Spec Sits Research

Yü Group Plc

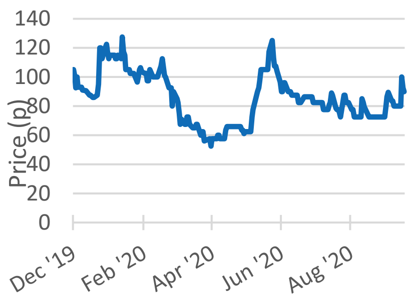
Time for a Closer Look

Non-Independent Research
MiFID II Exempt: Marketing Material
SP Angel acts as Nomad and Broker

October 5, 2020

Stock Data	
Ticker (AIM)	YU. LN
Share Price	90p
Market Cap	£14.7M
Yr High/Yr Low	142.50/52.50p
Target Price	207p
Rating	Buy

Price Chart



SOURCE: Bloomberg

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Yü Group Plc (YU. LN) listed on the AIM Exchange in London is a multi-utility provider to small and medium sized business, as well as larger corporate customers across the UK. As a direct supplier of electricity, gas, water and other solutions such as electric vehicle (EV) charge points, smart meter installations and green energy solutions, Yü Group (YUG) provides a simple approach to a business's energy management, offering competitive fixed-price, bundled utility plans. The certainty of utility costs supported by a strong commitment to customer service and product innovation is rapidly solidifying YUG as a trusted supplier in the £35b UK B2B utility market.

Event: Following the release of H120 financial results, we are issuing forecasts for YUG.

Forecast Assumptions:

- **Average Monthly Bookings:** For H220E, we expect average monthly billings to reach ~£7.0m, increasing to ~£8.0m during H121E and to about £9.0m per month by the end of next year. Of that, we expect that off-contract revenue is <5% of contracted revenue, and other revenue related to innovative products and services, and gross margin life-cycle initiatives is ~1% of contracted revenue.
- **Net Customer Contribution (NCC):** With a focused management team and Board oversight, we expect this trend of improvement to continue. While conservative estimates are currently in place for bad debt provisions at ~3% each year, we forecast NCC to increase to 4% and 5% in 2020E and 2021E.
- **General overheads:** We expect general overheads to trend down as a percent of revenue over time, as a large proportion of these costs are fixed. However, YUG is continuing to invest in its sales and marketing over the short-term, negatively impacting profits today for longer-term gains. F2020E general overheads are forecast at ~7.6% of revenue, declining to ~6% in 2021E.
- **Contracted Revenue:** The contracted revenue at the end of F2020 will be impacted by COVID-19 recovery, any organic growth that has been achieved through F2020 (both contracted and other revenue), as well as from acquisition growth. Our estimates include contracted revenue of around £100m for F2021E, and increasing annually thereafter.

We expect revenue of ~£92m in 2020E, followed by £115.8m in 2021E. This results in EBITDA losses of £2.8m in 2020E and £0.87 in 2021E, though the Company achieves break-even later in 2021E and in 2022E. Losses for the year 2020E are £0.17/shr and 2021E losses are £0.07/shr, turning positive in 2022E. Operating cash flow generation is positive starting in 2021E, and increasing thereafter.

Valuation: We are currently using a DCF valuation in order to determine a starting target price for the Company. In this calculation, we believe we are using conservative assumptions (WACC 13.5%; TG 2.5%), in part due to the continued impact of COVID in the market. The result is an equity value of ~£35m, translating to a share value of 207p, ~130% higher than the current share price. With this type of potential return, the stock overwhelmingly fits into our Buy rating category.

Outlook: We really want to underscore that these are conservative estimates. While there remain risks in the market and some specific to the Company, what we're seeing at the moment is significant strength - the revamped management and Board know and understand their business well; they clearly understand the complexities of the market in which they operate and they have restructured their operating platform to enable high quality customer acquisition that will drive growth in profitability and cash flow. The acquisition and integration of the Bristol Energy contract book is a good example of the effectiveness of the team – a very smooth transition of a customer book that was ~41% of their existing business. That is an achievement, and we expect to see more such acquisitions in the near-term with the same efficiency of integration. We believe it is worthwhile for investors to take a fresh look at YUG and evaluate the potential for growth as it challenges the incumbent energy providers with innovative products and very high levels of customer service. There are few others in the market, with the same prospects for capturing market share away from the incumbents.

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Forecasts: Assumptions and Estimates

Following the release of the H120 financial results, we are issuing financial forecasts for YUG for 2020E and 2021E. The management and Board are comfortable that it has the required risk controls in place to manage any additional impacts related to COVID. The restructuring and strategic overhaul completed in 2018/19 have been critical to the strength of the Company through this uncertain period. While the spread of the virus continues and government measures to reduce the spread are increasing, there may be reduced energy demand in H220E and 2021E. However, the hedging policy is being actively monitored and is unlikely to result in significant mark to market losses. We believe we have accounted for this additional risk in our forecasts at this time.

According to management, the balance of the year is expected to show improvement over the first half, assuming that the brakes are not put on the economy again because of a COVID lockdown.

- Monthly bookings are expected to be well ahead of H120, with revenues trending in the same direction.
- Customer meter points are expected to reach about 17,000 by year-end 2020E, representing organic growth of about 3,000 meters by year-end.
- 2020E revenue is unlikely to exceed full year 2019 revenue. Improvements are driven by a recovery in customer demand, increased organic growth, and the acquisition and integration of the Bristol Energy B2B customer book.
- Operating cash flow for the full year 2020 is expected to be positive and greater than Adjusted EBITDA.
- Cash holdings are expected to be above that of December 2019 of £2.4m.

The Board anticipates a return to more scalable growth in 2021E and beyond achieving break-even towards the end of that year. The Bristol Energy book is expected to contribute a total of ~£10m through the end of 2021E (over the next 16 months), with mid-single digit contribution to margin and EBITDA. As the customer book continues to increase the economies of scale will become more evident, driving Adjusted EBITDA and net customer contribution to higher levels, particularly as a large component of general overheads are fixed. The expiry of legacy contracts signed in 2018 also results in a customer book with a significantly better quality of earnings for the Company, ensuring coverage of core costs throughout the term.

Key Forecast Drivers

The primary assumptions used to build our forecasts are based on the key performance indicators that the Company monitors in order to drive profitability of the business over the longer term.

- **Contracted Revenue:** This represents revenue that is expected to be generated from signed customer contracts over the subsequent 12-month period. As at August 31, 2020 the 2021E contracted revenue book stood at £71.7m, including the recently acquired Bristol Energy contracts. This is still expected to increase for the year as new bookings are added monthly. At year-end 2019, there was £80m expected for contracted revenue during the F2020 period, down 10% y/y from that contracted at the end of F2018. During regular market environments this metric can vary by up to +/-10%. The contracted revenue at the end of 2020E will be impacted by COVID-19 recovery, any organic growth that has been achieved through F2020 (both contracted and other revenue), as well as from acquisition growth. Our estimates include contracted revenue of around £100m for 2021E, and increasing annually thereafter.

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- **Average Monthly Bookings** – This is the annualised value of contracts secured during a period. The monthly average bookings during H120 reached £6.2m, +17% over H219 monthly average bookings of £5.3m and nearly double that of H119 of £3.2m. Now that improvements have been made to the sales and marketing operating platform the team has returned to focus on driving growth through increased customer contracts each month. Recall that this metric includes all energy that must be delivered under contract for the month. As new contracts are added and as renewal rates for expiring contracts increase, we expect average monthly bookings to increase over time. Note that this is not the only revenue line for YUG, noting that there are some customers who prefer to remain off contract (typically at higher price points), and there are some additional products provided by YUG that also generate revenue.

  For H220E, we expect average monthly billings to reach ~£7.0m, increasing to ~£8.0m during H121E and to about £9.0m per month by the end of next year. Of that, we expect that off-contract revenue is <5% of contracted revenue, and other revenue related to innovative products and services is ~1% of contracted revenue.

- **General Overheads (%)**: The percentage of revenue that is charged to adjusted EBITDA on a normalised, recurring basis is included in this metric. This excludes exceptional/one-time items, as well as non-cash items and any bad debt write-downs (which are included in NCC). General overheads for H120 were 6.3%, in line with F2019 (F2018: 7.4% and F2017: 9.1%). In order to drive growth, YUG is investing in sales and marketing, which is currently sized to handle the current growth plans. Sales and marketing represent about a third of the overheads spent, with the balance split between the cost to serve customers and general admin costs which are typically fixed costs. We expect general overheads to trend down as a percent of revenue over time despite continued investment in sales and marketing, as the balance of overhead costs are largely fixed. F2020E general overheads are forecast at ~7.6% of revenue, declining to ~6% in 2021E.

- **Net Customer Contribution (NCC):** This is a newer KPI which measures the profit contribution from customer contracts in terms of gross margin, less bad debt and expected credit losses charged in overhead expenses. NCC for H120 was 2.2%, up 0.8% over H119 at 1.4%, despite a £1.6m negative impact from COVID. NCC would have been 4.9% excluding the charge and revenue impact related to COVID. Enhancing the life cycle value of customers, improvements to the credit control cycle and the expiry of low margin legacy contracts are contributing to continuous improvements across the business. With a focused management team and Board oversight, we expect this trend of improvement to continue. While conservative estimates are currently in place for bad debt provisions at 2.5-3% each year, we forecast NCC to increase to 4% and 5% in 2020E and 2021E.

- **Receivables:** Overdue receivables from customers, net of provisions, beyond the standard one-month billing cycle is an indicator of risks to the income statement. A target of ten days, the industry benchmark, has been set as a maximum goal for overdue receivables. In F2019 there was a two-day improvement to 7 days over F2018, and a 7-day improvement over F2017. H120 receivables was ~7 days, supported by very strong cash conversion levels for the period. Our forecasts maintain receivable days outstanding about 7 days.

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Forecasts

Table 1 depicts the results of our analysis. We expect revenue of ~£92m in 2020E, followed by £115.8m in 2021E. This results in EBITDA losses in each year of £2.8m in 2020E and £0.87 in 2021E, though the Company achieves break-even during H121E and 2022E. Losses for the year 2020E are £0.17/shr and 2021E are £0.07/shr, turning positive in 2022E.

TABLE 1: Financial Forecasts

Income Statement YE Dec (£000s)	H120	H220E	2018A	2019A	2020E	2021E	2022E
Revenue	45,873.00	46,174.95	80,635.00	111,613.00	92,047.95	115,822.74	149,436.01
Cost of sales	(43,246.00)	(42,818.83)	(77,387.00)	(106,128.00)	(86,064.83)	(107,136.04)	(137,854.72)
Gross Profit	**2,627.00**	**3,356.12**	**3,248.00**	**5,485.00**	**5,983.12**	**8,686.71**	**11,581.29**
			4.03%	4.91%	6.50%	7.50%	7.75%
Operating costs before exceptionals and IFRS 2	(4,660.00)	(4,641.20)	(11,963.00)	(10,362.00)	(9,301.20)	(9,895.57)	(10,735.90)
Operating costs- non-recurring items	-	-	(441.00)	(378.00)	-	-	-
Operating costs- unrealised losses on derivative contracts	137.00	-	(125.00)	(518.00)	137.00	-	-
Operating costs - exceptional IPO costs	-	-	-	-	-	-	-
Operating Costs - IFRS 2 share option charge	(166.00)	(155.00)	(314.00)	(125.00)	(321.00)	(100.00)	(100.00)
Total operating costs	**(4,689.00)**	**(4,796.20)**	**(12,843.00)**	**(11,383.00)**	**(9,485.20)**	**(9,995.57)**	**(10,835.90)**
NCC				2.15%	4.00%	5.00%	5.25%
Profit/(Loss) from operations	**(2,062.00)**	**(1,440.08)**	**(9,595.00)**	**(5,898.00)**	**(3,502.08)**	**(1,308.86)**	**745.39**
Non-recurring operational costs	-	-	441.00	378.00	-	-	-
Non-recurring mutualisation costs	-	-	-	236.00	-	-	-
Impact of first-time adoption of IFRS 9	-	-	1,768.00	-	-	-	-
Unrealised loss on derivative contracts	-	-	125.00	518.00	-	-	-
Equity-settled share based payment charge	166.00	155.00	685.00	125.00	321.00	100.00	100.00
Depreciation of property plant and equipment	186.00	150.00	291.00	397.00	336.00	336.00	336.00
Amortisation of intangibles	1.00	1.00	2.00	2.00	2.00	2.00	2.00
Adjusted EBITDA	**(1,709.00)**	**(1,134.08)**	**(6,283.00)**	**(4,242.00)**	**(2,843.08)**	**(870.86)**	**1,183.39**
Finance Income	7.00	7.00	21.00	33.00	14.00	14.00	14.00
Finance costs	(31.00)	(31.00)	(63.00)	(112.00)	(62.00)	(97.50)	(97.50)
Profit/(Loss) before tax	**(2,086.00)**	**(1,464.08)**	**(9,637.00)**	**(5,977.00)**	**(3,550.08)**	**(1,392.36)**	**661.89**
Taxation	375.00	375.00	3,370.00	1,009.00	750.00	264.55	-
Profit/(Loss) after tax	**(1,711.00)**	**(1,089.08)**	**(6,267.00)**	**(4,968.00)**	**(2,800.08)**	**(1,127.81)**	**661.89**
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income/(Expense) for the year	(1,711.00)	(1,089.08)	(6,267.00)	(4,968.00)	(2,800.08)	(1,127.81)	661.89
Non-recurring items after tax	-	-	357.00	497.00	-	-	-
Unrealised loss on derivative contracts after tax	-	-	101.00	420.00	-	-	-
Share based payments after tax	-	-	254.00	101.00	-	-	-
Adjusted basic loss for the year	**(1,711.00)**	**(1,089.08)**	**(5,555.00)**	**(3,950.00)**	**(2,800.08)**	**(1,127.81)**	**661.89**
Earnings/(Loss) per share (GBp)							
Basic	(0.11)	(0.07)	(0.42)	(0.31)	(0.17)	(0.07)	0.04
Adjusted Basic	(0.11)	(0.07)	(0.37)	(0.24)	(0.17)	(0.07)	0.04
Diluted	(0.10)	(0.06)	(0.40)	(0.29)	(0.16)	(0.07)	0.04
Weighted Average Shares	16,267.56	16,267.56	14,054.06	16,267.56	16,267.56	16,267.56	16,267.56
Effect of shares issued in the year	11.13	-	787.37	11.13	-	-	-
Ordinary shares for basic earnings calculation	**16,278.69**	**16,267.56**	**14,841.43**	**16,278.69**	**16,267.56**	**16,267.56**	**16,267.56**
Dilutive effect of outstanding options	786.55	786.55	768.03	786.55	786.55	786.55	786.55
Ordinary shares for diluted earnings calculation	**17,065.24**	**17,054.10**	**15,609.45**	**17,065.24**	**17,054.10**	**17,054.10**	**17,054.10**
Dividend/share	-	-	0.03	-	-	-	-
Note: Restated values for 2018							

SOURCE: Company reports and SP Angel forecasts

Cash generation from operations is expected to be positive each year going forward. The recovery of the collateral deposit from trading activities has largely been recovered during H120 (~£9.3m), with a small amount still to recover during H220E. Even though there have been some increased costs associated with the network operators and generators that have been passed through to the suppliers, and the renewable obligation payment was made in August, cash balances are still expected to be higher at year-end 2020E - ~£6.6m. This leaves the Company in a solid position going into 2021E, particularly since receivables collections have been much better than expected through this COVID period (billing to cash conversion for H120 noted to be 99.5%). Despite this, the bad debt provision assumption has been kept at 4-5% for the year, well above a more normal run rate of 2-3% - again a relatively conservative view.

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Valuation

We are currently using a discounted cash flow valuation in order to determine a starting target price for the Company. In this calculation, we believe we are using conservative assumptions, in part due to the continued impact of COVID in the market. Our baseline assumptions for the DCF valuation are as follows:

- The risk-free rate in the UK is ~3%
- Long-term growth rate estimated by the rate of inflation is ~1-1.5% plus 1%
- YUG beta according to Bloomberg is 1.25 against the LSE AIM 100 Index
- The market return for the UK is around 10-12%

The result is an equity value of ~£35m, translating to a share value of 207p, ~130% higher than the current share price. With this type of potential return, the stock overwhelmingly fits into our Buy category. The thing is, these are conservative estimates, and while there remain risks in the market and some specific to the Company, what we're seeing in this company at the moment is strength in relative market position. The revamped management and Board know and understand their business well; they clearly understand the complexities of the market in which they operate and they have restructured their operating platform to acquire high quality customers that will drive long term growth. The acquisition and integration of the Bristol Energy contract book is a good example of the effectiveness of the team – a very smooth transition of a customer book that was ~41% of their existing business. That is an achievement, and we expect to see more such acquisitions in the near-term with the same efficiency of integration.

We believe it is worthwhile for investors to take a fresh look at YUG and evaluate the potential for growth as it attempts to challenge the incumbent energy providers with innovative products and very high levels of customer service. As we pointed out in the research initiation, Opus Energy successfully built a very similar operating model, organically growing its customer base from a few thousand meter points to a few hundred thousand, at which time it was acquired for about 10.9x EBITDA. There are few others in the market at the moment, with the same prospects for capturing market share away from the incumbents.

TABLE 2: Discounted Cash Flow

YE Mar (£m)			2020	2021	2022	2023	2024	2025
WACC			13.5%	13.5%	13.5%	13.5%	13.5%	13.5%
Time (yrs)	4/10/20		0.24	1.24	2.24	3.24	4.24	5.24
Revenue			92,048.0	115,822.7	149,436.0	162,023.7	175,522.5	195,235.9
Growth				*25.8%*	*29.0%*	*8.4%*	*8.3%*	*11.2%*
FCF			5,923.5	106.9	406.8	1,401.9	2,893.2	3,745.9
Discount factor			0.97	0.85	0.75	0.66	0.58	0.51
DCF			5,745.4	91.3	306.3	930.0	1,691.0	1,929.0
EV/EBITDA (x)			**(12.4)**	**(40.5)**	**29.8**	**17.6**	**11.1**	**9.2**
EBITDA			(2843.1)	(870.9)	1183.4	1999.3	3180.5	3814.1
Terminal value	17,974.3							
Net cash / (debt)	6,611.5							
PV of equity £'000	35,278.8							
Price per share (p)	**206.9**	***+ 129.8%***						
Current price (p)	**90.0**							

SOURCE: Company reports and SP Angel forecasts

FINANCIAL SUMMARY

Financials (£000)	H1 2019	H2 2019	H1 2020	H2 2020E	2016	2017	2018	2019	2020E	2021E	2022E
Revenue	56,561.0	55,052.0	45,873.0	46,175.0	16,264.0	45,631.0	80,635.0	111,613.0	92,048.0	115,822.7	149,436.0
Gross Margin (%)	3.2%	6.7%	5.7%	7.3%	21.2%	14.9%	4.0%	4.9%	6.5%	7.5%	7.8%
Operating Income	(3,248.0)	(2,650.0)	(2,062.0)	(1,440.1)	(1,518.0)	784.0	(9,595.0)	(5,898.0)	(3,502.1)	(1,308.9)	745.4
Operating Margin (%)	-5.7%	-4.8%	-4.5%	-3.1%	-9.3%	1.7%	-11.9%	-5.3%	-3.8%	-1.1%	0.5%
Adjusted EBITDA	(2,674.0)	(1,568.0)	(1,709.0)	(1,134.1)	(1,518.0)	1,537.0	(6,283.0)	(4,242.0)	(2,843.1)	(870.9)	1,183.4
Net Income	(2,716.0)	(2,252.0)	(1,711.0)	(1,089.1)	(1,359.0)	711.0	(6,267.0)	(4,968.0)	(2,800.1)	(1,127.8)	661.9
Earnings per Share (£) basic	(0.1669)	(0.1383)	(0.1051)	(0.0669)	(0.1029)	0.0506	(0.4223)	(0.3)	(0.1721)	(0.0693)	0.0407
Adjusted Net Income	(2,411.0)	(1,539.0)	(1,711.0)	(1,089.1)	136.0	1,413.0	(5,555.0)	(3,950.0)	(2,800.1)	(1,127.8)	661.9
Adj. EPS (£) basic	(0.1481)	(0.0945)	(0.1051)	(0.0669)	0.0103	0.1005	(0.3743)	(0.2426)	(0.1721)	(0.0693)	0.0407
Basic Shares (000s)	16,276.3	16,278.7	16,278.7	16,267.6	13,212.2	14,054.1	14,841.4	16,278.7	16,267.6	16,267.6	16,267.6
Net Cash in/(Out)-flow	2,809.0	(15,044.0)	15,509.0	(11,274.5)	5,150.0	(1,822.0)	9,725.0	(12,235.0)	4,234.5	1,318.4	454.9
Debt	-	-	-	-	-	-	-	-	-	(1,476.0)	(1,313.5)

Growth Rates (%)	H1 2019	H2 2019	H1 2020	H2 2020E		2017	2018	2019	2020E	2021E	2022E
Revenue			-18.9%	-16.1%		180.6%	76.7%	38.4%	-17.5%	25.8%	29.0%
EBITDA			36.1%	27.7%		201.3%	-508.8%	32.5%	33.0%	69.4%	235.9%
Net Income			37.0%	51.6%		152.3%	-981.4%	20.7%	43.6%	59.7%	158.7%
Adjusted Net Income			-29.0%	-29.2%		939.0%	-493.1%	28.9%	29.1%	59.7%	158.7%

Financial Health	H1 2019	H2 2019	H1 2020	H2 2020E	2016	2017	2018	2019	2020E	2021E	2022E
Working Capital (£000)	2,967.00	187.00	(2,498.00)	(7,132.08)	4,748.00	7,021.00	6,664.00	187.00	(7,132.08)	(6,726.90)	(5,780.25)
Current Ratio	(1.10)	(1.01)	(0.92)	(0.70)	(1.89)	(1.65)	(1.31)	(1.01)	(0.7)	(0.7)	(0.8)
Long-term Debt (£m)	-	-	-	-	-	-	-	-	-	(1,476)	(1,314)
Total Equity (£m)	7.35	5.30	3.75	2.82	5.41	8.81	10.44	5.30	2.8	1.8	2.6
LT Debt/Assets	-	-	-	-	-	-	-	-	-	(0.05)	(0.05)
LT Debt/Equity	-	-	-	-	-	-	-	-	-	0.05	0.05

Financial Position (£000)	H1 2019	H2 2019	H1 2020	H2 2020E	2016	2017	2018	2019	2020E	2021E	2022E
Cash	17,421.0	2,377.0	17,886.0	6,611.5	5,197.0	4,887.0	14,612.0	2,377.0	6,611.5	7,929.9	8,384.8
Inventory	-	-	-	-	-	-	-	-	-	-	-
Debtors	16,139.0	25,886.0	10,985.0	10,430.3	4,891.0	13,011.0	13,569.0	25,886.0	10,430.3	10,142.6	10,272.0
Creditors	(30,593.0)	(28,076.0)	(31,369.0)	(24,173.9)	(5,340.0)	(10,877.0)	(21,517.0)	(28,076.0)	(24,173.9)	(24,799.4)	(24,437.1)
Total Assets	38,405.0	33,822.0	35,496.0	27,316.8	10,821.0	20,061.0	31,955.0	33,822.0	27,316.8	28,390.5	28,627.6
Total Liabilities	(31,059.0)	(28,524.0)	(31,743.0)	(24,497.9)	(5,412.0)	(11,248.0)	(21,517.0)	(28,524.0)	(24,497.9)	(26,599.4)	(26,074.6)
Total Equity	7,346.0	5,298.0	3,753.0	2,818.9	5,409.0	8,813.0	10,438.0	5,298.0	2,818.9	1,791.1	2,553.0

Profitability	H1 2019	H2 2019	H1 2020	H2 2020E	2016	2017	2018	2019	2020E	2021E	2022E
ROE	-37.0%	-42.5%	-45.6%	-38.6%	-25.1%	8.1%	-60.0%	-93.8%	-99.3%	-63.0%	25.9%
ROA	-7.1%	-6.7%	-4.8%	-4.0%	-12.6%	3.5%	-19.6%	-14.7%	-10.3%	-4.0%	2.3%

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