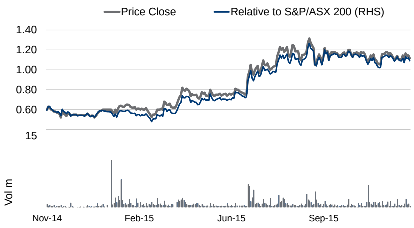
Morgans IN ALLIANCE WITH CIMB

Yowie Group

The YOW Factor

ADD

Current price:	A$1.12
Target price:	A$1.33
Previous target:	A$
Up/downside:	19.3%
Reuters:	YOW.AX
Bloomberg:	YOW AU
Market cap:	US$128.2m
	A$177.4m
Average daily turnover:	US$0.49m
	A$0.69m
Current shares o/s	159.1m
Free float:	100.0%



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	4.7	0.0	71.5
Relative (%)	7.3	-0.7	74.9

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- Yowie Group (YOW) has the global rights to the Yowie brand, which is being led initially by the launch of the Yowie chocolate toy product in the US, the largest confectionery market in the world. YOW has a proven brand and global potential, in our view.
- YOW is on a strong growth trajectory as it expands throughout the US, led by the national Walmart roll-out. Further growth will be driven by entering new markets and selling other merchandise items that leverage off the Yowie brand.
- We initiate coverage with an Add rating and A$1.33 target price. A strong growth outlook underpins this company's investment appeal. However, given YOW is in the early stages of development, it is suited to investors with a higher risk profile.

Yowie Group – a global brand owner and licensing company

YOW owns the global rights to the Yowie brand. YOW's near-term focus is to accelerate the global roll-out of its core product, the chocolate-toy confectionery product, which rivals Ferrero's Kinder Surprise. We highlight that Kinder Surprise does not have the regulatory approval to sell in the US. Whilst YOW is in the early stages of development, we note that it has a proven brand that was highly successful in Australia and New Zealand in the mid-1990s. YOW now deals with 47 clients across more than 10,000 stores in the US with Walmart as its flagship customer with +4,500 stores (strong endorsement of the product's potential). With more than 140m customers passing through Walmart stores each week, this exposure is considerable. Yowies are attractive products for retailers as they are high margin. The product is ideally suited for counter sales and impulse purchases. YOW operates a capital light business model in that it outsources the manufacturing and packaging of its products.

Primed for strong growth over the next few years

YOW is currently not profitable or generating positive operating cashflow. Given the early stage of YOW's US roll-out, forecasting the company's earnings is difficult. However, its sales are increasing strongly quarter on quarter. We forecast YOW to be profitable and cashflow positive in FY18 as earnings over FY16 and FY17 are re-invested into building the brand. We expect YOW to generate strong earnings growth over the next few years from: 1) the successful roll-out of the confectionery product in Walmart and other Tier 1 retailers in the US; 2) expansion into new geographies such as the Middle East; 3) increasing efficiency through economies of scale; and 4) commercialisation of other revenue streams and licensing opportunities. YOW has recently announced a licensing agreement with Angry Birds, which we think will pave the way for more licensing opportunities.

Initiate coverage with an Add rating and A$1.33 DCF-based TP

We believe the next 12-24 months will be a defining period for YOW as it executes on its global roll-out of the Yowie brand. We see a number of major catalysts for the stock including: 1) new retail account wins; 2) strong sales performance post the national Walmart roll-out; 3) achieving profitability; 4) expansion into new markets; 5) new licensing opportunities; and 6) corporate activity.

Financial Summary	Jun-15A	Jun-16F	Jun-17F	Jun-18F	Jun-19F
Revenue (US$m)	2.16	13.63	28.46	51.78	74.98
Operating EBITDA (US$m)	-4.80	-3.40	-0.57	6.37	13.61
Net Profit (US$m)	-2.52	-3.50	-0.80	5.06	11.05
Normalised EPS (US$)	(0.038)	(0.019)	(0.004)	0.028	0.060
Normalised EPS Growth	(19%)	(50%)	(77%)	NA	118%
FD Normalised P/E (x)	NA	NA	NA	29.29	13.41
DPS (US$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	NA	22.60	10.23
P/FCFE (x)	NA	NA	NA	NA	30.13
Net Gearing	(59.6%)	(30.3%)	5.9%	(17.2%)	(25.9%)
P/BV (x)	9.08	10.66	10.88	6.24	4.26
ROE	(43.6%)	(26.8%)	(6.2%)	27.6%	37.8%

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary (USD)

Profit and Loss	2015A	2016F	2017F	2018F	2019F
Sales	**2.2**	**13.6**	**28.5**	**51.8**	**75.0**
Total Operating Costs	7.0	17.0	29.0	45.4	61.4
EBITDA	**-4.8**	**-3.4**	**-0.6**	**6.4**	**13.6**
Depreciation	0.0	0.1	0.2	0.3	0.4
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	**-4.8**	**-3.5**	**-0.8**	**6.1**	**13.2**
Net Interest Income	0.0	0.0	0.0	0.1	0.1
Pre-tax Profit	-4.8	-3.5	-0.8	6.0	13.2
Tax	0.0	0.0	0.0	1.0	2.1
Underlying NPAT	**-4.8**	**-3.5**	**-0.8**	**5.1**	**11.0**
Exceptional items	2.3	0.0	0.0	0.0	0.0
Reported NPAT	**-2.5**	**-3.5**	**-0.8**	**5.1**	**11.0**

Cashflow Statement	2015A	2016F	2017F	2018F	2019F
EBITDA	-4.8	-3.4	-0.6	6.4	13.6
Other income	0.0	0.0	0.0	0.0	0.0
Net interest	0.1	0.0	0.0	-0.1	-0.1
Tax	0.0	0.0	0.0	0.0	0.0
Changes in working capital	-0.9	-0.8	-1.9	-4.2	-5.6
Operating cash flow	**-5.6**	**-4.2**	**-2.5**	**2.1**	**7.9**
Capex	-0.3	-3.0	-3.0	-3.0	-3.0
Free Cash Flow	**-5.8**	**-7.2**	**-5.5**	**-0.9**	**4.9**
Acquisitions and divestments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Investing cash flows	**-0.3**	**-3.0**	**-3.0**	**-3.0**	**-3.0**
Increase / decrease in Equity	7.9	3.2	0.8	5.7	0.0
Increase / decrease in Debt	0.0	0.0	1.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Other financing cash flows	-0.5	0.0	0.0	0.0	0.0
Financing cash flows	**7.5**	**3.2**	**1.8**	**5.7**	**0.0**
Increase/decrease in cash	1.6	-3.9	-3.7	4.8	4.9

Balance Sheet	2015A	2016F	2017F	2018F	2019F
Assets					
Cash	7.9	3.9	0.2	5.1	10.0
Debtors	0.3	1.9	3.9	7.1	10.3
Inventory	0.2	6.1	8.5	12.9	18.7
Other current assets	0.2	0.2	0.2	0.2	0.2
Total Current Assets	**8.6**	**12.1**	**12.9**	**25.3**	**39.2**
Fixed Assets	1.0	3.9	6.7	9.4	12.0
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill	0.0	0.0	0.0	0.0	0.0
Intangibles	0.4	0.4	0.4	0.4	0.4
Other non-current assets	0.0	0.0	0.0	0.0	0.0
Total Non-Current Assets	**1.5**	**4.4**	**7.2**	**9.9**	**12.5**
TOTAL ASSETS	**10.0**	**16.5**	**20.0**	**35.2**	**51.7**
Liabilities					
Short Term Debt	0.0	0.0	0.2	0.2	0.2
Creditors	1.5	3.6	6.1	9.5	12.8
Other current liabilities	0.0	0.0	0.0	1.0	3.1
Total Current Liabilities	**1.5**	**3.6**	**6.2**	**10.6**	**16.1**
Long Term Debt	0.0	0.0	0.8	0.8	0.8
Other Non current liabilities	0.0	0.0	0.0	0.0	0.0
Total Non-Current liabilities	**0.0**	**0.0**	**0.8**	**0.8**	**0.8**
TOTAL LIABILITIES	**1.5**	**3.6**	**7.1**	**11.5**	**16.9**
Equity					
Issued capital	20.4	23.6	24.5	30.2	30.2
Retained earnings	-8.8	-12.3	-13.1	-8.1	3.0
Other reserves and FX	1.7	1.7	1.7	1.7	1.7
Minority interests	0.0	0.0	0.0	0.0	0.0
TOTAL EQUITY	**13.2**	**12.9**	**13.0**	**23.7**	**34.8**

Valuation details			
Share Price in AUD	$1.12	Market Cap (A$m)	$177.4
Share price in USD	$0.81		
Price Target in AUD	$1.33		
DCF valuation in AUD	$1.33		
WACC	14.0%		

Key metrics/ multiples	2015A	2016F	2017F	2018F	2019F
P/E	-21.0	-42.3	-185.7	29.3	13.4
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
PEG	0.0	-0.8	-2.4	0.0	0.1
EV/EBITDA	-19.6	-42.4	-260.6	22.6	10.2

Per share data	2015A	2016F	2017F	2018F	2019F
Diluted shares on issue	126.4	183.9	183.9	183.9	183.9
Normalised EPS (A$)	-3.8	-1.9	-0.4	2.8	6.0
Dividends per share (A$)	0.0	0.0	0.0	0.0	0.0
Payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%

Result quality	2015A	2016F	2017F	2018F	2019F
Cash flow conversion	118.5%	122.9%	437.0%	34.5%	58.6%
FCF vs NPAT	120.4%	205.1%	692.5%	-16.9%	44.5%

Gearing	2015A	2016F	2017F	2018F	2019F
Net Debt	-7.9	-3.9	0.8	-4.1	-9.0
Net Debt / Equity	-59.6%	-30.3%	5.9%	-17.2%	-25.9%
Net Debt / EBITDA (x)	1.6	1.1	-1.3	-0.6	-0.7
EBIT interest cover (x)	n/a	n/a	n/a	n/a	n/a
Invested Capital	5.3	9.0	13.7	19.6	25.8
Enterprise Value	94.0	144.2	148.9	144.1	139.1

Growth ratios	2015A	2016F	2017F	2018F	2019F
Sales		531.1%	108.8%	82.0%	44.8%
Operating costs		144.5%	70.5%	56.4%	35.2%
EBITDA		29.2%	83.2%	1215.7%	113.4%
EBIT		27.7%	78.0%	887.5%	117.4%
NPAT		27.7%	77.2%	734.2%	118.4%
EPS growth		50.3%	77.2%	734.2%	118.4%
DPS growth		n/a	n/a	n/a	n/a
Operating cash flow		24.8%	39.6%	185.0%	269.1%

Margin analysis	2015A	2016F	2017F	2018F	2019F
Gross Profit Margin	59.8%	47.0%	48.0%	49.0%	50.0%
EBITDA Margin	-222.4%	-25.0%	-2.0%	12.3%	18.1%
EBIT margin	-224.1%	-25.7%	-2.7%	11.7%	17.6%
NPAT margin	-224.1%	-25.7%	-2.8%	9.8%	14.7%
ROE	-36.7%	-27.1%	-6.1%	21.3%	31.8%
ROIC	-90.8%	-38.9%	-5.6%	30.9%	51.2%

Key assumptions	2015A	2016F	2017F	2018F	2019F
Units sold (m)	1.9	8.0	15.8	27.3	37.5
Average no. of stores	2,000	10,239	17,025	24,350	30,850
Stores at year end	5,055	14,200	19,700	28,900	35,400
Units sold/store (mth)	78.8	65.2	77.4	93.3	101.3
Sale price per unit (US$)	1.70	1.70	1.80	1.90	2.00

SOURCE: MORGANS RESEARCH, COMPANY

The new Kinder Surprise?

Yowie Group (YOW) owns 100% of the global rights to the Yowie brand – an international award winning consumer brand targeted at a diverse range of ages, genders and cultures. The near term focus of YOW is to accelerate the global roll-out of the group's core product, the chocolate-toy confectionery product that rivals Ferrero's Kinder Surprise.

Investment thesis

June 2015 was a watershed moment for YOW with the company announcing the national roll-out of its confectionery product throughout all +4,500 Walmart stores in the US (a strong endorsement of the product). This outcome was the result of a strong sales performance in a trial period over nine months. The national roll-out is now complete and sales are performing well. Last financial year, Walmart attracted nearly 140m shoppers weekly to its US stores (2014 Walmart Annual Report). With the Yowie product displayed in prime locations, and with many points of sale to reach these customers, we forecast significant growth in Walmart sales over the coming years.

YOW should receive strong retailer support as it is a high margin product. The retailers make a multiple on selling one Yowie to other confectionery goods e.g. the retailer needs to sell six snickers bars for every Yowie. We note that the retailers are always looking for products that boost impulse sales at the checkout and Yowies fit this case.

Further strengthening YOW's position is that it has the only patented product which permits the sale of an embedded toy in a confectionery product in the US. In the short term (until 2018), the company will benefit from monopolistic trading conditions in the world's biggest confectionery market with no competition from the likes of Kinder Surprise.

YOW is in the early stage of a product roll-out and we do not expect the company to report a profit until FY18 as revenue is re-invested back into growth. We note over the next couple of years, YOW needs to invest in a US office fit out, marketing, expand its sales team, back office, finance team, invest in new systems and infrastructure (including additional manufacturing capacity) and appoint a group CEO and CFO and increase its number of board members. This investment may require additional capital.

YOW is now at the cross-roads and we believe the next 12-24 months will be a defining period as the company executes on the global roll-out of the Yowie brand, starting with the US. We initiate coverage on YOW with an Add recommendation and A$1.33 target price.

Key strengths

- **Proven product -** When first introduced by Cadbury in Australia in the mid-1990s, Yowie took 30% market share from market leader Kinder Surprise and was the #1 selling confectionery line in Australia and New Zealand. When going head-to-head with Kinder Surprise, Yowie outsold its competitor 2:1, and in its first full year, Cadbury Schweppes achieved A$100m in retail sales (65m units sold).

- **Monopolistic trading in the US** – Through a royalty agreement with Hank Whetstone, YOW has exclusive use of the Whetstone patented capsule, which is the only design approved by the US FDA and Consumer Product Safety Commission (CPSC) to sell a chocolate-toy combination in the US. The company has exclusive use of this patent until April 2018, removing competition in the short term. We note that Kinder Surprise is not sold in the US.

- **High barriers to entry** – For a competitor like Kinder Surprise to enter the US market, it would need to re-design their product in order to obtain regulatory approval. The 1938 Act bans "the sale of any candy which has embedded in it a toy or trinket". A new product design must pass the "choke test" which would require a new capsule design and a one piece toy. The re-design and investment in manufacturing capability would come at a considerable cost in order to compete with Yowie on a large scale.

- **Walmart validates product appeal** – It is notoriously difficult to be included in the Walmart planogram (floorplan) and the national roll-out of the Yowie product was achieved within 11 months. To put this into context, it has taken other companies years to get into Walmart. This achievement was the result of its consistent sales performance during the product's trial period that began with a 50 store trial in Texas during September 2014. This trial was extended in March 2015 to a roll-out across 1,500 Walmart stores. From November 2015, the Yowie product was on sale in all +4,500 Walmart stores. In our view, this is a significant achievement and validates the saleability of the product. The retailers are also supportive of the product given it is a high margin sale for them.

- **More Tier 1 accounts to follow?** - Yowies are currently being trialled or sold with other Tier 1 accounts and like Walmart, we expect sales success will result in a large-scale roll-out of the product across a range of different retailers. There is near-term potential for the product to expand into over 50,000 stores in the US across a range of retailing categories including: fuel and convenience such as 7-Eleven (+5,000 stores) and Valero (1,100 stores); mass merchandisers like Target (1,800); Drug stores such as CVS (7,600) and Walgreens (8,200); specialist food stores like Stark Foods (1,000); and distributors such as First Source LLC (2,000). A key objective of the company is to become a permanent planogram fixture with priority Tier 1 retailers.

- **Many points-of-sale, prime location** - The product is ideally suited for counter sales and impulse purchases. By nature of its prime location and colourful display, Yowies are marketed in store and benefit from direct exposure to store traffic. With more than 140m customers passing through Walmart stores each week, this exposure is considerable.

- **Global opportunity** – While YOW's focus is on the national roll-out in North America, the company is advanced in other geographies including the Middle East. Before Cadbury shelved the product (see 'company history' for more detail), it briefly entered Singapore, the UK and Japan.

- **Asset light business model with scalable capacity** – Manufacturing is undertaken via a contract manufacturing agreement per unit, with existing production capacity of 20m units pa. With the installation of another wrapping machine (already purchased), capacity can increase to 40m units pa. The production facility is also scalable to 100m units.

- **Quality inputs and low capital intensity** – Key production inputs such as the capsules, toys and leaflets are manufactured in China and imported to the production facility in Florida. The milk chocolate recipe is nut and gluten free and does not contain palm oil. We note recent media scrutiny on Ferrero (makers of Kinder Surprise) for its use of palm oil and concerns over increasing deforestation. The Whetstone facility manufactures the chocolate with other components assembled on-site.

- **Numerous licensing opportunities and revenue streams** – The confectionery product is core to the group and expected to drive brand awareness. We note that over 2m Yowie books were sold in Australia alone and there is potential to drive meaningful revenue from other licensing opportunities. These opportunities include digital, TV/film, books and merchandise. YOW has recently announced a licensing agreement with Angry Birds, which we think will pave the way for more licensing opportunities in the future.

- **Strong corporate appeal** – We think it makes sense for a large international FMCG company to own this brand. We believe this product would appeal to a FMCG company with the manufacturing capacity, purchasing power, balance sheet and global distribution network to capitalise on the unique market dynamics in the US and global expansion.

- **We expect YOW to generate strong earnings growth over the next few years** – Earnings growth will reflect: 1) the successful roll-out of the confectionery product in Walmart and other Tier 1 retailers; 2) expansion into new geographies such as the Middle East; 3) increasing efficiency through economies of scale; and 4) commercialisation of other revenue streams and licensing opportunities.

Catalysts for share price performance

- Sales momentum and quarterly updates.
- Growth in customer accounts – especially Tier 1 retailers.
- Expansion of manufacturing capacity, which would significantly lower YOW's COGS.
- Becoming profitable and cashflow positive.
- Expansion into new global markets.
- New revenue streams and licensing opportunities gain traction.
- Corporate activity.

Risks to consider

- **Given the early stage of YOW's roll-out in the US, forecasting the company's earnings is difficult** – However, its sales are increasing strongly quarter on quarter. We forecast YOW to be profitable and cashflow positive in FY18. The risk is that it takes longer and costs more to achieve our sales forecasts.

- **Financing risk** – YOW is currently not profitable and is expanding its operations considerably. Additional resources will be needed over time to build capacity and facilitate growth. The ability of the group to finance this growth may be restricted by future cashflows and debt or equity financing may be required.

- **Managing supply and inventory** – The product is in its early stages of roll-out and is expected to see significant demand growth. One of the biggest challenges for the group is managing logistics and distribution over the course of an aggressive product roll-out. From a supply chain point of view, we see limited risks. Getting large quantities of the product to the customer in an efficient, cost effective manner and across such a large country can be complex.

- **Competition** – While the Whetstone patent provides some competitive protection in the short term and allows time for YOW to gain substantial market share, we expect that competition will be inevitable, particularly as competitors respond to rapid market growth. We take comfort in the product's sales history although recognise that the unique market dynamics and the monopolistic competitive environment will not last forever. YOW also competes against some very large and well capitalised confectionery companies such as Nestle, Mars, Mondelez International, Hershey, Lindt and Ferrero (Kinder Surprise).

- **Sales momentum crucial** – We see the next 12-24 months as being crucial to the make-or-break of the company. Success will feed success and as sales momentum increases, so too will the number of stores stocking the product. Early sales momentum will be crucial and the US market has not seen a product like this for over a decade. The sales potential and viability of the confectionery product will not be known until it is rolled out to the mass market.

- **New licensing deals may cannibalise the Yowie brand, especially given the Yowie brand/characters are less known**.

- **Loss of Walmart** – As a cornerstone customer, Walmart will be vital to YOW's successful expansion in the initial years of the roll-out strategy. We see this risk reducing over time; however, over 70% of purchase orders in the next 12 months are expected to come from Walmart.

- **Pricing pressure from the major retailers could put pressure on margins** - The large retailers have the buying/negotiating power to extract a disproportionate share of the value chain, exerting pressure on their suppliers. The major retailers' competitive stance on lowest price leadership is driving an increase in the percentage of product sold through supermarkets on promotion. This particularly affects branded products that are in direct competition with their private label offerings.

- **Private label push from the major retailers could limit growth** - The major retailers have a strategy of increasing their private label product offering at the expense of branded product. The retailers are also cutting the selling price of private label products. Shelf space availability to food and beverage manufacturers is being influenced by the supermarkets as they expand their private label offering.

- **Supply arrangements with customers are subject to change with product margin pressure and the de-listing of stock lines having the potential to impact performance** - There has been a net reduction in both brand and SKU count predominantly affecting products that are either sub-scale, have low consumer loyalty, or lack a clear role within the category.

- **Rising input costs (particularly chocolate, plastic and aluminium prices)** – Input costs could increase significantly. In a competitive market place, YOW may not be able to pass these costs onto customers.

- **Limited product diversification** – YOW has only begun commercialising the confectionery product and other revenues are not expected to materialise for a minimum of 12 months. We have not included any other revenue streams in our forecasts.

- **Food activism** – Lobbying pressure by food activists significantly affected Nestle's Magic Ball product in the 1990s. While YOW has the regulatory approvals to somewhat mitigate these issues, there is no guarantee that the product will not be the target of food activists. Social concerns around childhood obesity and the notion that the toy encourages consumption of junk food may lead to food activism. There are also efforts to regulate and limit marketing on junk food directly to children.

- **Brand perception** - The reputation and value of the brand may be adversely affected by a number of factors such as failing to provide customers with the quality of product they expect, disputes or litigation with third parties, employees, suppliers or customers or adverse media coverage.

- **Product risk** – The risk of product contamination, liability and product recalls. Manufacturing defects may also arise. YOW sources its capsules and toys from China and the products are safety tested once they arrive in the US.

- **Production risk** – The risk that YOW's operations could be impacted by fire, explosion, contamination or industrial action, which could reduce its production.

- **Volatile market conditions and investor sentiment towards loss making/high PE stocks** - There is no room for disappointment or the stock could be punished.

Morgans valuation

We value YOW at A$1.33 per share based on a DCF methodology. Given YOW is a high growth company, we have chosen a DCF to capture its medium to longer term upside. With a capital light business model, we also expect YOW will generate strong FCF over the medium to longer term. Our valuation is most sensitive to our assumptions on average number of stores, units sold pa and per store, key expense items and working capital. We have converted our USD valuation to spot AUD. Our valuation has been fully diluted for all the options on issue. Our valuation does not include any potential new licensing deals (other than Angry Birds), new products/merchandise or YOW entering any new regions. We apply a WACC of 14.0%, a terminal growth rate of 3.0%, a risk free rate of 4.25%, a risk premium of 6.0% and an asset beta of 1.66. to derive our DCF valuation of A$1.33. When the company achieves profitability, we intend to lower the WACC. We have conducted the following valuation sensitivity to different WACCs:

- WACC of 13.0% = A$1.52
- WACC of 12.0% = A$1.76
- WACC of 11.0% = A$2.06
- WACC of 10.0% = A$2.46

Company overview

Board and management

The YOW Board consists of three directors with strong corporate, FMCG and marketing expertise. Executive Director Patricia Fields led the development and commercialisation of the Yowie brand for Cadbury, which saw it become an award-winning brand achieving over A$100m in retail sales. More recently, YOW has increased its executive management team in the US and we expect more additions to the management team as the business increases its presence in North America.

Figure 2: Yowie Group's Board of Directors and senior management

Wayne Loxton	Executive Chairman	Wayne has extensive corporate executive experience spanning over 30 years across a number of companies, disciplines and international markets.
Patricia Fields	Executive Director	Patricia led the development and commercialisation of the Yowie brand for Cadbury Schweppes Asia Pacific into a +A$100m retail brand in the 1990's. Patricia has over 30 years commercial and brand experience in the FMCG industry, including a role as ex-Global Director for Cadbury Schweppes Plc.
Trevor Allen	Non-Executive Director	Trevor has held senior executive positions at SBC Warburg and its predecessors for eight years and was a corporate finance partner at KPMG for 12 years. His commercial experience includes merger and acquisitions and business integration. Trevor is also currently a Non-Executive Director of Freedom Foods Group (FNP.ASX), Eclipx Group (ECX.ASX) and Peet Limited (PPC.ASX).
Sal Alvarez	Chief Executive Officer	Sal brings 32 years of experience in consumer sales and marketing to Yowie North America having worked in pharmaceutical, consumer products and spirits industries. Sal has a proven track record of leading high performance teams to achieve superior business results. Sal is supported by a recently strengthened sales, broker, distributor and account management team with confectionery and US retail trade experience, plus finance, supply and logistics support together with an external in store merchandising team servicing the Walmart account.

SOURCE: MORGANS RESEARCH, COMPANY

Company history

The Yowie characters were created by Australian authors Geoff Pike and Bryce Courtenay. Originally designed as an educational tool to teach children about the natural environment, the Yowie brand was developed by Kidcorp Pty Ltd in the early 1990s.

The colourful history of the Yowie brand is as follows:

- 1993: Kidcorp enters partnership with Cadbury (Australia and New Zealand) to develop and commercialise the brand in the Asia Pacific region, excluding China. Kidcorp retained the rights to the rest of the world including US, India and China.
- 1995: Yowie brand was launched by Cadbury into the ANZ market.
- 1997: Yowie confectionery item was launched with over 65m units and A$100m in retail sales in the ANZ market to become the #1 best-selling confectionery line in the ANZ market.
- 1997: Over 2m Yowie books sold, making it a #1 best seller on the Australian children's book list.
- 1997: Won international awards at an industry trade show in Paris as "Best New Global Supermarket Product" and "Best New Global Confectionery Product".
- Late 1990s: Won a host of Australian awards including:
  - 'Best in Business' – Business Review Weekly
  - 'Best New Australian Supermarket Product' - grocery retail trade
  - 'Most Innovative & Best New Product' – Foodweek Magazine
  - 'Best New Product' – Safeway Food Stores

- 2005: Cadbury's efforts to acquire the global rights from Kidcorp failed. Cadbury shelved the product due to a corporate decision to focus solely on company-owned brands and non-food licensing opportunities.
- 2010: Kraft Foods takeover of Cadbury.
- 2012: Kraft Foods split the company into two with Mondelez International becoming the confectionery business.
- February 2012: Kidcorp assigns the global rights (ex-Asia Pacific) of the Yowie brand to Yowie Group.
- June 2012: Yowie Group negotiates the buy-back of the Cadbury owned rights in the Asia Pacific from Mondelez (Kraft) to secure global rights to the Yowie brand.
- December 2012: Yowie Group listed on the ASX under the code YOW.
- July 2014: Yowie secures a National Convenience Account – Valero Corner Store – 1,100 stores.
- September 2014: Yowie goes on sale in Walmart Texas (50 store trial).
- November 2014: Yowie goes on sale in a Second Tier 1 US retail chain.
- November 2014: Appointment of the CEO of Yowie North America.
- January 2015: Completed A$10m capital raising to fund the roll-out of Yowie in the US.
- February 2015: Successful Yowie Walmart trial leads to a roll-out across 1,500 stores.
- February 2015: Yowie achieves national ranging in 1,318 US Safeway stores.
- April 2015: Successful Middle East Yowie supermarket trial.
- June 2015: YOW announces that it will roll out nationally to about 4,300 Walmart stores in the US from the end of September 2015.
- June 2015: YOW launched a Sponsored Level 1 ADR program through BNY Mellon in the US to increase its exposure to the US investment community. The company's ADRs trade under the symbol "YWRPY" and represent 1 ADR for every 10 ordinary YOW ASX listed shares.
- August 2015: YOW launched a partnership project with the American Association of Zoos and Aquariums (AZA) to increase its brand awareness. YOW undertook a product sampling program across the 229 AZA-accredited zoos and aquariums in the US over holidays and weekends in August. In 2014, the 228 zoos and aquariums accredited by AZA attracted more than 183m visitors, of which approximately 50m visitors were children.
- November 2015: YOW secured an Angry Birds licence agreement. Angry Birds is a video game franchise and one of the world's biggest entertainment brands. The original mobile game was launched in 2009 and remains the number one paid app of all time. YOW will essentially manufacture and distribute an Angry Birds chocolate candy inclusion product with an Angry Birds collectable surprise inside for the US market. YOW will have the licensing rights for three years (until September 2018). The Angry Birds chocolate candy launch will occur at the same time of the release of a new Angry Birds movie in May 2016. We believe that YOW will pay 5% of net sales as a royalty to Rovio Entertainment, the developer of Angry Birds. This arrangement should not impact YOW's margins given the licensing deals have a higher selling price.
- November 2015: YOW announced at its AGM that the progressive roll-out to +4,500 Walmart stores is now complete and that 100% of the

stores have achieved Yowie sales. Yowie is ranged on 16 checkout stands on average per store.

The Yowie brand

The Yowie brand is designed to have a wide appeal across age, gender and culture and focuses on the 'Play & Learn' philosophy. Targeted at children, their parents, grandparents and friends, the brand promotes education and the protection of the natural environment to children. There are six main Yowie characters - Rumble, Boof, Crag, Ditty, Nap and Squish. From Independence Day (4 July 2016), YOW will launch a second series of characters that will include American native animals.

Figure 3: Six main Yowie characters

SOURCES: Yowie Group

Confectionery product

YOW's confectionery product, rival to the Kinder Surprise, is the core focus of the company in the near term and is the launch pad for the brand.

Figure 4: Yowie chocolate-toy product

SOURCES: Yowie Group

The 28g moulded chocolate is designed to split into two halves for portion control (parents can eat half). The patented capsule is opened when squeezed in the centre, ensuring that consumers cannot bite through the chocolate and choke on the product.

Figure 5: Yowie confectionery product and patented design

SOURCES: Yowie Group

Each inclusion contains a colour-coded information leaflet profiling the animal and its conservation status (eg. endangered, vulnerable, threatened). Toy designs differ and each inclusion is a limited edition. While it is suggested this reflects the endangered nature of the creatures themselves, we believe it is a clever marketing strategy designed to encourage consumers to collect, swap and share. After a series is launched, it is never repeated thus ensuring stock is limited and to promote the collectability of the product.

Food activists have targeted multi-nationals in the past with criticism for the use of candy-toy products in enticing the consumption of junk food amongst children. Consumer groups have also campaigned against some products thought to be a choking hazard. Nestle's Magic Ball was taken off shelves in the 1990s as a result of such protests. By promoting the 'Play & Learn' proposition and making the product as consumer friendly as possible, YOW has taken action to minimise potential criticism from activist groups. It has a responsible ecology positioning 'Save the Natural World'. Other consumer benefits of the Yowie product include:

- 100% natural milk chocolate, nut and gluten free;
- Not high in fructose corn syrup or palm oil;
- No embedded or small parts in a tamper proof locking device (US FDA and Consumer Product Safety Commission compliant);
- Portion controlled, containing 2 x 14g halves;
- Recyclable and reusable products; and
- Ethically sourced chocolate with Rainforest Alliance Certification.

Hank Whetstone patent

Yowie North America (United States, Canada and Mexico) has a license agreement with Hank Whetstone of Whetstone Candy Company Inc for the exclusive use of US patents #5,925,391 and #6,099,872. These patents are the only design approved by the US FDA and Consumer Product Safety Commission (CPSC) that satisfy the 'choke test', permitting the sale of the chocolate-toy combination in North America. Without the necessary regulatory backing, Nestles' Magic Ball product was taken off shelves and Ferrero's Kinder has never been sold in the US.

This patent is valid until April 2018, providing a further 2.5 years of monopoly-like trading conditions for the Yowie brand to saturate the US market. In time, we do expect competition as a result of the successful roll-out of the product. However, we note the brand's previous success when competing head-to-head with Kinder Surprise.

In consideration for the exclusive use of the patent, Yowie North America pays a small annual Licensing Fee and per unit royalty to Whetstone Candy Company Inc.

Supply, manufacturing and distribution

All components are sourced externally and assembled at the Whetstone manufacturing facility at St Augustine, Florida. The supply chain is simple with components such as the chocolate, capsule, toy and leaflet sent to the production facility in Florida. Currently, there is capacity to produce at a rate of 40m units and with a small capital investment (estimated at €2m), capacity can increase to 100m units pa. Our model forecasts this capital spend to occur in FY17.

- **Chocolate**: Sourced from Barry Callebaut arrives in blocks at the Whetstone production facility as required. The milk chocolate is nut and gluten free and does not contain high fructose corn syrup or palm oil (noting recent public pressure on Ferrero for use of palm oil).

- **Toy, capsule, leaflet**: Manufactured by WELLHOPE in Shenzhen China, the manufacturer has the capacity to deliver vast quantities when required.

- **Whetstone facility**: A tolling fee is paid per unit. There is no contractual obligation involved, only a fee-for-service arrangement. This production facility is scalable and can increase capacity to 100m units pa.

    - Note: YOW has exclusive use of the Whetstone patent and pays a fee and royalty on sales for this exclusivity. These agreements are independent of each other.

- **Wrapping and packaging**: Currently this is the only bottleneck for an immediate expansion to a rate of 100m units pa. There is one wrapping machine installed with a production capacity of 20m units pa. There is a second wrapping machine which has not been installed and can increase production capacity to 40m units with a 16 week installation lead time. We estimate installation costs of A$700k. Additionally, the company has identified suitable wrapping and packaging machines in Europe which will ensure the group can achieve the 100m production capacity. We expect a 6-9 month lead time from ordering these machines to commissioning at a total cost of €2m.

The final product is then sent to one of YOW's six distribution centres (DCs) for distribution. YOW makes use of a software platform to assist in the management of all aspects of supply and distribution such as transport, stock management and manufacturing, as well as capture customer data. An external merchandising company provides in store merchandising assistance to the Walmart account to ensure stock levels are maintained and sales potential is maximised.

Customer base

YOW currently has 47 active group and individual accounts in the US. Its largest client is Walmart, which accounts for about 75% of sales. YOW's active retail accounts include mass merchandise, grocery, convenience, oil, drug, speciality candy stores, retail groups, brokers and distributors. To date, YOW has not lost a customer.

Figure 6: YOW's US customer base

SOURCES: COMPANY REPORTS

Inventory

Inventory levels currently sit at about 5m units to give the company plenty of runway to accommodate the Walmart roll-out. These levels are likely to fall to a target inventory level of two months of supply.

Retailing

Prices vary between retailer in the range of US$2.48-3.99 per unit (varies between Walmart at the lower end to specialty candy retailers at the higher end). The wholesale price is approximately US$1.70 and while retail prices will differ, the mark-up per unit (US$0.80+) makes Yowies a high margin product for the retailers compared to other confectionery items. The stackable nature of the packaging also makes the product a high yielding item for the retailers with little shelf space required. The colourful packaging also catches the eye of consumers and provides an attractive display item for retailers.

Figure 7: Yowies on sale in the US

SOURCES: COMPANY REPORTS

Marketing and brand awareness

To date, there have been limited resources dedicated to marketing the product or brand. YOW has not committed large quantities of funds on marketing while it has focused on building production capacity (it is a waste of resources to build demand you cannot meet). Currently YOW's marketing program is centred around:

- **Affiliations and partnerships** with groups promoting a responsible ecological message such as the American Association of Zoos and Aquariums 'Saving Animals from Extinction' initiative;
- **Social media** such as Facebook, Twitter, Instagram and Youtube;
- **Yowieworld.com** digital platform;
- **In-store promotional opportunities** such as the annual Eco Calendar and exclusive Christmas promotion with Walmart; and
- **Free Yowie app** available through the App Store or Google Play.

The group's website Yowieworld.com has been the focus of marketing to date with over A$1m spent on a A$2m+ digital market strategy developing the website. Yowieworld.com contains free 3D games, free apps, online quizzes, a virtual sticker book and other activities engaging with children. There is also a 'Where to Buy' section that shows the nearest store location stocking Yowie products. Inside each confectionery product is an invitation to visit Yowieworld.com. While the company has plans to commercialise the website and generate a digital revenue stream, we assume no earnings from a digital revenue stream in our model.

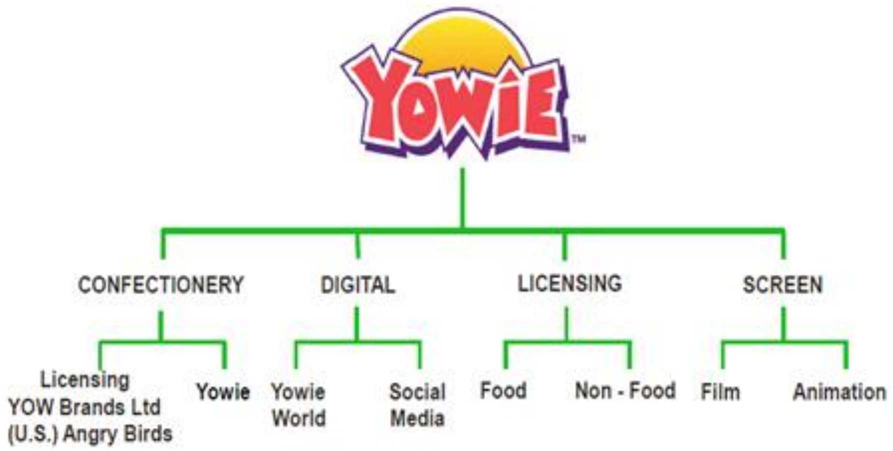
YOW has identified that 40% of the company's target market in the US (children 3-12 years) is located in five States. When marketing ramps up in 2016, we expect this will be the focus of the group.

Figure 8: YOW's marketing focus

SOURCES: COMPANY REPORTS

Growth strategy

Figure 9: YOW's global brand vision



SOURCES: MORGANS, COMPANY REPORTS

To date, YOW has focused on building production and distribution capacity, increasing its 'account pipeline' with US retailers and demonstrating the sales potential of the confectionery product through a series of product trials. The next phase for YOW is to achieve strong earnings growth from three key objectives:

1) Building a confectionery led global Yowie brand via an aggressive US roll-out of the confectionery product;
2) Launch a broad range of Yowie branded licensed products globally in food and non-food markets; and

3) Establish a commercially successful Yowie digital platform.

YOW's strategy to achieve these objectives are summarised below:

- **Increasing sales focus and optimising accounts** – YOW appointed industry veteran Salvador Alvarezas as CEO in late 2014 and has increased its internal sales team to four staff members. A dedicated staff member has been assigned to optimise the Walmart account, ensuring the Yowie product gets maximum exposure (floor space) and is located in prime positions in-store. We expect the sales team will grow as the number of stores increases and that the sales team will help boost per store sales numbers.

- **Targeting Tier 1 retailer accounts** – YOW has secured a national roll-out with Walmart (#1 ranked US retailer) and Safeway (#10 ranked). Yowies are also being trialled in Walgreens (#5) and CVS (#7). We note that of the top 10 retailers in North America who stock confectionery products, only Target and The Kroger Co. do not have Yowies in any of their stores. It is clear to us that YOW has focused its efforts on Tier 1 retailers and is likely to continue this strategy, which has proven to be successful thus far.

- **Evaluating distribution opportunities outside the US** – YOW has said that expansion into the Middle East and Asia are key strategic priorities for a second-stage brand roll-out. In April 2015, YOW completed a small 12 store trial in Dubai with an international Tier 1 grocery account. All benchmarks were exceeded in the trial with sales performance consistent with other retailers. This outcome validates the global potential of the product and we expect further updates on the second stage Middle East trial later in 2015. According to Confectionery News, the Middle East is emerging as one of the fastest growing chocolate markets across the globe. The market is said to be set for a CAGR of 6.09% from 2014 to 2019. A strong sales performance in the new geographies is important as it demonstrates YOW's ability to sell in more competitive markets alongside Kinder Surprise.

- **Other food and non-food licensing opportunities** – YOW has recently announced a licensing agreement with Angry Birds, which we think will pave the way for more licensing opportunities. The company has reportedly been in discussions with film studios in relation to the development of an animated feature film. We also note that approximately 2m Yowie books were sold in Australia, making it a best-selling children's book. Over the next 12-18 months the group will look to diversify through new food licensing opportunities (e.g. Angry Birds) and non-food licensing (books, music CDs, games, pencil cases, clothing, hats, puzzles, TV, film) when the brand has been firmly established.

Figure 10: Examples of Yowie licensed products under Cadbury

SOURCES: YOWIE GROUP

Summary financials

YOW is in the early stage of a product roll-out and we do not expect the company to report a profit until FY18 as revenue is re-invested back into growth. We note over the next couple of years, YOW will need to invest in a US office fit out, marketing, expanding its sales team, back office, finance team, invest in new systems and infrastructure (including additional manufacturing capacity) and appoint a group CEO and CFO and increase the number of board members. This investment may require the need for additional capital.

It is important to note that from FY16 onwards, Yowie will report in USD given the majority of its business is conducted in the US. We have also restated its actuals to USD.

Figure 11: Financial summary (US$)

	FY15A	FY16F	FY17F	FY18F	FY19F
Average no. of stores	2,000	10,239	17,025	24,350	30,850
Number of stores at year end	5,055	14,200	19,700	28,900	35,400
Units sold (m)	1,891,276	8,016,000	15,808,500	27,253,500	37,490,162
Units sold/store (mth)	79	65	77	93	101
Sale price per unit (US$)	1.70	1.70	1.80	1.90	2.00
Operating Revenue	**2.2**	**14.0**	**28.7**	**52.0**	**75.3**
Growth	2240%	547%	106%	81%	45%
Cost of Sales	0.9	7.4	14.9	26.5	37.7
Gross Profit	**1.3**	**6.6**	**13.8**	**25.5**	**37.7**
Gross Profit Margin %	59.8%	47.0%	48.0%	49.0%	50.0%
Selling and Distribution	1.5	2.7	4.5	6.7	9.4
Growth	81%	80%	65%	50%	40%
Marketing & Promotion	0.8	1.5	2.5	3.5	4.4
Growth	302%	100%	65%	40%	25%
Administrative Costs	3.7	5.2	6.4	7.7	8.9
Growth	83%	40%	25%	20%	15%
Finance	0.0	0.1	0.4	0.6	0.8
Growth	3788%	125%	550%	50%	35%
Write-offs/FX losses	0.1	0.5	0.5	0.5	0.5
Growth	-93%	0%	0%	0%	0%
Total Costs	**6.1**	**10.0**	**14.4**	**19.1**	**24.1**
Growth	31%	64%	44%	33%	26%
EBITDA	**-4.8**	**-3.4**	**-0.6**	**6.4**	**13.6**
Growth	-5%	29%	83%	1216%	113%
EBITDA margin	-222.4%	-25.0%	-2.0%	12.3%	18.1%
D&A	0.0	0.1	0.2	0.3	0.4
EBIT	**-4.8**	**-3.5**	**-0.8**	**6.1**	**13.2**
Growth	-6%	28%	78%	888%	117%
EBIT margin	-224.1%	-25.0%	-2.7%	11.7%	17.5%
Underlying NPAT	**-4.8**	**-3.5**	**-0.8**	**5.1**	**11.0**
Growth	-6%	28%	77%	734%	-118%
Selling and Distribution/Sales	70%	19%	16%	13%	12%
Marketing & Promotion/Sales	36%	11%	9%	7%	6%
Admin costs/Sales	171%	37%	22%	15%	12%
Finance/Sales	1%	0%	1%	1%	1%

SOURCE: COMPANY, MORGANS ESTIMATES

Revenue

The wholesale price of the confectionery product is estimated at US$1.70 per unit. From FY17 onwards, we assume that the selling price rises by US$0.10 pa. Included in revenue is interest revenue and royalties. YOW's current royalty income comes from Bulla ice creams, which uses the Yowie trademark on its ice cream cups.

Sales forecasts

Given the early stage of YOW's roll-out in the US, forecasting the company's sales is difficult. Sales growth will be the direct result of two factors: 1) increasing the number of Yowie products in stores; and 2) high turnover per store. We expect both will increase significantly over the next three years as YOW builds its sales team and actively promotes its brand in the market place.

Store growth

In September 2014, the Yowie confectionery product began sales/trials in 1,125 stores in the US. By October 2015 and after the Walmart national roll-out, we estimate that Yowie will be sold in 10,000-12,000 stores. With trials well advanced with Tier 1 retailers such as CVS and Walgreens, we believe growth will continue at its current trend and reach 14,200 stores by June 2016. A key upside to this estimate would be another national roll-out with a Tier 1 retailer.

- **30 Sep-14**: 1,125 stores
- **31 Oct-15**: 8,800 stores
- **31 Dec-15**: 10,000 – 12,000 stores
- **30 Jun-16**: 14,200 stores (Morgans estimate)
- **30 Jun-17**: 19,700 stores (Morgans estimate)
- **30 Jun-18**: 28,900 stores (Morgans estimate)
- **30 Jun-19**: 35,400 stores (Morgans estimate)

Based on retail data for the top 100 US retailers, we estimate the store potential for Yowie to be over 72,000 for these stores alone (see Appendix). We note that Yowies are already being sold in over 3,000 stores that fall outside the top 100 US retailers. The company has a focused strategy to target 19 core accounts who represent approximately 70% of the US market (see Figure 12 below).

Figure 12: Yowie customer focus

	Top 3 Players		2014 US Sales ($B)	Channel Share	Channel Rank	# US Stores	Geographic Footprint
Mass	Walmart	☆	288	77%	1	4500[1]	• National
	Target		73	19%	2	1,790	• National
Drug	Walgreens		76	32%	1	8,232[1]	• National
	CVS		68	29%	2	7,775[1]	• National
	Rite-Aid		27	11%	3	4,570	• National
Grocery	Kroger		87	15%	1	2,625	• National
	Safeway	☆	36	6%	2	1,326	• CA, TX, WA, AZ, CO
	Publix		31	5%	3	1,095	• FL, GA, AL, SC, TN, NC
	Albertsons[2]		23	4%		904	• CA, TX, IL
	Delhaize		20	3%		1,295	• VA, NC, SC, MD
	Ahold		26	4%		768	• MA, RI, CT, NH, NY, NJ
	H-E-B	☆	20	3%		313	• TX
	Meijer		15	3%		213	• MI, IN, IL, OH, KY
	Wakefern / Shoprite		15	3%		363	• NY, NJ, CT, MD, PA, DE
C-Store	7-Eleven	☆	8	9%	1	8,278	• National
	ACT		5	5%	2	7,800[3]	• National
	Speedway		4	4%	3	2,746	• National
Club	Costco		80	53%	1	474[1]	• National
	Sam's		58	39%	2	647[1]	• National
	Total					55,714	

☆ Current accounts

SOURCES: YOWIE GROUP

We also highlight the takeover by Albertsons of Safeway, which was completed at the end of January 2015. The merged group is believed to have over 2,200 stores throughout the US and by default, a roll-out in Safeway may soon result in a roll-out in the Albertsons +900 stores. Trials with Walgreens commenced earlier in the year and we expect an outcome on the account (+8,000 stores) by the end of 2015.

Sales per store

The product is being sold in a variety of stores including groceries, drug stores/pharmacies, fuel and convenience, mass merchandise and general retail. These outlets vary in respect to size, location, traffic and customer profile. For these reasons, we expect a wide turnover range from one store to another. We estimate that the group is currently selling at an average rate of about 65 units per store/month.

We see potential upside to this number as:

- Walmart will be stocking the product in more points-of-sale and in prime locations such as the checkouts;
- YOW's internal sales team has been increased to optimise the Walmart and other retail accounts;
- Brand awareness increases; and
- YOW's marketing and sales focus ramps up.

Figure 13: Morgans key assumptions

Key assumptions	2015A	2016F	2017F	2018F	2019F
Units sold (m)	1.9	8.0	15.8	27.3	37.5
Average no. of stores	2,000	10,239	17,025	24,350	30,850
Stores at year end	5,055	14,200	19,700	28,900	35,400
Units sold/store (mth)	79	65	77	93	101
Sale price per unit (US$)	1.70	1.70	1.80	1.90	2.00

SOURCES: MORGANS, COMPANY REPORTS

Tier 1 retailers sales potential

As previously noted, in 2014 an average of 140m customers visited US Walmart stores per week. This equates to 32,558 patrons visiting each store per week. If Yowies can sell at an average rate of 100 units per 32,558 customers, the Walmart account alone would generate close to 22.4m sales pa.

Figure 14: Tier 1 retail accounts and market potential

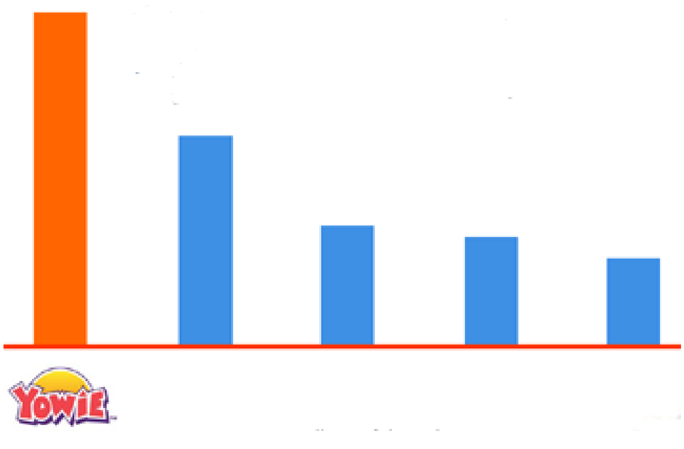
	Walmart	Walgreens	CVS pharmacy
Weekly traffic (US)	140m	44.1m	35m
Number stores	4,300	8,200	7,800
Weekly traffic/ store	32,558	5,378	4,487
Yowie Sales per week	100	30	30
Annual Yowie sales pa	22.36m	12.79m	12.17m

SOURCE: COMPANY ANNUAL REPORTS, MORGANS ESTIMATES

If Yowies sold in Walgreens sell at a rate of 30 units per 5,378 customers, a national roll-out has the potential to generate 12.8m sales. Similarly, a sales rate of 30 units per 4,487 customers in CVS stores would generate a further 12.17m sales pa. Given the product is a 'white space' category, the sales potential is unknown. However, this analysis demonstrates the substantial potential and we have been deliberately conservative with our estimates.

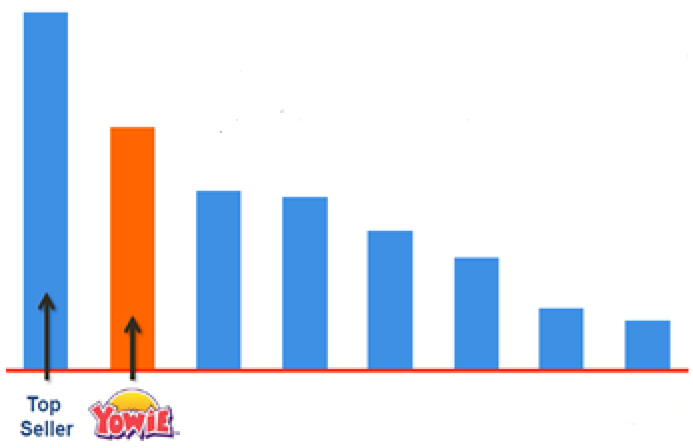
Sales data to date shows that the product is gaining traction amongst Tier 1 retailers. In Walmart, Yowie is ranged on 16 checkout stands on average per store. The following charts highlight that Yowie has moved to #1 New Chocolate Item at the front end as measured by sales value per week. For all chocolate items, Yowie was #13 best seller out of a total of ~120 chocolate items over the 13 weeks ending 5 September 2015. During the same period, the product was #2 best-selling Novelty Item. Initial sales data demonstrates the product is increasing in popularity and competing against well-known brands and products, despite the absence of marketing and limited in-store merchandising.

Figure 15: Tier 1 Account Data - New Chocolate Front End Sales / Week



SOURCES: Commercially confidential customer data

Figure 16: Tier 1 Account Data - Novelty Item Front End Sales / Week



SOURCES: Commercially confidential customer data

We also note the recently launched Christmas line, which is an exclusive for Walmart. This Christmas promotion began 1 November with sales expected to benefit the December Quarter. Coupled with the addition of in-store display units (not yet rolled out), we believe sales momentum will continue as product visibility improves in high traffic locations.

US market potential

In 2014, Ferrero sold 2bn Kinder Surprise units globally. Sales in Western Europe accounted for 1.2bn units or 60% and with a population of 495m people, this equated to 2.4 units per capita. In 1997, the population of Australia and New Zealand combined was a little over 22m people. During that year, over 65m units were sold equating to a sales rate of approximately 3.0 units per capita. This implies that in a fully mature market such as the US, YOW could sell +700m units pa which equates to >US$210m of EBIT at a US$0.30 EBIT margin. Given YOW's key age demographic is 0-14 years or 63m Americans, assuming per capita consumption of 2.5 units, this equates to 157.5m units pa. Our FY25 forecast for YOW to sell 77.6m units could therefore prove to be conservative.

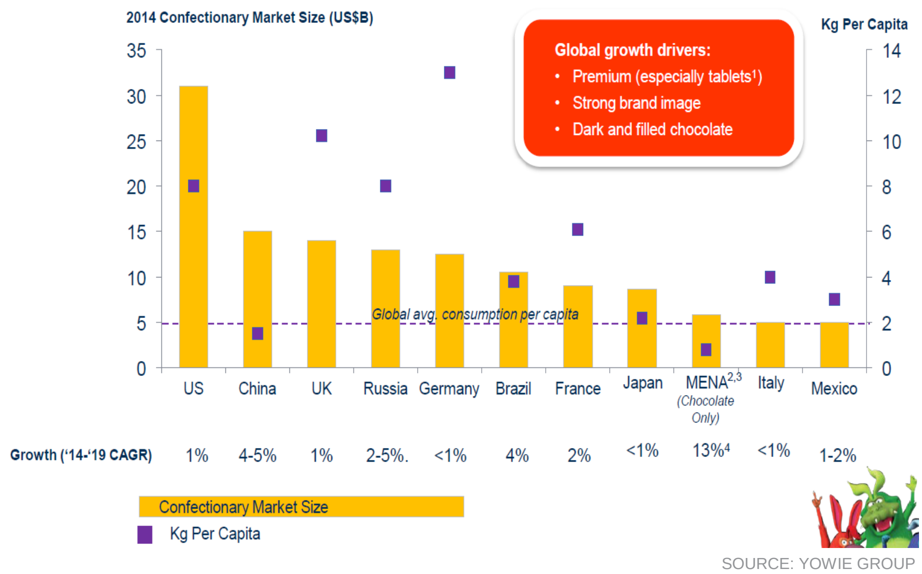
Figure 17: Historical sales and market potential

	Yowie	Kinder Surprise	Yowie
Retail market	Australia & NZ	Western Europe	USA
Year	1997	2014	2015
Population	22 million	495 million	320 million
Annual Sales	65 million units	1.2 billion units	700+ million units
Sales per capita	3.0	2.4	2.2

SOURCE: YOWIE GROUP

The US is the world's largest confectionery market by some margin with estimated retail sales of over US$30bn in 2014. About US$13bn of this market is most relevant to YOW given it competes in the Novelty (molded/toy), Bars <3.5 oz, Snack Packs and Seasonal segments. Consumption per capita is highest in Western Europe (Germany and the UK); however, recent estimates suggest the US consumes approximately 8kg per capita – making the nation one of the largest confectionery consumers per head of population.

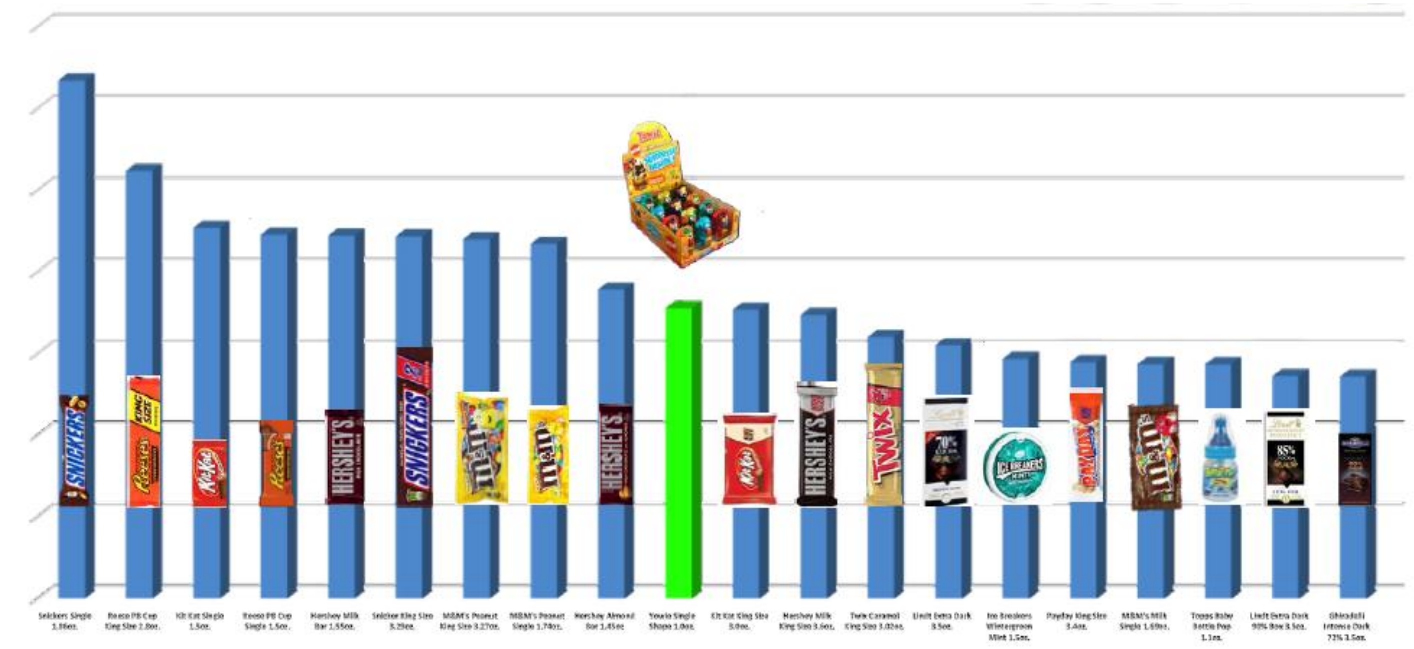
Figure 18: 2014 Global confectionery market



SOURCE: YOWIE GROUP

Encouragingly, sales data shows that YOW is making inroads in this market. In the latest Nielsen data, Yowies were the #10 best-selling item in the Grocery Channel for the 13 weeks ending 5 September 2015. The data shows that Yowies outsold Kit Kat, Twix, Hershey's and M&Ms using a measure of dollars per store per week (excluding Walmart sales).

Figure 19: Nielsen US food data (13 weeks to 5 September 2015)



SOURCE: YOWIE GROUP USING NIELSON COMPANY DATA

COGS

We estimate YOW's COGS is US$0.80 per unit. This includes raw materials such as chocolate, toy and capsule (plastic) and wrapping (aluminium), as well as other per unit costs such as the tolling fee and royalty payments for use of the Whetstone patent and trademark. YOW buys its chocolate from a number of wholesalers in the US. There is currently some upward pressure on YOW's COGS with rising cocoa and plastic prices, although we note that aluminium prices are lower. With scale, YOW's buying power with key suppliers should improve. Owning manufacturing equipment outright would also lower its COGS.

Figure 20: YOW's COGS

	Cost US$/unit	Notes
Capsule, toy, leaflet cost	0.27	manufactured in China
Chocolate	0.13	sourced in-country
Tolling fee	0.25	Whetstone tolling fee
Wrapping & packaging	0.08	foils and wrappers
Whetstone royalty	0.04	exclusive use of patent in U.S.
Trademark royalty	0.03	trademark for North America
Total	**0.8**	

SOURCE: COMPANY, MORGANS ESTIMATES

Figure 21: Cocoa price (US$/MT)

SOURCE: http://www.tradingeconomics.com

Other costs

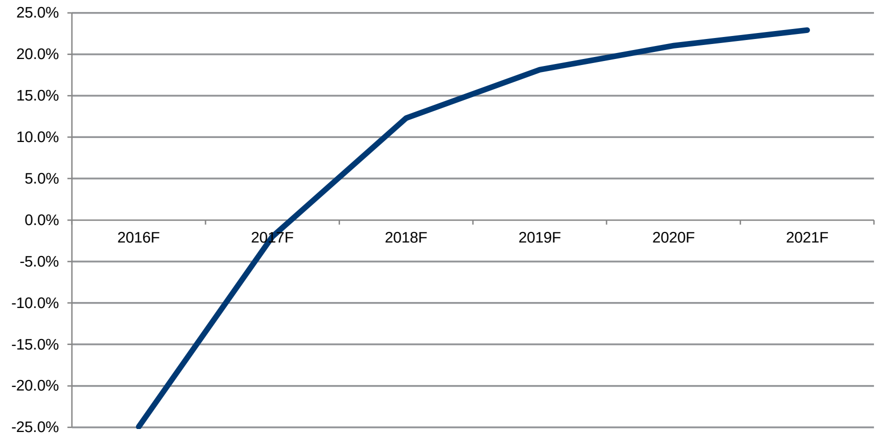
YOW's key operating costs include:

- Selling and distribution – YOW's sales team was expanded during the 1Q16 to include three new senior account people all with confectionery and retail industry experience. We forecast YOW to employ additional sales staff over coming years.
- Marketing and promotion - We highlight that YOW has got to its position with immaterial marketing spend. YOW also doesn't incur trade spend. In FY15 A$0.8m of finished goods were expensed as the company undertook product sampling to increase brand awareness and to expand future sales and distribution channels. However, in the 4Q16, formal US advertising of the Yowie chocolate capsule will begin and we expect marketing spend to ramp up from here on in.
- Administrative costs (includes consulting fees, business development, travel, legal, tax, listing, compliance, insurance, share-based payments and super) are forecast to rise as YOW expands its back office and senior management team. New staff will also be incentivised with share options.
- Finance – In FY17 we forecast YOW to appoint a group CFO.

EBITDA margins

We expect YOW's EBITDA margin will rise with increased scale.

Figure 22: EBITDA margin



SOURCE: MORGANS ESTIMATES

Depreciation and amortisation (D&A) expense

Depreciation is minimal given YOW's capital light business model.

Tax rate

We forecast an effective tax rate of 16% from FY18 and beyond. 16% reflects the tax rate in Hong Kong where the Yowie Group is based.

Seasonality of sales

Sales history to date suggests there may be some seasonality with sales peaking in holiday periods such as school holidays, Easter and Christmas. During the 4Q16 we also expect to see strong sales growth from the Angry Birds licence agreement.

Recent results

FY15 result - In FY15 YOW reported an underlying loss of US$4.8m. The reported loss of US$2.5m was boosted by an unrealised FX gain.

1Q16 sales – YOW reported sales of US$2.5m based on 1.5m units sold. We understand that this number was bolstered by stock building sales associated with the Walmart national roll-out (channel stocking).

Outlook

Given the early stage nature of the business, YOW hasn't provided any formal FY16 earnings guidance.

Sensitivity analysis

Given FY18 is the year we forecast YOW to be profitable, we have conducted the following sensitivity analysis of key drivers:

- The average number of stores increases by 500 new stores adds US$1.0m to EBITDA;
- 0.5m additional units sold adds US$0.4m to EBITDA;
- 5 more units sold per store per month adds US$1.4m to EBITDA; and
- Every US$0.10 increase in YOW's wholesale price adds US$1.3m to EBITDA.

Balance sheet

YOW's balance sheet is dominated by cash, receivables and inventory. We look at each of these balance sheet items in more detail below.

- Cash – As at 19 November 2015, YOW had US$9.9m of cash. The company also has over 11.9m outstanding options which expire in December 2015 at an exercise price of A$0.20. We have assumed that these options are exercised with our forecasts.
- Trade debtors - Given the majority of YOW's sales are to the major retailers, there is a low ongoing credit risk associated with the company's sales. Its average trade debtors is between 30-60 days.
- Inventory is split between raw materials and finished goods (larger contributor). The company's policy is to maintain stocks that are equivalent of at least two months of future sales so that it can ensure it can always meets current and future demand. While this requires significant working capital, it provides assurance that the business can meet sudden increases in demand and also manage any unavoidable delays in the manufacturing of its products. In the short term, inventory has been run down from 30 June 2015 levels to fulfil the Walmart roll-out. We expect the company to replenish its inventory during the 2H16.

Intangible items are small and relate to rights and licenses and software.

YOW's trade creditors largely relate to suppliers of raw materials, packaging, freight and marketing. Payables are usually within 30 days.

YOW currently has no debt. We forecast the company to take on US$1m of debt in FY17.

Cashflow commentary

In FY15 YOW reported an operating cash outflow of US$5.6m compared to an outflow the pcp of US$5.4m. While the business is scaling and developing in new markets, YOW's working capital requirements are large. Consequently, accurately forecasting its operating cashflow is difficult. At this point, we forecast the company to start generating positive operating cashflow in FY18. With about US$4m of tax losses, YOW won't pay tax for a number of years.

YOW has relatively limited capex requirements due to its capital light business model. During FY15, YOW put in place software to assist in the global management of transportation, stock management, materials planning, procurement, accounting, customer data capture/management and manufacturing processes. Over the next few years, we expect the company will spend capex on a US office fit out, a front end frozen cone line and a bigger wrapper.

Dividend policy

Given the company is currently unprofitable, YOW does not have a formal dividend policy. At this point, we have not assumed that YOW pays any dividends.

Capital structure

To date, YOW has raised the following funds:

Figure 23: YOW equity raisings (A$m)

Date	Amount	Type	Price	Notes
Nov-12	$2.75m	Prospectus Offer	20c	Completed back-door listing into GSF
Mar-13	$0.52m	Placement	13c	Strategic to Daleford Way Pty Ltd (Bob Watson, ex-Chairman of SEEK)
Jun-13	$1.7m	Prospectus Offer	15c	Offer to raise maximum of $5m
Nov-13	$3.56m	Prospectus Offer	17c	Offer to raise maximum of $5m
Mar-14	$9.1m	Placement	70c	Funds raised for working capital and operational flexibility
Jan-15	$10.0m	Placement	50c	Capital raising to rollout Yowie in the US
TOTAL	**$27.63m**			

SOURCES: MORGANS, COMPANY REPORTS

Ordinary Shares:	159.1m
Listed Options (YOWO.ASX):	11.9m (A$0.20, 15 December 2015)
Unlisted Options:	12.9m (A$0.285 - A$1.25, 31 December 2017)
Fully diluted capital:	183.9m

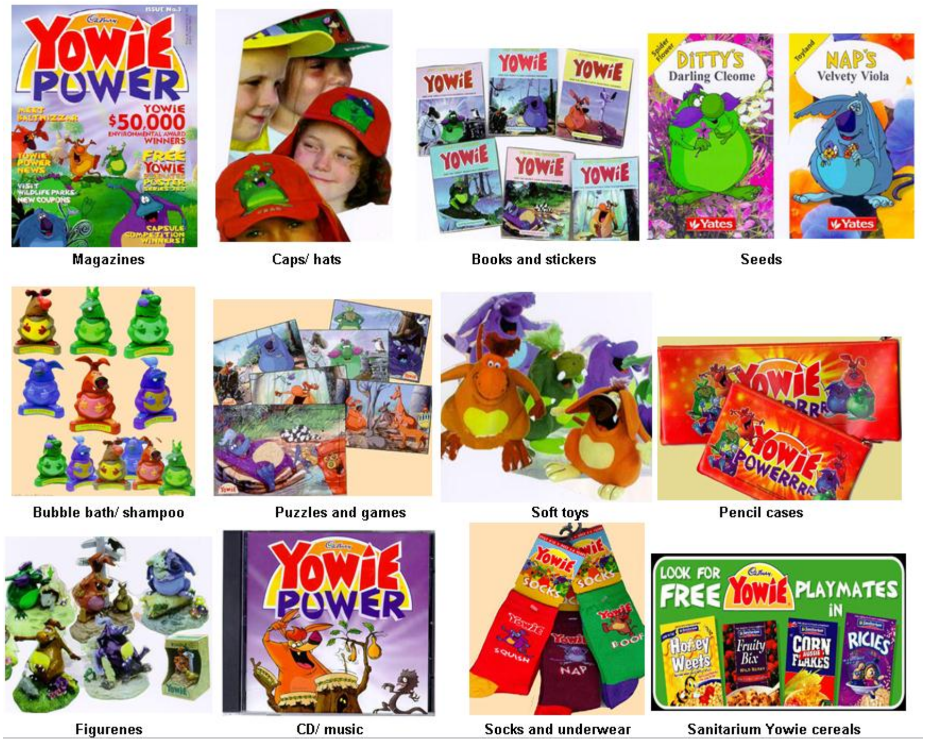
Appendix

Figure 24: Top 100 US retailers (2014)

Rank	Company	Headquarters	2014 US Retail Sales	2014 Global Retail Sales	US % of Global Sales	2014 Global Stores
1	Wal-Mart Stores	Bentonville, Ark.	US$343,624m	US$508,465m	67.60%	5,109
2	The Kroger Co.	Cincinnati, Ohio	US$103,033m	US$103,033m	100.00%	3,730
3	Costco	Issaquah, Wash.	US$79,694m	US$111,530m	71.50%	464
4	The Home Depot	Atlanta	US$74,203m	US$83,195m	89.20%	1,965
5	Walgreen	Deerfield, Ill.	US$72,671m	US$75,085m	96.80%	8,157
6	Target	Minneapolis	US$72,618m	US$74,564m	97.40%	1,790
7	CVS Caremark	Woonsocket, R.I.	US$67,974m	US$69,132m	98.30%	7,808
8	Lowe's Companies	Mooresville, N.C.	US$54,805m	US$56,203m	97.50%	1,793
9	Amazon.com	Seattle	US$49,353m	US$83,391m	59.20%	N/A
10	Safeway	Pleasanton, Calif.	US$36,330m	US$36,330m	100.00%	1,326
11	Best Buy	Richfield, Minn.	US$35,957m	US$42,437m	84.70%	1,445
12	McDonald's	Oak Brook, Ill.	US$35,447m	US$87,786m	40.40%	14,350
13	Publix Super Markets	Lakeland, Fla.	US$30,560m	US$30,560m	100.00%	1,296
14	Apple Store / iTunes	Cupertino, Calif.	US$28,380m	US$32,879m	86.30%	259
15	Macy's	Cincinnati, Ohio	US$28,027m	US$28,105m	99.70%	821
16	Rite Aid	Camp Hill, Pa.	US$26,528m	US$26,528m	100.00%	4,570
17	Royal Ahold / Ahold USA	Carlisle, Pa.	US$25,976m	US$44,121m	58.90%	768
18	Sears Holdings	Hoffman Estates, Ill.	US$25,763m	US$26,792m	96.20%	1,659
19	TJX	Framingham, Mass.	US$22,206m	US$29,061m	76.40%	2,569
20	H-E-B Grocery	San Antonio, Texas	US$19,819m	US$21,166m	93.60%	317
21	YUM! Brands	Louisville, Ky.	US$19,727m	US$31,051m	63.50%	17,326
22	Albertsons	Boise, Idaho	US$19,458m	US$19,458m	100.00%	1,108
23	Kohl's	Menomonee Falls, Wis.	US$19,023m	US$19,023m	100.00%	1,162
24	Dollar General	Goodlettsville, Tenn.	US$18,910m	US$18,910m	100.00%	11,789
25	Delhaize America	Salisbury, N.C.	US$17,069m	US$28,417m	60.10%	1,361
26	Meijer	Grand Rapids, Mich.	US$15,689m	US$15,689m	100.00%	213
27	WakeFern / ShopRite	Keasbey, N.J.	US$14,985m	US$14,985m	100.00%	330
28	Ace Hardware	Oak Brook, Ill.	US$14,299m	US$14,345m	99.70%	4,251
29	BJ's Wholesale Club	Westborough, Mass.	US$13,811m	US$13,811m	100.00%	210
30	Whole Foods Market	Austin, Texas	US$13,642m	US$14,060m	97.00%	381
31	Doctor's Assoc. / Subway	Milford, Conn.	US$13,389m	US$24,355m	55.00%	27,062
32	Nordstrom	Seattle	US$13,259m	US$13,280m	99.80%	283
33	Gap	San Francisco	US$13,071m	US$16,956m	77.10%	2,465
34	AT&T Wireless	Dallas	US$12,960m	US$12,960m	100.00%	2,156
35	J.C. Penney Co.	Plano, Texas	US$12,184m	US$12,257m	99.40%	1,063
36	Aldi	Batavia, Ill.	US$11,728m	US$53,522m	21.90%	1,376
37	Bed Bath & Beyond	Union, N.J.	US$11,708m	US$11,878m	98.60%	1,466
38	SUPERVALU	Eden Prairie, Minn.	US$11,499m	US$11,499m	100.00%	1,557
39	7-Eleven	Dallas	US$11,390m	US$88,025m	12.90%	8,154
40	Ross Stores	Pleasanton, Calif.	US$11,032m	US$11,042m	99.90%	1,361
41	Verizon Wireless	Basking Ridge, N.J.	US$10,959m	US$10,959m	100.00%	7,024
42	Starbucks	Seattle	US$10,604m	US$16,448m	64.50%	12,560
43	Family Dollar Stores	Matthews, N.C.	US$10,489m	US$10,489m	100.00%	8,042
44	Bi-Lo	Jacksonville, Fla.	US$10,362m	US$10,362m	100.00%	800
45	L Brands	Columbus, Ohio	US$10,303m	US$10,966m	94.00%	2,685
46	Menard	Eau Claire, Wis.	US$9,689m	US$9,689m	100.00%	287
47	Trader Joe's	Monrovia, Calif.	US$9,388m	US$37,606m	25.00%	447
48	Wendy's	Dublin, Ohio	US$8,886m	US$9,388m	94.70%	5,750
49	Burger King Worldwide	Miami	US$8,517m	US$17,110m	49.80%	7,128
50	Dollar Tree	Chesapeake, Va.	US$8,390m	US$8,596m	97.60%	5,157
51	Hy-Vee	West Des Moines, Iowa	US$7,895m	US$7,895m	100.00%	236
52	Army / Air Force	Dallas	US$7,738m	US$7,738m	100.00%	610
53	Dunkin' Brands Group	Canton, Mass.	US$7,720m	US$9,774m	79.00%	10,566
54	Health Mart Systems	Omaha, Neb.	US$7,623m	US$10,382m	73.40%	3,419
55	AutoZone	Memphis, Tenn.	US$7,523m	US$9,132m	82.40%	4,947
56	Toys "R" Us	Wayne, N.J.	US$7,450m	US$14,561m	51.20%	1,132
57	Wegmans Food Market	Rochester, N.Y.	US$7,405m	US$7,405m	100.00%	85
58	O'Reilly Automotive	Springfield, Mo.	US$7,216m	US$7,216m	100.00%	4,366
59	DineEquity	Glendale, Calif.	US$7,137m	US$7,589m	94.00%	3,449
60	Giant Eagle	O'Hara Township, Pa.	US$7,056m	US$7,056m	100.00%	429
61	Sherwin-Williams	Cleveland, Ohio	US$7,047m	US$7,360m	95.80%	3,764
62	Dick's Sporting Goods	Coraopolis, Pa.	US$6,811m	US$6,811m	100.00%	695
63	Staples	Framingham, Mass.	US$6,607m	US$9,573m	69.00%	1,364
64	Office Depot	Boca Raton, Fla.	US$6,587m	US$8,106m	81.30%	1,745
65	Dillard's	Little Rock, Ark.	US$6,490m	US$6,490m	100.00%	297
66	Good Neighbor Pharmacy	Chesterbrook, Pa.	US$6,414m	US$6,414m	100.00%	3,096
67	Darden Restaurants	Orlando, Fla.	US$6,259m	US$6,286m	99.60%	2,174
68	GameStop	Grapevine, Texas	US$6,225m	US$8,683m	71.70%	4,198
69	PetSmart	Phoenix	US$6,073m	US$6,897m	88.10%	1,291
70	QVC	West Chester, Pa.	US$5,972m	US$8,718m	68.50%	N/A
71	Chick-fil-A	Atlanta	US$5,936m	US$5,936m	100.00%	1,890
72	WinCo Foods	Boise, Idaho	US$5,872m	US$5,872m	100.00%	98
73	Tractor Supply Co.	Brentwood, Tenn.	US$5,820m	US$5,820m	100.00%	1,382
74	Barnes & Noble	New York	US$5,790m	US$5,790m	100.00%	1,364
75	A&P	Montvale, N.J.	US$5,630m	US$5,630m	100.00%	283
76	AVB Brandsource	Tustin, Calif.	US$5,268m	US$5,425m	97.10%	3,018
77	Signet Jewelers	Akron, Ohio	US$5,251m	US$6,312m	83.20%	2,868
78	Foot Locker	New York	US$5,239m	US$7,267m	72.10%	2,369
79	Big Lots	Columbus, Ohio	US$5,177m	US$5,177m	100.00%	1,460
80	Hudson's Bay	Ontario, Canada	US$5,174m	US$7,937m	65.20%	165
81	Alimentation Couche-Tard	Tempe, Ariz.	US$5,167m	US$8,983m	57.50%	4,044
82	Defense Commissary	Fort Lee, Va.	US$4,890m	US$4,890m	100.00%	179
83	Neiman Marcus	Dallas	US$4,823m	US$4,823m	100.00%	87
84	Jack in the Box	San Diego, Calif.	US$4,781m	US$4,781m	100.00%	2,888
85	Ascena Retail Group	Suffern, N.Y.	US$4,713m	US$4,850m	97.20%	3,834
86	Burlington Coat Factory	Burlington, N.J.	US$4,707m	US$4,761m	98.90%	530
87	Ikea North America	Conshohocken, Pa.	US$4,611m	US$38,437m	12.00%	40
88	Williams-Sonoma	San Francisco	US$4,591m	US$4,682m	98.10%	594
89	Save Mart Supermarkets	Modesto, Calif.	US$4,518m	US$4,518m	100.00%	217
90	Panera Bread Company	St. Louis, Mo.	US$4,487m	US$4,487m	100.00%	1,880
91	Advance Auto Parts	Roanoke, Va.	US$4,379m	US$4,406m	99.40%	4,098
92	Michaels Stores	Irving, Texas	US$4,277m	US$4,738m	90.30%	1,170
93	True Value Co.	Chicago	US$4,117m	US$3,891m	98.00%	4,602
94	Domino's Pizza	Ann Arbor, Mich.	US$4,116m	US$8,915m	46.20%	5,067
95	Belk	Charlotte, N.C.	US$4,110m	US$4,110m	100.00%	297
96	Chipotle Mexican Grill	Denver, Colo.	US$4,069m	US$4,108m	99.00%	1,766
97	Sonic	Oklahoma City, Okla.	US$4,033m	US$4,033m	100.00%	3,518
98	Stater Bros. Holdings	San Bernardino, Calif.	US$3,910m	US$3,910m	100.00%	167
99	Price Chopper	Schenectady, N.Y.	US$3,890m	US$3,890m	100.00%	135
100	Dell	Round Rock, Texas	US$3,868m	US$3,868m	100.00%	N/A

SOURCE: NATIONAL RETAIL FEDERATION

Figure 25: Yowie past licensing opportunities



SOURCE: YOWIE GROUP

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