Hartleys

YOWIE GROUP LTD (YOW)

YOW.asx
Speculative Buy

28 Aug 2017	
Share Price:	$0.195
12mth price target:	$0.27

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:

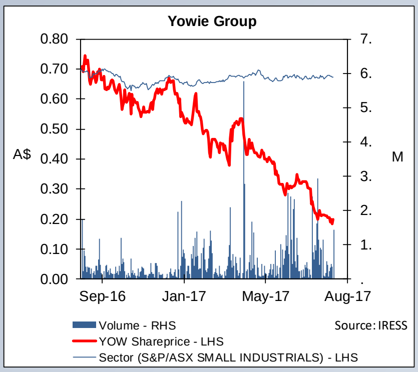
FIL Limited	9.3%
Pie Funds Management Ltd	6.9%

Company Address:
216 St Georges Terrace
Perth WA 6000

Issued Capital:	215.3m
- fully diluted	226.5m
Market Cap:	A$42.0m
- fully diluted	A$44.2m
Net Cash (Current)	US$26.9m

	FY17a	FY18e	FY19e
Op Cash Flw	-5.1	-1.1	1.4
Free Cash Flw	-5.7	-2.1	-0.1
NPAT* (US$m)	-7.3	-1.5	0.5
EPS ($, bas)	-3.4	-2.1	0.2
P/E (basic)	-4.3x	-7.4x	60.0x
P/E (diluted)*	-4.6x	-23.4x	60.0x
EBITDA	-3.5	-1.3	1.7
Volume (m)	13.4	18.7	25.5
N.D. / equity	-74%	-67%	-63%

Source: Hartleys Research. * normalised



Authors:
Aiden Bradley
Energy & Industrials Analyst
Ph: +61 8 9268 2876
E: aiden.bradley@hartleys.com.au

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.

Cost Control and Guidance

Yowie Group (YOW, "Company") reported a FY17 full year loss of US$7.3m. Adjusting for weaker 4Q sales this was approximately $2m worse than we expected at the cost level. This $2m was roughly split equally between higher marketing spend and share based administrative expenses. Behind the weaker than expected FY17 result and yearlong share price collapse, FY17 was actually a good year operationally. The Company increased net sales 51% YoY to US$19.48m, while increasing gross margins by 300bp to 55%. This highlights the two key challenges the Company faces to repair the share price in the near term, cost control and guidance.

Cost Control and Guidance

As we outlined in our note "Much More than a Novelty Item" (18th April 2017) we do not see the challenges facing YOW (especially in the short term) as the core product or even growing revenue, rather it is their ability to control their costs structure and communications with equity market. FY18 has hence become a pivotal year for YOW and its management team. Firstly, they must start meeting guidance and rebuilding market confidence in the story and team. Secondly, they must show that they can start to translate the already impressive top line growth into profit and that their decisions to spend aggressively over a number of years on Admin, Sales and Marketing were actually justified. Success on both fronts would see the stock re-rate significantly. However, we view their guidance of 55-70% revenue growth for FY18 as again 'aggressive' (why set the bar so high again?).

Earnings changes and Outlook

We have made some significant changes to earnings across the board post the 4Q and FY17 results. 1Q as flagged is likely to be relatively weak and recent history suggests caution on new rolls outs (whether new products, series or regions). However, we again see these as timing issues more than anything and natural for such an early stage growth company. As outlined we are more worried about the growth in costs and have made some upward adjustments here to reflect mixed evidence to date these are under control or delivering the desired boost to revenue.

Investment Case and Valuation – Speculative Buy retained

Despite these cuts we still view YOW as attractive value at current levels and have a revised 12-month target price of 27c. We still believe much greater upside to our current target price exists, but due to slower near-term growth, risks to FY18 guidance and a cost structure that for now continues to rise, further upside likely lies beyond a 12-month horizon.

Key Chart: Earnings Changes post Q4 and FY Updates

		FY16A	FY17A			FY18F		
		Actual	Old	New	% Chg	Old	New	% Chg
Volume	m	8.61	13.97	13.42	-4%	21.34	18.72	-12%
Revenue	US$ m	12.94	20.26	19.48	-4%	30.94	28.26	-9%
EBIT	US$ m	-6.87	-5.93	-8.29	-40%	-1.03	-2.53	-146%

Source: YOW and Hartleys Estimates

SUMMARY MODEL

Yowie Group Limited (YOW)

Recommendation: Speculative Buy

Company Information		
Date	28 Aug 2017	Yowie Group Ltd
Share Price	$0.195	Level 4
52 Week High-Low	$1.24 - $0.52	216 St Georges Terrace
Market Cap ($m)	$42.0	Perth WA 6000
Market Cap - FD ($m)	$44.2	www.yowiegroup.com
Enterprise Value ($m)	$10.4	
Ordinary Shares	215.3	
Fully Diluted Shares	226.5	

Valuation

FY19	ASX Comps (F,B&T)	Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	10x	10x	35%	0.26
EV/EBIT	14x	14x	25%	0.19
Earnings	19x	19x	15%	0.06
DCF			25%	0.27
Cost out/Synergy Opportunity (US$ m)			10.0	0.06

12-month Target Price	**$0.27**
Upside / downside from current share price	40%
P / E (6/18F) at price target	*-32.9x*
P / E (6/19F) at price target	*88.5x*
EV / EBITDA (6/19F) at price target	*11.6x*
EV / EBIT (6/19F) at price target	*46.0x*

Multiples (S/price at $0.20)	6/15A	6/16A	6/17A	6/18F	6/19F
P / E (reported, basic weighted)	-4.5x	-3.5x	-4.3x	-7.4x	60.0x
P / E (normalised, dil. weighted)	-6.5x	-4.9x	-4.6x	-23.4x	60.0x
P / E (mkt cap / norm. NPAT)	-7.7x	-4.7x	-4.3x	-22.3x	60.0x
P / E (fully diluted mkt cap / norm. NPAT)	-8.1x	-4.9x	-4.6x	-23.5x	63.1x
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Group Free Cash Flow (f.c.f) / EV	-56.8%	-14.5%	-41.6%	-16.1%	-1.0%
Equity f.c.f. / Mkt Cap	-14.0%	-3.6%	-10.3%	-4.0%	-0.3%
Price / FCF	-5.1x	-13.2x	-7.2x	-8.6x	-302.7x
Mkt cap / operating cash flow	-5.5x	-233.3x	-6.2x	-29.9x	23.5x
EV/EBITDA multiple	-1.5x	-1.5x	-1.8x	-5.2x	3.8x
EV/EBIT multiple	-1.8x	-1.1x	-0.9x	-3.2x	18.1x
Price / Book Value	2.6x	0.9x	0.9x	1.1x	1.0x
Price / NTA	2.7x	0.9x	1.0x	1.1x	1.0x
Ave FX	0.85	0.74	0.75	0.79	0.76
Ratios	**6/15A**	**6/16A**	**6/17A**	**6/18F**	**6/19F**
Return period end Equity	-33.1%	-19.6%	-20.2%	-13.7%	1.6%
ROA	-10.5%	-8.1%	-11.8%	-17.4%	-19.0%
ND / ND + Equity	-147.3%	-599.9%	-288.5%	-199.1%	-171.6%
ND / Equity	-59.6%	-85.7%	-74.3%	-66.6%	-63.2%
Net Interest Cover (EBIT)	-35.8	n,a,	-20.1	-6.3	1.3
ROIC	-79.8%	-124.1%	-77.4%	-13.5%	4.2%

Free Cash Flow Analysis ($m)	6/15A	6/16A	6/17A	6/18F	6/19F
Net Operating Cash Flow	-6.5	-0.1	-5.1	-1.1	1.4
Capex (Reported)	-0.4	-1.9	-0.6	-1.0	-1.5
Group Free Cash Flow (rep'ted)	-6.9	-2.0	-5.7	-2.1	-0.1
Fixed Debt Repayments	0.0	0.0	0.0	0.0	0.0
Equity Free Cash Flow (rep'ted)	**-6.9**	**-2.0**	**-5.7**	**-2.1**	**-0.1**
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0
Free Cash Flow (normalised)	-6.9	-2.0	-5.7	-2.1	-0.1

Share Data	6/15A	6/16A	6/17A	6/18F	6/19F
Ord Issued shares (m)	139.1	215.3	215.3	215.3	215.3
growth	18.1%	54.7%	0.0%	0.0%	0.0%
Weighted ave shares (m)	128.5	177.2	215.3	215.3	215.3
growth	32.2%	37.9%	21.5%	0.0%	0.0%
Diluted shares wgted (m)	181.0	225.7	225.7	225.7	215.3
growth	37.3%	24.7%	24.7%	0.0%	-4.6%

Options

Year Expires	Number	% ord	Avg Price	$m unpaid
31-Dec-17	3,625,000	1.7%	$ 0.29	$ 1.03
31-Dec-17	2,425,000	1.1%	$ 0.77	$ 1.86
31-Dec-17	2,775,000	1.3%	$ 0.90	$ 2.50
31-Dec-17	320,000	0.1%	$ 1.05	$ 0.34
31-Dec-17	640,000	0.3%	$ 1.15	$ 0.74
24-Aug-18	200,000	0.1%	$ 1.25	$ 0.25
24-Aug-18	400,000	0.2%	$ 1.51	$ 0.60
8-Sep-18	75,000	0.0%	$ 1.63	$ 0.12
8-Sep-18	125,000	0.1%	$ 1.40	$ 0.18
TOTAL	10,460,000	**4.9%**	**$ 0.71**	**$ 7.44**

Directors & Senior Management		Substantial Shareholders	%
Trevor Allen	Interim Chairman	FIL Limited	9.3%
Bert Alfonso	CEO/MD	Pie Funds Management Ltd	6.9%
Mark Schuessler	COO		
Patricia Fields	Executive Director		

Profit & Loss	6/15A	6/16A	6/17A	6/18F	6/19F
Sales Volume (YOW)	2.0	8.6	13.4	18.7	25.5
Growth	*n.a.*	*330.7%*	*55.8%*	*39.5%*	*36.3%*
Revenue YOW (US$m)	2.0	12.9	19.5	27.2	37.0
Profit & Loss (US$m)					
Total Revenue	**2.2**	**12.9**	**19.5**	**28.3**	**39.8**
growth	*1626%*	*477%*	*51%*	*45%*	*41%*
COGS	-1.0	-6.2	-8.8	-13.0	-19.2
Distribution	-1.7	-2.6	-3.2	-3.7	-4.3
G&A	-3.3	-6.0	-6.6	-7.1	-7.5
Marketing	-0.8	-2.2	-4.4	-5.7	-7.0
- % of sales	-37.4%	-16.7%	-22.7%	-20.0%	-17.5%
EBITDA	**-4.7**	**-4.1**	**-3.5**	**-1.3**	**1.7**
margin	**-210.4%**	**-31.6%**	**-18.0%**	**-4.6%**	**4.4%**
Depreciation/Amortisation	-0.04	-0.07	-0.20	-0.23	-0.30
Share Based Payments	-0.90	-2.55	-4.59	-1.00	-1.00
EBIT	**-4.8**	**-6.7**	**-8.3**	**-2.5**	**0.4**
EBIT / Sales	**-212.2%**	**-51.9%**	**-42.5%**	**-8.9%**	**1.1%**
Net Interest	0.13	0.12	0.41	0.40	0.33
Profit Before Tax	**-4.6**	**-6.6**	**-7.9**	**-2.1**	**0.8**
- margin	**-206.3%**	**-51%**	**-40%**	**-8%**	**1.9%**
Normalised Tax	0.0	0.0	0.6	0.6	-0.2
Effective Tax Rate	0.0%	0%	7%	30%	30%
NPAT Pre Minorities	-4.6	-6.6	-7.3	-1.5	0.5
Minorities					
Normalised NPAT to equity	**-4.6**	**-6.6**	**-7.3**	**-1.5**	**0.5**
Norm. Net Profit / Sales	**-206.3%**	**-51%**	**-37%**	**-5%**	**1.3%**
Abnormals / discontinued	-0.1	-0.6	0.0	-3.0	0.0
Reported Profit to equity	-4.7	-7.2	-7.3	-4.5	0.5
Reported EPS (basic, w'ghted)	-3.7	-4.1	-3.4	-2.1	0.2
Normalised EPS (dil, wghtd)	-2.6	-2.9	-3.2	-0.7	0.2
Normalised EPS (full. diluted)	-2.0	-2.9	-3.2	-0.7	0.2
EPS (full dil) Growth %	***106%***	***43%***	***10%***	***-80%***	***-136%***
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	6/17A	6/18F	6/19F
EBITDA	-1.9	-4.2	-3.5	-1.3	1.7
Working Capital Change	-2.1	4.2	-2.8	-0.9	-0.5
Net interest Paid	0.1	0.1	0.4	0.4	0.3
Tax Paid	0.0	0.0	0.6	0.6	-0.2
Other	-2.7	-0.2	0.2	0.0	0.0
Net Operating Cash Flow	**-6.5**	**-0.1**	**-5.1**	**-1.1**	**1.4**
Capital Expenditure	-0.4	-1.9	-0.6	-1.0	-1.5
Asset Sales	0.0	0.0	0.0	0.0	0.0
Other (inc Investments)	0.1	-1.3	-0.4	-3.0	0.0
Free Cash Flow	**-6.9**	**-3.3**	**-6.2**	**-5.1**	**-0.1**
Proceeds from Equity Issues	8.2	26.3	0.8	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**	**-5.4**	**-5.1**	**-0.1**
Free Cash Flow per share	-3.8	-1.5	-2.7	-2.3	-0.1

Balance Sheet (US$m)	6/15A	6/16A	6/17A	6/18F	6/19F
Cash	8.5	31.7	26.9	21.8	21.6
Receivables	0.3	1.3	1.5	2.8	4.0
Inventories	5.2	1.1	3.7	4.6	5.8
Other	0.2	1.7	1.2	1.2	1.2
Total Current Assets	**14.2**	**35.8**	**33.3**	**30.3**	**32.5**
Property, Plant & Equipment	1.2	3.1	3.5	4.3	5.5
Intangibles	0.4	0.8	1.1	1.1	1.1
Other	0.0	0.0	0.0	1.0	2.0
Total Non Current Assets	**1.6**	**3.9**	**5.7**	**6.5**	**7.7**
Total Assets	**15.8**	**39.7**	**39.0**	**36.8**	**40.2**
Accounts Payable	1.5	2.7	2.7	4.0	5.8
Interest Bearing Liabilities	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Total Current Liabilities	**1.6**	**2.7**	**2.8**	**4.1**	**6.0**
Interest Bearing Liabilities	0.0	0.0	0.0	0.0	0.0
Total Non Current Liabilities	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total Liabilities	**1.6**	**2.7**	**2.8**	**4.1**	**6.0**
Net Assets	**14.2**	**37.0**	**36.2**	**32.7**	**34.2**
Net Asset Value / Share ($)	0.06	0.16	0.16	0.14	0.15
NTA / Share ($)	0.06	0.16	0.15	0.14	0.15
Net Debt (net cash)	-8.5	-31.7	-26.9	-21.8	-21.6

Analyst: Aiden Bradley
Phone: +61 8 9268 2876

28-August-2017

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

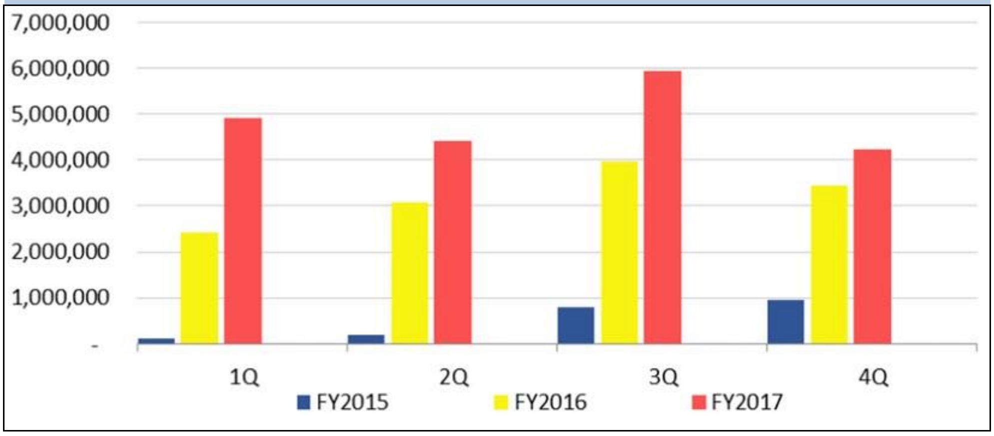
Behind the share price collapse, FY17 was actually a good year operationally. The Company increased net sales 51% YoY to US$19.48m, while increasing gross margins by 300bp to 55%.

Fig. 1: *Sales Growth and Gross Profit Margin*

Source: YOW and Hartleys Estimates

While QoQ sales momentum slowed in the 4th Quarter, the launch of Series 3 and Discovery World in the second quarter of FY18 is planned to arrest this. Q4 sales were also impacted by a delay in the Canadian launch.

Fig. 2: *Net Sales Revenue (US$)*



Source: YOW

Despite the weak share price performance in FY17 and the fact the stock value traded as low as an $3m Enterprise Value on 24th August 2017, we still believe YOW has developing a very solid business. However, as we outlined in our note “Much More than a Novelty Item” (18th April 2017) we do not see the challenges facing YOW (especially in the short term) as the core product or even growing revenue, rather it is their ability to control their costs structure and communications with the equity market.

Since April, unfortunately the Company has not satisfied the market that it is tackling either of these issues. Further guidance has been provided and missed, eroding market confidence in the management team generally. And again, we view the 55-70% revenue growth guidance for FY18 as possibly achievable but once again aggressively high.

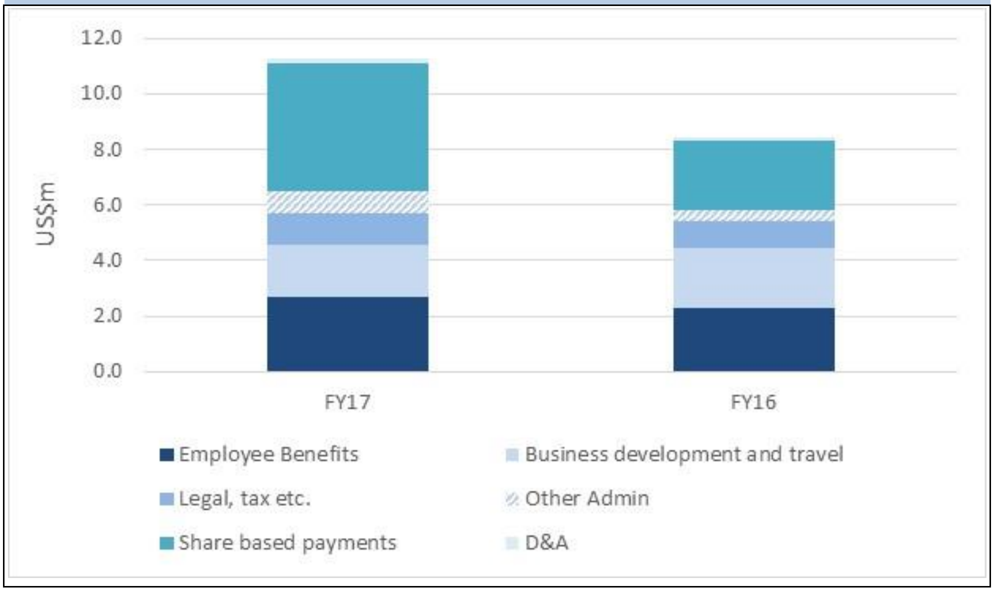
The Company flags the need for conservativism in their full year result, but then do not seem to capture this in their own guidance (at least up to now) – "*It is important to note, however, that we are a small company and any variation in sales plans by our customers or in the timing of new releases will have a significant impact, and that not everything goes according to plan.*"

YOW is somewhat unique as a small listed confectionary player, and hence the cost of running such a business is hard to benchmark. However, the running costs of the business look high versus other similarly sized industrial stocks.

Fig. 3: *Admin Costs and as a % of sales*

Source: YOW and Hartleys Estimates

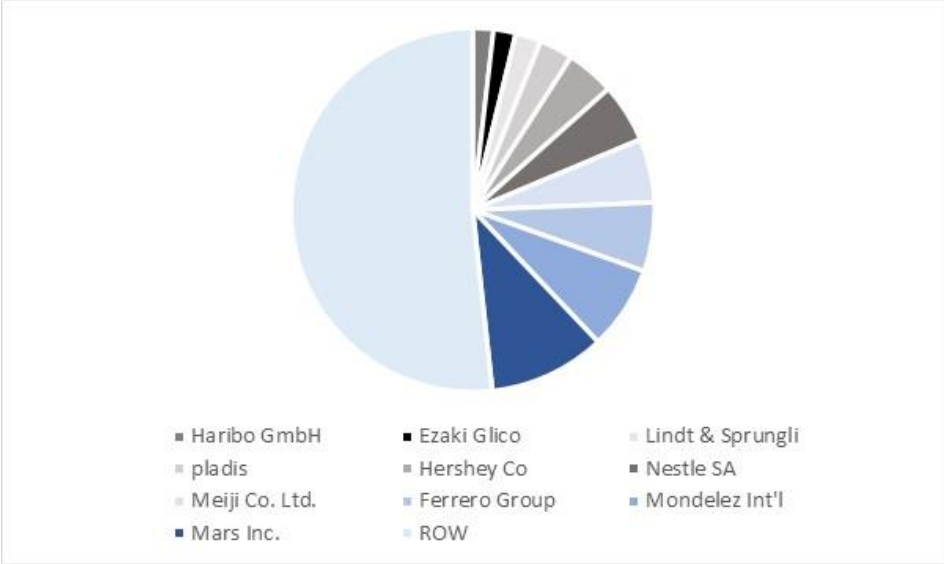
Fig. 4: *Admin Costs Break down FY17 versus FY16*



Source: YOW

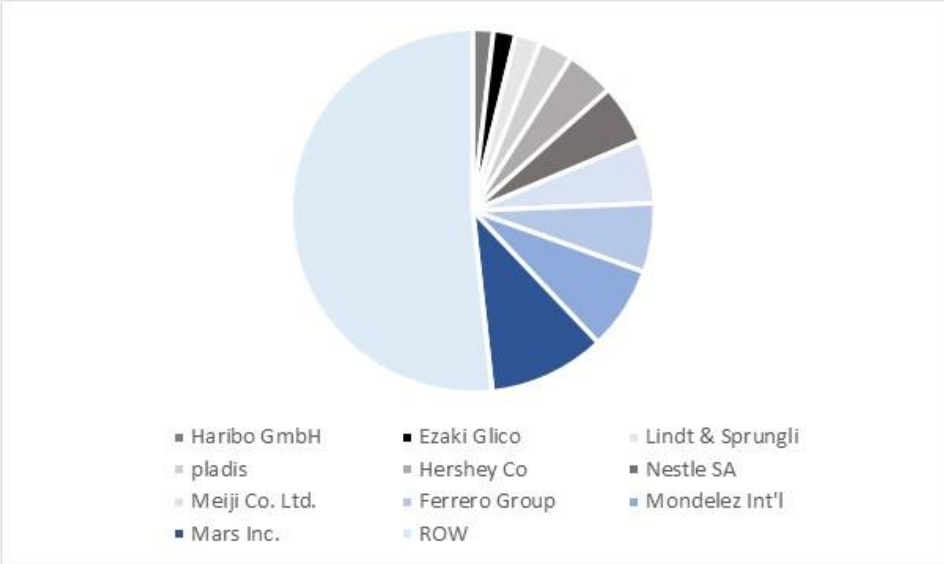
This may simply be a consequence of the highly concentrated industry it operates in and are par for the course for a new single confectionary product operator. If so this may explain why there are relatively few smaller, single product players and this industry is dominated by multi product multinationals.

Fig. 5: Challenging industry for small players – Global Confectionary Market Share by Company



Source: Candy World

Fig. 6: Australian Confectionary Market Share



Source: IBIS World

While we have written before that a capital management programme should be considered, the Board as outlined in their result "*believes that it needs to have available all of the cash reserves in the business. There are a range of market opportunities, competitor actions that need to be met and the innovation, IP and product development pipeline need ongoing support*."

Having to retain this level of cash we believe sends a negative message to the market about the possible risks the business may face in the future.

Excess cash as outlined can alternatively be used to boost expenditure on marketing and IP. However, the market will only reward you for this when convinced it will be converted to sales and hopefully profit. Increased marketing expenditure in FY17 did not translate to a desired boost to sales in FY17 and as highlighted by the Company they have through this expenditure "*created brand awareness and we now have to translate that to sales".*

Fig. 7: Marketing Costs and as a % of sales

Source: YOW and Hartleys Estimates

FY18 has become a pivotal year for YOW and its management team. Firstly, they must start meeting guidance and rebuilding market confidence in the story and team. Secondly, they must show that they can start to translate the already impressive top line growth into profit and that their decisions to spend aggressively over a number of years on Admin, Sales and Marketing were actually justified.

Downgrades to earnings, valuation and price target.

We have taken (what is hopefully) a very cautious approach to the roll out of Series 3 and its impact on US sales, initial sales from Discovery World and International sales.

We have also become more cautious on the Company's ability to control internal costs and also increased the need for external spend to deliver sales (i.e. an increased marketing spend).

As a result, we now forecast 45% revenue growth in FY18 versus Company guidance of 55-70%.

We also do not forecast EBITDA breakeven until the end of 2018 versus guidance of 2H18 from the Company.

Due to ongoing high G&A costs (A$7.1m cash costs in FY18) and further modest share based payments (which could be much higher given the evidence of the last two years) the reported NPAT stays modest out to beyond FY20.

The upside is that even despite these costs the Company should start to generate free cash flow from FY18 and its cash balance will likely bottom at a healthy circa US$22m. Even on our reduced revenue numbers the Company should still sell close to 30m units in total in FY19, a tremendous base to grow further from. EBITDA of close to US$2m in FY19 is post expenditure of US$7.5m on G&A and US$7.0m on Marketing. Surely YOW is a business at that stage that has the scale and track record to attract the interest of a major multinational, keen to add such a growing global brand to its stable of products!

Fig. 8: *YOW P&L*

Profit & Loss	**6/15A**	**6/16A**	**6/17A**	**6/18F**	**6/19F**
Sales Volume (YOW)	2.0	8.6	13.4	18.7	25.5
Growth	*n.a.*	*330.7%*	*55.8%*	*39.5%*	*36.3%*
Revenue YOW (US$m)	2.0	12.9	19.5	27.2	37.0
Profit & Loss (US$m)					
Total Revenue	**2.2**	**12.9**	**19.5**	**28.3**	**39.8**
growth	*1626%*	*477%*	*51%*	*45%*	*41%*
COGS	-1.0	-6.2	-8.8	-13.0	-19.2
Distribution	-1.7	-2.6	-3.2	-3.7	-4.3
G&A	-3.3	-6.0	-6.6	-7.1	-7.5
Marketing	-0.8	-2.2	-4.4	-5.7	-7.0
- % of sales	-37.4%	-16.7%	-22.7%	-20.0%	-17.5%
EBITDA	**-4.7**	**-4.1**	**-3.5**	**-1.3**	**1.7**
margin	**-210.4%**	**-31.6%**	**-18.0%**	**-4.6%**	**4.4%**
Depreciation/Amortisation	-0.04	-0.07	-0.20	-0.23	-0.30
Share Based Payments	-0.90	-2.55	-4.59	-1.00	-1.00
EBIT	**-4.8**	**-6.7**	**-8.3**	**-2.5**	**0.4**
EBIT / Sales	**-212.2%**	**-51.9%**	**-42.5%**	**-8.9%**	**1.1%**
Net Interest	0.13	0.12	0.41	0.40	0.33
Profit Before Tax	**-4.6**	**-6.6**	**-7.9**	**-2.1**	**0.8**
- margin	**-206.3%**	**-51%**	**-40%**	**-8%**	**1.9%**
Normalised Tax	0.0	0.0	0.6	0.6	-0.2
Effective Tax Rate	0.0%	0%	7%	30%	30%
NPAT Pre Minorities	-4.6	-6.6	-7.3	-1.5	0.5
Minorities					
Normalised NPAT to equity	**-4.6**	**-6.6**	**-7.3**	**-1.5**	**0.5**
Norm. Net Profit / Sales	**-206.3%**	**-51%**	**-37%**	**-5%**	**1.3%**
Abnormals / discontinued	-0.1	-0.6	0.0	-3.0	0.0
Reported Profit to equity	-4.7	-7.2	-7.3	-4.5	0.5
Reported EPS (basic, w'ghted)	-3.7	-4.1	-3.4	-2.1	0.2
Normalised EPS (dil, wghtd)	-2.6	-2.9	-3.2	-0.7	0.2
Normalised EPS (full. diluted)	-2.0	-2.9	-3.2	-0.7	0.2
EPS (full dil) Growth %	***106%***	***43%***	***10%***	***-80%***	***-136%***
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%

Source: YOW and Hartleys Estimates

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

WE RETAIN OUR SPECULATIVE BUY RECOMMENDATION. WE DOWNGRADE OUR 12-MONTH FORWARD VALUATION POST FURTHER MAJOR EARNINGS REVISIONS TO A$0.27 (MINUS 24 CENTS). WE STILL BELIEVE MUCH GREATER UPSIDE TO OUR CURRENT TARGET PRICE EXISTS, BUT DUE TO SLOWER NEAR-TERM GROWTH, RISKS TO FY18 GUIDANCE AND A COST STRUCUTRE THAT FOR NOW ONLY SEEMS TO INFLATE, FURTHER UPSIDE LIKELY LIES BEYOND 12 MONTHS.

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 a perceived 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 heavily discounted value having recently reached an EV of just $3m).

Fig. 9: Valuation Summary

Valuation

FY19	ASX Comps (F,B&T)	Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	10x	10x	35%	0.26
EV/EBIT	14x	14x	25%	0.19
Earnings	19x	19x	15%	0.06
DCF			25%	0.27
Cost out/Synergy Opportunity (US$ m)			10.0	0.06
12-month Target Price				**$0.27**

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).

HARTLEYS CORPORATE DIRECTORY

Research

Trent Barnett	Head of Research	+61 8 9268 3052
Mike Millikan	Resources Analyst	+61 8 9268 2805
John Macdonald	Resources Analyst	+61 8 9268 3020
Paul Howard	Resources Analyst	+61 8 9268 3045
Aiden Bradley	Research Analyst	+61 8 9268 2876
Michael Scantlebury	Junior Analyst	+61 8 9268 2837
Janine Bell	Research Assistant	+61 8 9268 2831

Corporate Finance

Dale Bryan	Director & Head of Corp Fin.	+61 8 9268 2829
Richard Simpson	Director	+61 8 9268 2824
Ben Crossing	Director	+61 8 9268 3047
Ben Wale	Associate Director	+61 8 9268 3055
Stephen Kite	Associate Director	+61 8 9268 3050
Scott Weir	Associate Director	+61 8 9268 2821
Scott Stephens	Associate Director	+61 8 9268 2819
Rhys Simpson	Manager	+61 8 9268 2851

Registered Office

Level 6, 141 St Georges Tce	**Postal Address:**
PerthWA 6000	GPO Box 2777
Australia	Perth WA 6001
PH:+61 8 9268 2888	FX: +61 8 9268 2800
www.hartleys.com.au	info@hartleys.com.au

Note: personal email addresses of company employees are structured in the following manner:firstname.lastname@hartleys.com.au

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.

Institutional Sales

Carrick Ryan	+61 8 9268 2864
Justin Stewart	+61 8 9268 3062
Simon van den Berg	+61 8 9268 2867
Chris Chong	+61 8 9268 2817
Digby Gilmour	+61 8 9268 2814
Tia Hall	+61 8 9268 3053

Wealth Management

Nicola Bond	+61 8 9268 2840
Bradley Booth	+61 8 9268 2873
Adrian Brant	+61 8 9268 3065
Nathan Bray	+61 8 9268 2874
Sven Burrell	+61 8 9268 2847
Simon Casey	+61 8 9268 2875
Tony Chien	+61 8 9268 2850
Tim Cottee	+61 8 9268 3064
David Cross	+61 8 9268 2860
Nicholas Draper	+61 8 9268 2883
John Featherby	+61 8 9268 2811
Ben Fleay	+61 8 9268 2844
James Gatti	+61 8 9268 3025
John Goodlad	+61 8 9268 2890
Andrew Gribble	+61 8 9268 2842
David Hainsworth	+61 8 9268 3040
Murray Jacob	+61 8 9268 2892
Gavin Lehmann	+61 8 9268 2895
Shane Lehmann	+61 8 9268 2897
Steven Loxley	+61 8 9268 2857
Andrew Macnaughtan	+61 8 9268 2898
Scott Metcalf	+61 8 9268 2807
David Michael	+61 8 9268 2835
Jamie Moullin	+61 8 9268 2856
Chris Munro	+61 8 9268 2858
Michael Munro	+61 8 9268 2820
Ian Parker	+61 8 9268 2810
Matthew Parker	+61 8 9268 2826
Charlie Ransom	+61 8 9268 2868
Mark Sandford	+61 8 9268 3066
David Smyth	+61 8 9268 2839
Greg Soudure	+61 8 9268 2834
Sonya Soudure	+61 8 9268 2865
Dirk Vanderstruyf	+61 8 9268 2855
Samuel Williams	+61 8 9268 3041
Jayme Walsh	+61 8 9268 2828