

Talking Point...

SPEC BUY

Yowie Group Ltd (YOW.ASX, Mkt Cap \$77m, \$0.80/sh) – A sugar hit for your portfolio

Company Statistics

ASX Code	YOW
Share Price	\$ 0.81
52 week low - high (A\$)	\$0.13-0.92
Shares on Issue (m)	93
Restricted Shares (m)	24
Options (m)	37
12mth Av Daily Volume ('000)	193,092
Diluted Market Cap (\$m)	125
EV (\$m)	114

Investment highlights

- Re-launch of a proven brand.** Yowie Group ('YOW') is an early stage story set to re-launch the Yowie chocolate brand into the US market followed by Australia and New Zealand. Yowie is similar to the Kinder Surprise chocolate/toy product. Importantly, when Yowie was being sold in Australia, it outsold Kinder Surprise, achieving more than 40% of the \$80m annual children's chocolate market and achieved sales of 65m units within the first full 12 months of sales.
- Competitive advantage lies in exclusive patent to sell to the US.** Despite over 2B unit sales worldwide, Kinder Surprise is unable to be sold in US because the chocolate encapsulated toy is considered a choking hazard. YOW has partnered with Hank Whetstone who holds an exclusive use of a patent to commercialise an inclusion/capsule chocolate manufacturing process for the US market. It is the significant 'safe capsule' commercial advantage that is key to Yowie launching in the USA market.
- Entering the world's largest market with no competition.** To put the potential of the US market into perspective, Europe, which has a comparable population to the US, sells an estimated 1.2B Kinder Surprises annually. Management have indicated that they have received a very high level of interest from retailers to trial the launch of the product. The US market alone has potential to demand in the order of multiple hundred million units p.a. Sales launch is expected to commence Q2CY14
- Plant geared up for product launch.** The Yowie characters have been re-digitalised and the production facility in US is currently producing at a small scale. The current capacity is 20m units p.a, this will be expanded to 40m units p.a by September when the second wrapping machine is installed. Importantly any further expansion will be funded by the manufacturer.
- Further growth to be driven by international markets and merchandise.** Further growth to be driven by the launch of the product in international markets most notably AUS/NZ/Japan where brand recognition exists. Expansion into ancillary product lines such as animation, publishing, clothes, toys etc, merchandise this has potential to be a global brand, beyond just children's confectionery
- YOW has significant growth potential.** The growth potential for YOW is substantial yet simple. Based on 40m unit sales (production capacity as September 2014), \$0.30 per unit EBIT margin and an earnings multiple of 17 times we derive a valuation of \$168m or \$1.21/sh. **At annualised sales of 200m units the valuation increases to \$5.40/sh, demonstrating the upside potential of the company.** Post the recent raising YOW has \$11m cash and is funded for growth.

Major Shareholders

Keith Phillip Hudson	11.6%
Abdullah Hani Abdullah	5.5%
Board and Management	11.0%
Top 20	40.0%

Share Price Graph



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Recommendation:

- SPEC BUY, PT \$1.20/sh**

Yowie ('YOW') is an early stage story which is effectively reinvigorating the Yowie chocolate brand and rolling it out initially in the US

BUSINESS DESCRIPTION

- Yowie Group ('YOW') is an early stage story set to re-launch the Yowie chocolate brand into the US market followed by Australia and New Zealand where product sales achieved circa 65m units in its first full year of sales when it was marketed through Cadbury.
- YOW has a target to replicate the success of Kinder Surprise which is the only marketed competitor in the encapsulated toy and chocolate space. Last year Kinder Surprise sold an estimated 2B units globally; generating revenue of US\$3.6B which excludes the US where Kinder Surprise is not sold.
- Yowie is similar to the Kinder Surprise chocolate/toy product with market information indicating that it outsold Kinder Surprise in Australia, achieving more than 40% of the \$80m annual children's chocolate market.

Figure 1: Yowie Product



Source: FSB Research

Management's strategy is to build a high margin business based around licensing and contract manufacturing with a focus on building a global brand through multiple product lines

- The Yowie characters have been re-digitalised for relaunch with a production facility in US currently producing at small scale. We understand discussions are well advanced with US retail distributors to launch the product which is expected to occur in Q2CY14.
- Management's strategy is to build a high margin business based around licensing and contract manufacturing with a focus on building a global brand through multiple product lines including other chocolate products, merchandise, etc.

RELAUNCHING A PROVEN BRAND PREVIOUSLY OUT SELLING KINDER SUPRISE

- Yowie Products were launched initially in Australia in 1997 by the Cadbury group of companies which had the license to operate and distribute into the Asian Pacific region. In its first full 12 months of sales in Australia Cadbury sold 65m (\$100m) units and took 30% of Kinder Surprises market share. The product also won numerous global industry awards in 1997 including:
 - No.1 selling single unit confectionery line;
 - No.1 in value in total confectionery and
 - 31m units sold in Australia in 20 weeks
- Cadbury wanted to buy the IP for the brand globally however the creators refused. This in conjunction with a strategic move to a global core brand focus resulted in Cadbury pulling YOW off the shelves in 2005 after 10 successful years.
- After Kraft's takeover of Cadbury, YOW and Kidcorp acquired the license back. Kidcorp was capital constrained, so YOW acquired the global license, and are targeting a worldwide rollout, starting in US, then UAE and Australia and New Zealand.

Despite over 2B unit sales worldwide, Kinder Surprise is unable to be sold in US because the chocolate encapsulated toy and is considered a choking hazard.

COMPETITIVE ADVANTAGE LIES IN EXCLUSIVE PATENT TO SELL TO THE US

- Despite over 2 billion unit sales worldwide, Kinder Surprise is unable to be sold in US because the chocolate encapsulated toy and is considered a choking hazard. Therefore we see no major competitor with any scale or similar product to impact the launch of Yowie.
- YOW has partnered with Hank Whetstone of the Whetstone Candy Company who holds an exclusive use of a patent to commercialise an inclusion/capsule chocolate manufacturing process inside the US market. **It is the significant ‘safe capsule’ commercial advantage that is key to Yowie launching in the USA market.**
- The Whetstone patented capsule and process is the only method approved by the FDA and CPSC to sell chocolate-toy combinations in the US. The US manufacturing facility (Mr Hank Whetstone) is based in St Augustine Florida. Whetstone has extensive chocolate manufacturing experience with previous clients including Mars, Hershey and Nestle.
- Whetstone patent ensures that when the product is unwrapped the chocolate falls away from the Capsule, leaving three pieces, namely two pieces of chocolate and the capsule which is then opened to reveal a toy inside of the capsule. The toy is rated appropriate for a child aged zero.
- YOW has the exclusive use of Whetstone’s patent until April 2018 to sell Yowie in the US. Kinder Surprise and Nestle magic ball have previously tried to enter the US market but have had their products rejected by the FDA.

PLANT AND FACILITIES GEARED UP FOR IMMINENT LAUNCH INTO US MARKET

- Small production has commenced at the manufacturing plant in St Augustine Florida US. With regards to the manufacturing process the toy capsule and leaflets are manufactured in China and shipped to the US facility. The chocolate is manufactured on site, the components are then assembled and wrapped, and inventory is warehoused in distribution centres.

Figure 2: Yowie Product



The factory has a current capacity of 20m units pa and by Sept 14 they will ramp up to 40mpa by September.

- Dedicated factory in Florida
- Nut Free factory
- “Frozen Cone” manufacturing plant

- Rasch manufactured high speed foiling & wrapping
- Current capacity 20 million units with room for fast expansion

Source: FSB Research

- There are currently ~1.3m units in inventory, ample supply to meet the requirements for any near terms trials through a retail distributor.

Management have indicated that they have received a very high level of interest from numerous US retailers to trial the launch of the product in their store.

- The factory has a current capacity of 20m units pa and by September 2014 will ramp up to 40m pa at no additional capital cost as the second wrapping machine is already funded.
- The facility currently operates on one shift and produces approximately 25k units per day (7mpa run-rate). Operations can ramp up to 3 shifts a day (20mpa) when a sales agreement is reached.
- When the second wrapping machine is installed, commissioned and three shifts running the plant will be operating at 40m pa capacity.
- Each wrapping machine adds ~20m units p.a capacity and takes ~8 months from ordering to commissioning. Cost of a wrapping machine is ~US\$600K with all further expansion expected to be funded by the manufacturer – not YOW.
- Expansion capacity of the manufacturing facility can support up to 100 units p.a production.

READY TO LAUNCH IN THE WORLD'S LARGEST MARKET WITH NO COMPETITION

- Management have indicated that they have received strong interest from numerous retailers to trial the launch of the product in their stores.
- We anticipate an agreement to be completed shortly to meet the planned launch date of Q2CY14.
- The tier one retailers we believe to have interest in distributing the product through their stores include Walgreens, Walmart, TESCO, KMART, ALDI etc.
- **To put the potential of the US market into perspective, Europe which has a comparable population to the US currently sell 1.2B Kinder Surprises annually.**
- **YOW are entering the biggest market in the world, with effectively no competition. The growth prospects in the US alone are exciting. Conceivably if the brand is a success the demand for US alone could be multiple hundred million units p.a.**
- Conversely, the first year full year of sales in Australia was 65m units and steady state sales post launch year was 17m units for a population of only 17m at the time.

Management have indicated that they have received a very high level of interest from numerous US retailers to trial the launch of the product in their store

POTENTIAL TO BUILD A GLOBAL BRAND

- Management have indicated that the Yowie confectionery product sales are on track to commence in 2QCY14.
- On sale drivers include: major in store point of sale displays, Yowie World digital platform, including Yowie Ranger launch, staged real Yowie collectable release announcements, Media, PR, and promotion.
- The marketing and creative strategy development for the US launch is being built around environmental/educational/entertainment using digital media.
- YOW have recently launched a consumer website (\$2m development cost being spent progressively) as a medium to expand the brand beyond confectionery. The website contains games, apps and an interactive platform to build the characters. Yowieworld.com is free and has been designed to add value to the Yowie confectionery purchase by bringing the Yowie collectables to life through games, quizzes and interactive sticker books. It soon will also provide "live" online connection to endangered animals in zoos, aquariums and wildlife parks.

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MANAGEMENT & SHAREHOLDERS

- YOW have a strong Board & Management Team with extensive brand, global markets and manufacturing experienced.
- Patricia Fields is a Non-Executive Director (also a major shareholder), and previously led the development and commercialisation of the Yowie brand for Cadbury ANZ. She has a background 20+ years commercial and brand experience in FMCG, was the ex global director of Cadbury Schweppes and was instrumental in securing the license back from Cadbury.
- Wayne Loxton Executive Chairman, background is predominately resources and was one of the people involved in putting the Cameroon Fe asset into SDL. Wayne was a shareholder in YOW prior to becoming Executive Chairman. He has been influential in raising ~\$21m since his involvement and personally owns 10m shares/options.
- Mark Avery is an Executive Director. Mark is a former CEO of ThemeSTAR (AEGIS), division of Anschutz Entertainment Group who operates 100+ venues globally with revenues of \$1B annually. He has over 30 years experience in the entertainment industry across global market operations.

GROWTH TO BE DRIVEN FROM US AND ROLLING OUT INTERNATIONALLY

- Management have indicated that discussions with potential distributors in Australia and New Zealand, where the Yowie products are better known, have commenced.
- Opportunity also exists to distribute the Yowie product to UAE and South East Asian markets.

SIGNIFICANT EARNINGS POTENTIAL

- Post the recent \$9m capital raising the cash position has been bolstered to \$11m. There is no debt on the balance sheet and minimal capital requirements going forward apart from marketing and sales.
- There are 37m options which are currently in the money (exercise price between 20c and 28.5c) with the majority expiring December 2015. Conversion of these options should bring in ~ \$7.5.
- **Our understanding is the EBIT Margin will be in the order of \$0.30 per unit.**
- The growth potential for the product is substantial yet simple. If the re-launch of the Yowie brand in the US proves to be successful it has the **potential** to sell multiple hundred million units in the US alone. Further growth is to be driven by the launch of the product in international markets, most notably AUS/NZ/Japan where brand recognition already exists.
- Figure 3 below provides a conceptual model highlighting the valuation potential based on annualised unit sales.
 - On 40m unit sales (production capacity as September 14), \$0.30 EBIT margin and an earnings multiple of 17x we derive a valuation of \$168m or \$1.21/sh.

- Upgrading to annualised sales of 200m units the valuation increases to \$5.40/sh, demonstrating the upside potential of the company.
- As a reminder Europe which has a comparable population to US consumes an estimated 1.2B Kinder Surprises annually, there are no competitors in the US Yowie sold 65m units in AUS (population of 17m). So if the brand takes off annualised sales beyond 200m is a readily conceivable target.

Figure 3: Conceptual valuation under varying production scenarios

	40	140	200	250	300	350
Units Output mpa						
EBIT per unit	0.30	0.30	0.30	0.30	0.30	0.30
EBIT (\$USm)	12.0	42.0	60.0	75.0	90.0	105.0
TAX (\$USm)	-3.6	-15.8	-22.5	-28.1	-33.8	-39.4
NPAT (\$USm)	8.4	26.3	37.5	46.9	56.3	65.6
AUD/USD	0.9	0.9	0.9	0.9	0.9	0.9
NPAT A\$m	9.9	30.9	44.1	55.1	66.2	77.2
Eps (diluted)	0.1	0.2	0.3	0.4	0.5	0.6
Earnings multiple PE x	17.0	17.0	17.0	17.0	17.0	17.0
Target A\$	1.2	3.8	5.4	6.7	8.1	9.4
Valuation A\$m	168.0	525.0	750.0	937.5	1125.0	1312.5

Source: FSB Research

RECOMMENDATION & PRICE TARGET

- YOW provides a compelling growth opportunity set to launch in the one of the largest retail markets, no direct competitor and a self-funding model to support our growth assumptions.
- Our 12mth price target is predicated on the company achieving or contracting 40m unit's p.a annual sales, which will be the installed production capacity as of September 2014.
- We recommend YOW as a SPEC BUY and PT \$1.20/sh.

RISKS

- Securing sales distribution agreements in target markets.
- Supply of Yowie product inputs to meet growth projections.
- Industry specific risks including: fluctation in prices of input material in chocolates and or toys and capsules; competition and pricing and global food activism

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