

- Retail value US$4.8m – management comments that it achieved $4.8m in retail sales value in the September quarter. Retail sales prices for Yowies typically range from a low of $2.78 (at Walmart) to a high of $3.99 (at specialty candy retailers), suggesting retail volumes in a range from 1.2-1.7m units.
- Cash receipts US$1.8m – Yowie reports customer receipts on a cash basis, which reflect sales to customers at wholesale, but exclude any increase in accounts receivable. Customer receipts totalled US$1.8m in the September quarter. Using an average wholesale price of US$1.70-US$1.80, suggests the company shipped 1.0-1.1m units in the quarter.

We believe that the difference between management's retail sales estimate and cash receipts for the quarter likely reflects two factors: sales of units that were shipped to retailers prior to the September quarter; and any unreported increase in accounts receivable.

Management has set its sights high for the potential target market in the US, with a fairly aggressive peak sales target based on Yowie's success in Australia in the late 1990s, (where annual sales were an estimated 3.6 units per capita) as well as versus Kinder Surprise, which averages 1-2 units per capita each year in the EU. At a penetration of 2-3 units per head of population, the 320 million US market would represent a sales volume of some 750m units, around 30 times higher than our 2018 base case forecast volumes in Exhibit 1 below. Our forecast scenarios were discussed in detail in our 21 September 2015 initiation.

While management's unit sales targets may be achievable over the long term, we believe that the real opportunity for investors will be as Yowie moves beyond confectionery into other products and licensing. Merchandise and other licensing agreements would likely be structured as royalty revenues to the company, with some level of guarantee. Licensing revenue would likely be highly profitable and drop almost entirely to the operating line, after some level of administrative costs. However, we have not built this into our earnings model for 2016-17 and we have a modest licensing revenue assumption of US$1.4m for 2018.

Exhibit 1: Store and volume penetration scenarios	FY16e	FY17e	FY18e
Base case			
Store penetration at year end	12,281	18,481	20,481
Total units (m)	9.5	20.7	26.2
Product sales (US$000)	15,208	33,128	43,527
Moderately higher growth (15% in stores and volume)			
Store penetration at year end	13,509	20,329	22,529
Total units (m)	11.5	25.1	31.7
Product sales (US$000)	18,401	40,085	50,767
Moderately lower growth (10% in stores and volume)			
Store penetration at year end	11,053	16,633	18,433
Total units (m)	7.7	16.8	21.2
Product sales (US$000s)	12,318	26,834	33,985

Source: Edison Investment Research. Note: Product sales and units refer to sales into stores.

There is a further opportunity as Yowie renews its existing brand franchise in Australia, New Zealand and Asia, and extends into Europe and the Middle East, none of which we have attempted to value at this stage.

Sensitivities

In many ways, Yowie Group is a high-risk startup venture. It is still too early to know whether consumers will consistently flock to a premium-priced, novelty candy based on little-known characters.

Foreign exchange sensitivity for ADR investors has been mitigated as the company has switched its functional currency from Australian dollars to US dollars from the start of the current fiscal year (1 July 2015).

Success at Walmart is crucial to our sales forecasts. Walmart not only has 4,300 outlets in the US, but it also tends to have more points of sale (POS) in each store and higher sales per POS than Yowie's other outlets. While management will not break out sales to Walmart specifically (citing confidentiality agreements), we believe that sales from Walmart could drive more than 80% of Yowie's total sales in the next 12-18 months.

Other sensitivities for Yowie Group include commodity prices, reliance on a single-source manufacturer and typical regulatory and legal issues.

Valuation

Our primary valuation metric for Yowie is DCF, since the full value of the current opportunity is likely to become apparent over a number of years rather than from near-term results. However, a comparison with the branded confectionery peers gives reassurance on the significant earnings multiples available in the sector.

Our projections see rapid US revenue growth peaking in FY18. A reverse DCF at the current price with a WACC of 10% implies compound average revenue growth from FY16 to FY18 of 70% fading to terminal growth of 2%, and a terminal EBIT margin of 23%. There is nothing in our forecasts for rollout to other geographies, which would present upside.

In the short term, we see the Yowie story as somewhat binary – either US customers will love the brand or they will not. As a result, we believe that if the brand proves itself in the next year, the WACC and relative risks to the story will more closely reflect a consumer goods story – albeit one with very high growth. In this context, the retail sales data from the September quarter are encouraging.

Our 10-year reverse DCF model builds to sales of approximately US$120m by 2025. There is nothing in our forecast for rollout to other geographies, which thus represents pure upside. We also believe that there is a real opportunity for investors should Yowie move significantly beyond confectionery into other products and licensing. Evidence of success here would lead us to adjust our forecasts to more accurately reflect the impact of the increased license income.

We assume a terminal growth rate of 2% and use a WACC of 10.0% (reflecting 10% market gearing), an equity risk premium of 5.4% and a beta of 1.2. We selected these to reflect what we view as conservative earnings forecasts, a once strong and proven children's franchise and a business model that is not capital intensive. On this basis, our reverse DCF requires a terminal EBIT margin of 23%, a level that we regard as achievable given our forecast of a modest increase in licensing income over the next ten years, to c 9% of total revenue, albeit still significantly short of management's aspirations in this area.

Exhibit 2: Scenario Analysis (US$ per ADR)

		Terminal EBIT Margin				
		15%	19%	23%	27%	31%
WACC	7.0%	10.35	12.91	15.47	18.03	20.58
	8.0%	8.24	10.25	12.26	14.28	16.29
	9.0%	6.74	8.37	10.01	11.64	13.27
	10.0%	5.63	6.99	**8.34**	9.69	11.04
	11.0%	4.78	5.92	7.06	8.19	9.33
	12.0%	4.11	5.08	6.05	7.02	7.99
	13.0%	3.57	4.41	5.24	6.08	6.91

Source: Edison Investment Research. Note: Bold indicates current level.

Financials

Historic results largely reflect startup investment and meaningful sales have only commenced recently. Following a A$10m capital raise in January 2015, Yowie Group is well capitalised to invest in the US rollout as well as any plant expansion. At the end of September, Yowie Group had US$8.3m on the balance sheet, up $0.3m from the June quarter and reflecting financing cash flows of US$1.2 from listed and unlisted option exercises, partially offset by net operating and investing cash use of US$0.9m.

Assuming substantial success of the US rollout, led by strong uptake in Walmart stores, we forecast revenue of US$15.5m in FY16 rising to US$33.5m in FY17, when we expect breakeven and a pre-tax profit of US$4.1m. We forecast EPADR of US$0.49 by FY18.

With the Walmart rollout largely complete, Yowie Group is working down its inventory, moving the company towards positive operating cash flow and freeing up cash for other uses. Inventory at the end of September was $5.0m, down from $6.9m at the end of June, prior to the start of the rollout. Working capital used for raw materials and manufacturing costs was $0.7m, down from $1.0m in the June quarter. Net operating cash flow in the quarter improved to ($0.7m) from ($1.2m) in June.

Based on the information in Yowie Group's quarterly report to September and the early stage of the full rollout, we are maintaining our estimates, but believe that there may be upside to our numbers for fiscal 2016 for several reasons:

- Using management's retail sales value of US$4.8m in the quarter, our calculation of retail unit sales in the quarter is in a range 9-55% above our 1.1m unit estimate of sales to retailers for the period. However, as noted above, we believe that retail sales in the quarter include units that were shipped to retailers prior to the September quarter.

- Inventory build is largely complete and manufacturing and going forward, raw material costs are likely to more closely match demand.
- Operating cash flows are improving as working capital needs diminish.

However, two factors prompt us to maintain our F2016 estimates for now:

- Revenues for the quarter reflect both sales at retail and channel stocking. Once Walmart's distributors build inventory to normalised levels and reorders reflect retail sales more than stock building, we should get a more accurate indication of product sales trends.
- The company has made an increased investment in marketing and merchandising staff. While management has previously indicated that it will not spend excessively to grow the brand, we suspect that as manufacturing costs moderate, the company may shift those savings towards sales and marketing beyond our base case estimate of a US$6.7m expense in FY16.

Exhibit 3 Financial summary

	US$000s	2013	2014	2015	2016e	2017e	2018e
Year end June		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		11	19	1,917	15,520	33,456	44,595
Cost of Sales		0	(4)	(885)	(9,731)	(19,056)	(24,128)
Gross Profit		11	15	1,032	5,789	14,400	20,467
EBITDA		(810)	(3,283)	(2,619)	(785)	3,950	7,102
Operating Profit (before amort. and except.)		(814)	(3,298)	(2,678)	(903)	3,799	6,911
Intangible Amortisation		0	(0)	(3)	0	0	0
Exceptionals		(912)	(1,441)	(111)	0	0	0
Other		0	0	0	0	0	0
Operating Profit		(1,726)	(4,739)	(2,791)	(903)	3,799	6,911
Net Interest		18	75	258	243	340	672
Pre-tax profit (norm)		(796)	(3,223)	(2,419)	(660)	4,139	7,584
Pre-tax profit (FRS 3)		(1,708)	(4,665)	(2,533)	(660)	4,139	7,584
Tax		0	0	0	0	0	0
Profit After Tax (norm)		(796)	(3,399)	(2,418)	(658)	4,141	7,587
Profit After Tax (FRS 3)		(1,708)	(4,665)	(2,533)	(660)	4,139	7,584
Average Number of ADRs Outstanding (m)		4.1	9.7	12.7	15.5	15.5	15.5
EPADR - normalised (c)		(0.19)	(0.35)	(0.19)	(0.04)	0.27	0.49
EPADR - (IFRS) (c)		(0.41)	(0.48)	(0.20)	(0.04)	0.27	0.49
Dividend per share (US$)		0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)		100.0	80.3	53.8	37.3	43.0	45.9
EBITDA Margin (%)		N/A	N/A	N/A	N/A	11.8	15.9
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A	11.4	15.5
BALANCE SHEET							
Fixed Assets		1,100	980	1,488	1,657	2,122	2,402
Intangible Assets		410	173	364	362	362	362
Tangible Assets		690	807	1,123	1,295	1,760	2,041
Investments		0	0	0	0	0	0
Current Assets		2,851	8,907	13,449	12,592	17,664	25,728
Stocks		0	2,019	4,920	5,060	6,670	7,480
Debtors		28	54	302	310	669	892
Cash		2,335	5,975	8,013	7,000	10,034	17,029
Other		488	859	215	221	292	327
Current Liabilities		(352)	(677)	(1,485)	(1,460)	(2,858)	(3,619)
Creditors		(352)	(677)	(1,485)	(1,460)	(2,858)	(3,619)
Short term borrowings		0	0	0	0	0	0
Long Term Liabilities		0	0	0	0	0	0
Long term borrowings		0	0	0	0	0	0
Other long term liabilities		0	0	0	0	0	0
Net Assets		3,598	9,210	13,452	12,789	16,928	24,511
CASH FLOW							
Operating Cash Flow		(1,166)	(5,611)	(5,671)	(723)	3,650	7,467
Net Interest		18	75	0	0	0	0
Tax		0	0	0	0	0	0
Capex		(957)	(911)	(275)	(290)	(616)	(471)
Acquisitions/disposals		(180)	0	0	0	0	0
Financing		3,465	10,088	7,984	0	0	0
Dividends		0	0	0	0	0	0
Net Cash Flow		1,181	3,640	2,038	(1,013)	3,034	6,996
Opening net debt/(cash)		(1,154)	(2,335)	(5,975)	(8,013)	(7,000)	(10,034)
HP finance leases initiated		0	0	0	0	0	0
Other		0	0	0	0	(0)	0
Closing net debt/(cash)		(2,335)	(5,975)	(8,013)	(7,000)	(10,034)	(17,029)

Source: Edison Investment Research. Note: Historic results reflect past results prepared under presentation currency of A$ to June 2015 and translated at U$0.725/A$. Presentation currency for financial reporting changed from A$ to US$ from 1 July 2015.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand