WA Industrials: Confectionery

YOWIE GROUP LTD (YOW)

YOW.asx
Speculative Buy

	23 Jun 2017
Share Price:	$0.31
12mth price target:	$0.51

Another Guidance Downgrade

Yowie Group Ltd ('Yowie', 'YOW' or the 'Company') has provided updated revenue guidance to the market. The Company now projects FY17 year on year revenue growth of 55% versus prior guidance of 70%. The 70% projection was provided with the 3rd Quarter result on the 19th of April and itself was a downgrade from 85% previously. Year on year revenue growth in FY18 is now expected to be in the range of 55-70%, down from the objective of 'similar to FY17 growth' (i.e. 70%) provided again with the 3rd Quarter result. We were forecasting growth of 69% and 66% for FY17 and FY18, which we have now reduced to 55% and 53% respectively.

Weaker than expected revenue in 4Q17 was the result of a delay in the Canadian launch to 1Q18 (US$1m impact) and similarly the new Discovery product (US$0.5m). US sales growth was also basically flat q.o.q. perhaps a result of customer fatigue (particular at Wal-Mart which still represents 70% of their business) regarding series 2. Series 3 has a planned launch in 1Q18.

Guidance – missed opportunity to recalibrate. Buy Back stock.

Unfortunately, this is the latest in a series of downgrades to previously provided guidance, which continues to impact sentiment around the stock. We expected recent management changes to be a catalyst for the company to either stop providing guidance (quarterly updates may be sufficient) or provide more robust projections. That does not seem to have occurred yet.

As outlined in our note 'Much More than a Novelty Item (18th April)' YOW operates in a highly competitive industry and its achievement in growing revenue to over US$20m per annum is hugely impressive. However, the constant downgrades (Company guidance and broker estimates) has obviously left some investors disappointed. The Company has circa US$29m of cash, with EBITDA likely to be positive in FY18. We also view the company as offering good value, especially as we look out to FY19 numbers and beyond. Until the Company can rebuild market confidence in its outlook and to better utilise its balance sheet we believe the company might want to consider a buyback program as one option. If the Company can deliver its medium-term plans, then buying its own stock currently with what looks like excess cash would seem to be a smart investment.

Downgrades to valuation and price target.

On the back of our downgrades to earnings we downgrade our 12-month forward valuation and target price from A$0.83 per share to A$0.51 per share (based on the low end of FY18 guidance). We maintain our Speculative Buy.

Key Chart: Earnings Revisions

		FY16A	FY17F			FY18F		
		Actual	Old	New	% Chg	Old	New	% Chg
Volume	m	8.61	15.20	13.97	-8%	25.26	21.34	-16%
Revenue	US$ m	13.06	22.04	20.26	-8%	36.63	30.94	-16%
EBIT	US$ m	-6.75	-5.48	-5.93	-8%	0.51	-1.03	-303%

Source: Hartleys Research

Brief Business Description:
Yowie Group (YOW) has global distribution rights to the Yowie confectionary brand.

Hartleys Brief Investment Conclusion
Yowie Group (YOW) has succeeded in rolling out the Yowie confectionary product to 4,500 Walmart stores in the US. Growth opportunities exist with other US customers but also in other international markets.

Chairman & CEO:

Trevor Allen	Interim Chairman
Bert Alfonso	CEO/MD
Mark Schuessler	COO

Top Shareholders:

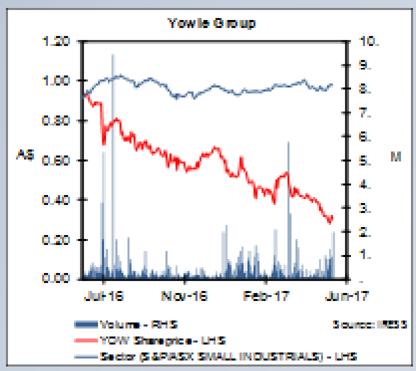
FIL Limited	8.4%

Company Address:
216 St Georges Terrace
Perth WA 6000

Issued Capital:	211.8m
- fully diluted	226.8m
Market Cap:	A$65.7m
- fully diluted	A$70.3m
Net Cash (Current)	US$29.4m

	FY17e	FY18e	FY19e
Op Cash Flw	-1.6	-0.5	2.6
Free Cash Flw	-2.6	-1.5	1.1
NPAT* (US$m)	-4.2	-0.7	1.9
EPS ($, bas)	-2.0	-1.8	0.9
P/E (basic)	-11.8x	-13.2x	25.6x
P/E (diluted)*	-12.6x	-73.3x	25.6x
EBITDA	-2.7	0.0	3.8
Volume (m)	14.0	21.3	28.8
N.D. / equity	-81%	-74%	-71%

Source: Hartleys Research. * normalised



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Hartleys has assisted in the completion of part of a capital raising in the past 12 months for Yowie Group Limited, for which it has earned fees.

SUMMARY MODEL

Yowie Group Limited (YOW)

Company Information		
Date	23 Jun 2017	Yowie Group Ltd
Share Price	$0.31	Level 4
52 Week High-Low	$1.24 - $0.52	216 St Georges Terrace
Market Cap ($m)	$65.7	Perth WA 6000
Market Cap - FD ($m)	$70.3	www.yowiegroup.com
Enterprise Value ($m)	$30.3	
Ordinary Shares	211.8	
Fully Diluted Shares	226.8	

Valuation				
FY19	**ASX Comps (F,B&T)**	**Target Multiple**	**Wgt.%**	**Tgt Price**
EV/EBITDA	10x	10x	35%	0.40
EV/EBIT	14x	14x	25%	0.39
Earnings	19x	19x	15%	0.22
DCF			25%	0.34
Cost out/Synergy Opportunity (US$ m)			25.4	0.15

12-month Target Price	**$0.51**
Upside / downside from current share price	63%
P / E (6/18F) at price target	*-119.6x*
P / E (6/19F) at price target	*44.8x*
EV / EBITDA (6/19F) at price target	*14.9x*
EV / EBIT (6/19F) at price target	*20.6x*

Multiples (S/price at $0.31)	6/15A	6/16A	6/17F	6/18F	6/19F
P / E (reported, basic weighted)	-7.2x	-5.5x	-11.8x	-13.2x	25.6x
P / E (normalised, dil. weighted)	-10.3x	-7.8x	-12.6x	-73.3x	25.6x
P / E (mkt cap / norm. NPAT)	-12.1x	-7.3x	-11.8x	-68.5x	25.6x
P / E (fully diluted mkt cap / norm. NPAT)	-12.9x	-7.8x	-12.6x	-73.3x	27.4x
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Group Free Cash Flow (f.c.f) / EV	-19.4%	-4.9%	-6.4%	-3.7%	2.8%
Equity f.c.f. / Mkt Cap	-9.0%	-2.3%	-2.9%	-1.7%	1.3%
Price / FCF	-8.2x	-21.0x	-27.1x	-15.6x	58.5x
Mkt cap / operating cash flow	-8.5x	-364.9x	-30.8x	-100.8x	19.0x
EV/EBITDA multiple	-5.7x	-5.7x	-8.5x	1,226.4x	6.1x
EV/EBIT multiple	-5.6x	-3.4x	-3.8x	-22.1x	8.3x
Price / Book Value	4.2x	1.4x	1.4x	1.6x	1.5x
Price / NTA	4.3x	1.4x	1.5x	1.6x	1.5x
Ave FX	0.85	0.74	0.75	0.75	0.76
Ratios	**6/15A**	**6/16A**	**6/17F**	**6/18F**	**6/19F**
Return period end Equity	-33.1%	-19.6%	-11.4%	-11.1%	5.3%
ROA	-10.5%	-8.1%	-11.7%	-17.1%	-10.2%
ND / ND + Equity	-147.3%	-599.9%	-425.7%	-287.1%	-247.9%
ND / Equity	-59.6%	-85.7%	-81.0%	-74.2%	-71.3%
Net Interest Cover (EBIT)	6,875.2	n,a,	n.a	n.a	n.a
ROIC	-79.8%	-124.1%	-59.7%	-8.2%	18.5%

Free Cash Flow Analysis ($m)	6/15A	6/16A	6/17F	6/18F	6/19F
Net Operating Cash Flow	-6.5	-0.1	-1.6	-0.5	2.6
Capex (Reported)	-0.4	-1.9	-1.0	-1.0	-1.5
Group Free Cash Flow (rep'ted)	-6.9	-2.0	-2.6	-1.5	1.1
Fixed Debt Repayments	0.0	0.0	0.0	0.0	0.0
Equity Free Cash Flow (rep'ted)	**-6.9**	**-2.0**	**-2.6**	**-1.5**	**1.1**
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0
Free Cash Flow (normalised)	-6.9	-2.0	-2.6	-1.5	1.1

Share Data	6/15A	6/16A	6/17F	6/18F	6/19F
Ord Issued shares (m)	139.1	211.8	211.8	211.8	211.8
growth	18.1%	52.2%	0.0%	0.0%	0.0%
Weighted ave shares (m)	128.5	175.5	211.8	211.8	211.8
growth	32.2%	36.6%	20.7%	0.0%	0.0%
Diluted shares wgted (m)	181.0	226.6	226.6	226.6	211.8
growth	37.3%	25.2%	25.2%	0.0%	-6.5%

Options				
Year Expires	Number	% ord	Avg Price	$m unpaid
30-Jun-17	4,200,000	2.0%	$ 0.29	$ 1.20
31-Dec-17	3,625,000	1.7%	$ 0.77	$ 2.78
31-Dec-17	2,500,000	1.2%	$ 0.90	$ 2.25
31-Dec-17	2,900,000	1.4%	$ 1.05	$ 3.05
31-Dec-17	320,000	0.2%	$ 1.15	$ 0.37
31-Dec-17	640,000	0.3%	$ 1.25	$ 0.80
24-Aug-18	200,000	0.1%	$ 1.51	$ 0.30
24-Aug-18	400,000	0.2%	$ 1.63	$ 0.65
8-Sep-18	75,000	0.0%	$ 1.40	$ 0.11
8-Sep-18	125,000	0.1%	$ 1.51	$ 0.19
TOTAL	**14,785,000**	**7.0%**	**$ 0.77**	**$ 11.39**

Directors & Senior Management		Substantial Shareholders	%
Trevor Allen	Interim Chairman	FIL Limited	8.4%
Bert Alfonso	CEO/MD		
Mark Schuessler	COO		
Patricia Fields	Executive Director		

Recommendation: Speculative Buy

Profit & Loss	6/15A	6/16A	6/17F	6/18F	6/19F
Sales Volume	2.0	8.6	14.0	21.3	28.8
Growth	*n.a.*	*330.7%*	*62.2%*	*52.7%*	*35.1%*
Ave. Selling Price (US$)	1.40	1.45	1.45	1.45	1.45
Revenue (US$m)	2.80	12.49	20.26	30.94	41.80
Profit & Loss (US$m)					
Total Revenue	**2.4**	**13.1**	**20.3**	**30.9**	**41.8**
growth	*1729%*	*450%*	*55%*	*53%*	*35%*
COGS	-1.0	-6.2	-9.8	-15.4	-21.3
Distribution	-1.7	-2.6	-2.2	-3.2	-3.7
G&A	-3.3	-6.0	-7.5	-7.7	-7.9
Marketing	-0.8	-2.2	-3.4	-4.6	-5.0
- % of sales	-35.3%	-16.6%	-17.0%	-15.0%	-12.0%
EBITDA	**-4.6**	**-4.0**	**-2.7**	**0.0**	**3.8**
margin	**-193.0%**	**-30.3%**	**-13.4%**	**0.1%**	**9.2%**
Depreciation/Amortisation	-0.04	-0.07	-0.04	-0.05	-0.06
Share Based Payments	-0.90	-2.55	-3.19	-1.00	-1.00
EBIT	**-4.6**	**-6.6**	**-5.9**	**-1.0**	**2.8**
EBIT / Sales	**-194.7%**	**-50.4%**	**-29.3%**	**-3.3%**	**6.7%**
Net Interest	0.00	0.00	0.00	0.00	0.00
Profit Before Tax	**-4.6**	**-6.6**	**-5.9**	**-1.0**	**2.8**
- margin	**-194.7%**	**-50%**	**-29%**	**-3%**	**6.7%**
Normalised Tax	0.0	0.0	1.8	0.3	-0.8
Effective Tax Rate	0.0%	0%	30%	30%	30%
NPAT Pre Minorities	-4.6	-6.6	-4.2	-0.7	1.9
Minorities					
Normalised NPAT to equity	**-4.6**	**-6.6**	**-4.2**	**-0.7**	**1.9**
Norm. Net Profit / Sales	**-194.7%**	**-51%**	**-20%**	**-2%**	**4.7%**
Abnormals / discontinued	-0.1	-0.6	0.0	-3.0	0.0
Reported Profit to equity	-4.7	-7.2	-4.2	-3.7	1.9
Reported EPS (basic, w'ghted)	-3.7	-4.1	-2.0	-1.8	0.9
Normalised EPS (dil, wghtd)	-2.6	-2.9	-1.8	-0.3	0.9
Normalised EPS (full. diluted)	-2.0	-2.9	-1.8	-0.3	0.9
EPS (full dil) Growth %	***106%***	***43%***	***-37%***	***-83%***	***-371%***
DPS (cps)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Franking	100%	100%	100%	100%	100%
Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%

Cashflow Statement (US$m)	6/15A	6/16A	6/17F	6/18F	6/19F
EBITDA	-1.8	-4.1	-2.7	0.0	3.8
Working Capital Change	-2.1	4.2	-0.7	-0.8	-0.4
Net interest Paid	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	1.8	0.3	-0.8
Other	-2.7	-0.2	0.0	0.0	0.0
Net Operating Cash Flow	**-6.5**	**-0.1**	**-1.6**	**-0.5**	**2.6**
Capital Expenditure	-0.4	-1.9	-1.0	-1.0	-1.5
Asset Sales	0.0	0.0	0.0	1.0	2.0
Other (inc Investments)	0.1	-1.3	0.0	-3.0	0.0
Free Cash Flow	**-6.9**	**-3.3**	**-2.6**	**-4.5**	**1.1**
Proceeds from Equity Issues	8.2	26.3	0.3	0.0	0.0
Net Change in Debt & Leases	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Movement in Cash	**1.3**	**22.9**	**-2.3**	**-4.5**	**1.1**
Free Cash Flow per share	-3.8	-1.5	-1.1	-2.0	0.5

Balance Sheet (US$m)	6/15A	6/16A	6/17F	6/18F	6/19F
Cash	8.5	31.7	29.4	24.9	26.0
Receivables	0.3	1.3	1.6	3.1	4.2
Inventories	5.2	1.1	1.8	2.8	3.9
Other	0.2	1.7	1.7	1.7	1.7
Total Current Assets	**14.2**	**35.8**	**34.5**	**32.5**	**35.7**
Property, Plant & Equipment	1.2	3.1	4.0	5.0	6.4
Intangibles	0.4	0.8	0.8	0.8	0.8
Other	0.0	0.0	0.0	1.0	2.0
Total Non Current Assets	**1.6**	**3.9**	**4.8**	**5.8**	**7.2**
Total Assets	**15.8**	**39.7**	**39.3**	**38.2**	**43.0**
Accounts Payable	1.5	2.7	2.9	4.6	6.4
Interest Bearing Liabilities	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Total Current Liabilities	**1.6**	**2.7**	**3.0**	**4.7**	**6.4**
Interest Bearing Liabilities	0.0	0.0	0.0	0.0	0.0
Total Non Current Liabilities	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total Liabilities	**1.6**	**2.7**	**3.0**	**4.7**	**6.4**
Net Assets	**14.2**	**37.0**	**36.3**	**33.6**	**36.5**
Net Asset Value / Share ($)	0.06	0.16	0.16	0.15	0.16
NTA / Share ($)	0.06	0.16	0.16	0.14	0.16
Net Debt (net cash)	-8.5	-31.7	-29.4	-24.9	-26.0

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23-June-2017

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

Yowie Group Ltd ('Yowie', 'YOW' or the 'Company') has provided updated revenue guidance to the market.

FY17 Outlook: The Company now projects FY17 year on year revenue growth of 55% versus prior guidance of 70%. The 70% projection was provided with the 3rd Quarter result on the 19th of April and itself was a downgrade from 85%.

Hartleys: We now forecast revenue of US$20.3m in FY17, down from US$22m previously.

FY18 Outlook: Year on year revenue growth in FY18 is now expected to be in the range of 55-70%, down from the 70% or 'similar to FY17 growth' provided again with the 3rd Quarter result.

Hartleys: We have downgraded our FY18 revenue to US$30.9m from US$36.6m previously. At this level of revenue, we forecast the Company will achieve EBITDA breakeven in FY18. We have also reviewed our forecasts for FY19 and beyond and on the back of the challenges facing YOW in entering new markets we have lowered our non-US sales penetration rate (especially in Asia and Europe). The result is a downgrade to revenue in FY19 from A$56.3m to A$41.8m.

Fig. 1: YOW P&L

Profit & Loss	6/15A	6/16A	6/17F	6/18F	6/19F
Sales Volume	2.0	8.6	14.0	21.3	28.8
Growth	*n.a.*	*330.7%*	*62.2%*	*52.7%*	*35.1%*
Ave. Selling Price (US$)	1.40	1.45	1.45	1.45	1.45
Revenue (US$m)	2.80	12.49	20.26	30.94	41.80
Profit & Loss (US$m)					
Total Revenue	**2.4**	**13.1**	**20.3**	**30.9**	**41.8**
growth	*1729%*	*450%*	*55%*	*53%*	*35%*
COGS	-1.0	-6.2	-9.8	-15.4	-21.3
Distribution	-1.7	-2.6	-2.2	-3.2	-3.7
G&A	-3.3	-6.0	-7.5	-7.7	-7.9
Marketing	-0.8	-2.2	-3.4	-4.6	-5.0
- % of sales	-35.3%	-16.6%	-17.0%	-15.0%	-12.0%
EBITDA	**-4.6**	**-4.0**	**-2.7**	**0.0**	**3.8**
margin	**-193.0%**	**-30.3%**	**-13.4%**	**0.1%**	**9.2%**
Depreciation/Amortisation	-0.04	-0.07	-0.04	-0.05	-0.06
Share Based Payments	-0.90	-2.55	-3.19	-1.00	-1.00
EBIT	**-4.6**	**-6.6**	**-5.9**	**-1.0**	**2.8**
EBIT / Sales	**-194.7%**	**-50.4%**	**-29.3%**	**-3.3%**	**6.7%**
Net Interest	0.00	0.00	0.00	0.00	0.00
Profit Before Tax	**-4.6**	**-6.6**	**-5.9**	**-1.0**	**2.8**
- margin	**-194.7%**	**-50%**	**-29%**	**-3%**	**6.7%**
Normalised Tax	0.0	0.0	1.8	0.3	-0.8
Effective Tax Rate	0.0%	0%	30%	30%	30.0%
NPAT Pre Minorities	-4.6	-6.6	-4.2	-0.7	1.9
Minorities					
Normalised NPAT to equity	**-4.6**	**-6.6**	**-4.2**	**-0.7**	**1.9**
Norm. Net Profit / Sales	**-194.7%**	**-51%**	**-20%**	**-2%**	**4.7%**

Source: Yowie and Hartleys Research

Despite this downgrade, the Company at the current share price (circa A$0.305) is trading on only 16.4x FY19 earnings (excluding share based payments) and a 5.7x FY19 EV/EBITDA multiple. A significant discount to the ASX Food, Beverage and Tobacco sector, while offering we feel significantly higher medium and longer-term growth potential.

Fig. 2: Multiples and Ratios

Multiples (S/price at $0.30)	6/15A	6/16A	6/17F	6/18F	6/19F
P / E (reported, basic weighted)	-7.0x	-5.3x	-11.4x	-12.8x	24.8x
P / E (normalised, dil. weighted)	-10.0x	-7.6x	-12.2x	-70.9x	24.8x
P / E (mkt cap / norm. NPAT)	-11.7x	-7.1x	-11.4x	-66.3x	24.8x
P / E (fully diluted mkt cap / norm. NPAT)	-12.5x	-7.6x	-12.2x	-71.0x	26.6x
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Group Free Cash Flow (f.c.f) / EV	-20.9%	-5.3%	-6.9%	-4.0%	3.0%
Equity f.c.f. / Mkt Cap	-9.3%	-2.4%	-3.0%	-1.8%	1.3%
Price / FCF	-7.9x	-20.3x	-26.2x	-15.1x	56.6x
Mkt cap / operating cash flow	-8.3x	-353.1x	-29.9x	-97.5x	18.4x
EV/EBITDA multiple	-5.3x	-5.3x	-7.9x	1,136.6x	5.7x
EV/EBIT multiple	-5.2x	-3.1x	-3.6x	-20.6x	7.7x
Price / Book Value	4.1x	1.4x	1.4x	1.5x	1.4x
Price / NTA	4.2x	1.4x	1.4x	1.6x	1.4x
Ave FX	0.85	0.74	0.75	0.75	0.76
Ratios	**6/15A**	**6/16A**	**6/17F**	**6/18F**	**6/19F**
Return period end Equity	-33.1%	-19.6%	-11.4%	-11.1%	5.3%
ROA	-10.5%	-8.1%	-11.7%	-17.1%	-10.2%
ND / ND + Equity	-147.3%	-599.9%	-425.7%	-287.1%	-247.9%
ND / Equity	-59.6%	-85.7%	-81.0%	-74.2%	-71.3%
Net Interest Cover (EBIT)	6,875.2	n,a,	n.a	n.a	n.a
ROIC	-79.8%	-124.1%	-59.7%	-8.2%	18.5%

Source: Hartleys Research

Downgrades Overshadowing Achievements

As we outlined in our recent note 'Much More than a Novelty Item (18th April)', YOW has performed impressively since listing in growing the business to over US$20m in annualised revenue in a highly concentrated sector, dominated by extremely large multi nationals.

Unfortunately, as we also outlined this performance has been overshadowed by a series of downgrades to growth expectations (and perhaps early unrealistic expectations by some brokers and investors as well). Given the challenges faced by YOW in trying to grow the business, providing guidance for the next 12 months was also going to be difficult. Unfortunately, it would seem that the Company has now on a number of occasions not being conservative enough with their projections.

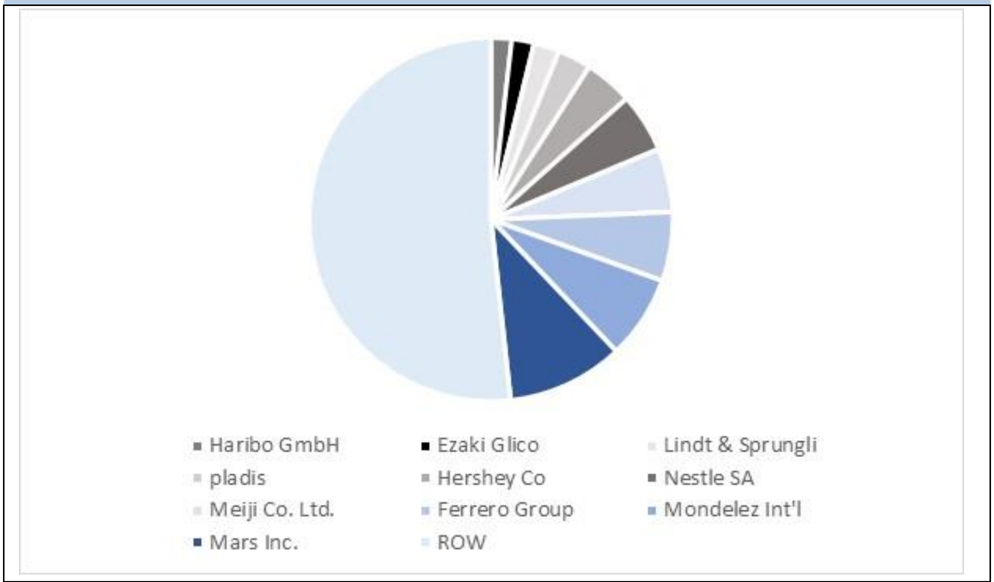
We expected recent management changes to be a catalyst for the company to either stop providing guidance (quarterly updates may be sufficient) or provide more robust projections. That does not seem to have occurred yet and is obviously impacting general sentiment around the stock and managements capabilities generally. This is obviously an area in need of improvement (and quickly).

At the current share price level, we view YOW as an attractive investment, although admittedly we felt the same circa 20c per share higher. We feel that the longer-term growth story remains intact, but continue to expect due to the nature of the industry for growth to be volatile as challenges they will inevitably face take time to overcome.

It is however understandable that a number of investors who bought on the basis of faster than expected growth may want to sell and we feel this mismatch between reality and previously guided expectations has likely been a key factor in the selloff in the stock over the past twelve months.

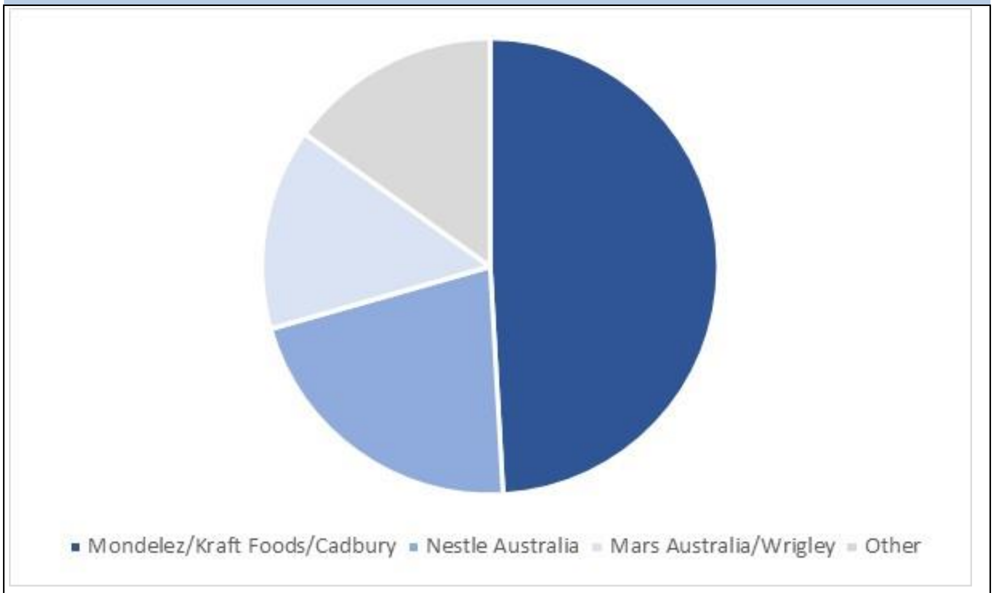
This is why we believe a stock buyback programme is advisable during this period of resetting expectations. The Company has circa US$29m of cash, with EBITDA likely to be positive in FY18. We also view the company as offering good value, especially as we look out to FY19 numbers and beyond. Until, the Company can rebuild market confidence in its outlook and to better utilise its balance sheet we feel a stock buyback program would be one effective use of its cash balance. If the Company can deliver its medium-term plans, then buying its own stock currently with what looks like excess cash would seem to be a smart investment.

Fig. 3: *Challenging industry for small players - Global Confectionary Market Share by Company*



Source: Candy Industry

Fig. 4: *Australian Confectionary Market Share*



Source: IBIS World

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

WE RETAIN OUR SPECULATIVE BUY RECOMMENDATION. WE DOWNGRADE OUR 12 MONTH FORWARD VALUATION TO A$0.51 (MINUS 32 CENTS). WE STILL BELIEVE SIMILAR UPSIDE TO OUR PREVIOUS TARGET PRICE EXISTS, BUT DUE TO SLOWER NEAR-TERM GROWTH IT IS LIKELY TO BE LONGER DATED.

We believe that YOW is in a unique position in the global confectionary sector. It has the potential to be one of few remaining independent global brands that are listed on a public stock exchange. With exposure to the growing chocolate and toy markets, underlying market drivers should provide strong tailwinds (among them the growing middle class in developing markets, the under 15-year-old demographic driving toy sales and a growing appetite for ‘surprise’ collectibles). Its sales outlook therefore remains positive; once the company tackles what we view as its high cost structure and improves its management of market expectations the stock continues to look compelling value.

We value YOW based on the average market multiples of the ASX Food, Beverage and Tobacco sector. We view this as conservative due to the fact that YOW has the potential to generate an above sector growth rate well into the next decade. As highlighted previously we have not assumed any major cost cutting in our explicit forecasts, however we do include a value for cost cutting / synergy benefits in our valuation. The rationale for this is quite simple, either the company eventually cuts costs or a likely acquirer will.

YOW’s share price has struggled in recent times from some slippage in sales due mainly to production issues (forgivable in our opinion at this stage of their development), a failure to fully convert top line growth to earnings and a what seems like a continual downgrade to revenue guidance and expectations. Even so we still believe in the long-term growth story and view the stock as offering attractive upside over the next 12 months (from what now hopefully is a low base).

Fig. 5: *Valuation Summary*

Valuation

FY19	ASX Comps (F,B&T)	Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	10x	10x	35%	0.40
EV/EBIT	14x	14x	25%	0.39
Earnings	19x	19x	15%	0.22
DCF			25%	0.34
Cost out/Synergy Opportunity (US$ m)			25.4	0.15
12-month Target Price				**$0.51**
Upside / downside from current share price				69%

Source: Hartleys Research

RISKS

We highlight the following as the major risks to our investment thesis:

YOW still relies on Wal-Mart for the majority of its revenue. Expansion within the US and now Internationally carries execution risk and can be expensive for a small company.

YOW does have exposure to commodity price increases. Rising chocolate, plastic and aluminium prices would have a minor negative impact.

YOW sells its product at a premium price, pressure from much larger competitors and customers could put margins under pressure.

YOW has been up to now focused on gaining market share in the US, delivering sales and in recent times planning the expansion into new markets. As a result, the company we feel has not taken full control of its cost profile. This could be a risk or an opportunity going forward.

Expansion into new markets will remain difficult in an industry dominated by very large competitors and customers.

S.W.O.T ANALYSIS

Strengths	Was previously a proven product in a developed confectionary market (Australia), repeating that success now in the US.
	Absence of largest competitors in the US market (ban on Kinder eggs) where they now have a first mover advantage.
	Ability to build cross product and cross border brand, become more than just a chocolate confectioner.
Weakness	Still heavily reliant on a key customer
	Lack of proven distribution Internationally.
Opportunities	Opportunities to expand into other markets especially Asia and Europe.
	Re-introduction into the Australian market where Yowie had been previously successful.
Threats	Operates in an industry dominated by very large multi-national confectionary companies.
	Key customers can also be highly concentrated and powerful negotiators (e.g. Wal-Mart in the US and Coles and Woolworths in Australia).

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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