# Spec Sits Research

# Yü Group Plc

# Outlook Remains Strong

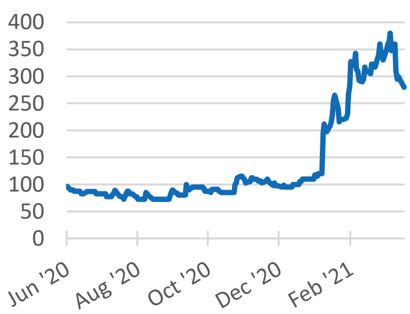
Non-Independent Research
MiFID II Exempt: Marketing Material
SP Angel acts as Nomad and Broker

7 April 2021

## Stock Data

| | |
|---|---|
| Ticker (AIM) | YU. LN |
| Share Price | 280p |
| Market Cap | £45.6M |
| EV | £34.2M |
| Yr High/Yr Low | 380/52.50p |
| **PRICE TARGET** | **500p** |
| **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 the 2020 financials that were ahead of expectations, we are upwardly revising our forecasts. Our Price Target increases to 500p which overwhelmingly translates to a Buy rating.

**Forecast Assumptions:**

- **Average Monthly Bookings:** For 2021E, we expect average monthly bookings to increase from £10.3m to around £11m by the end of the year. 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. With higher commodity prices in recent weeks, we anticipate that many customers are choosing to be on fixed contract pricing terms, so off-contract revenue is likely lower than last year. Though we do expect higher volume usage this year.
- **Net Customer Contribution (NCC):** While we are still cautious on the COVID recovery expectations post lockdown, keeping bad debt provisions at 2-3% each year, we forecast NCC to increase to reach 6.5% and 7.4% in 2021E and 2022E.
- **General overheads:** Recall that general overheads for 2020 were down slightly to 6.2% with costs split equally between cost to acquire, costs to serve and general and admin. For 2021E and 2022E we forecast general overheads at 6.1% and 5.8% respectively. 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. The investment in digital tools in 2021E is expected to help drive costs much lower in 2022E+.
- **Contracted Revenue:** As at 31 December 2020 the 2021E contracted revenue book stood at £93m (up from £71.7m at the end of August 2020). This is still expected to increase for the year as new bookings are added monthly

We expect revenue of £128.4m for 2021E, increasing to £159.9m in F2022E. This results in positive adjusted EBITDA of £0.45m in 2021E and £2.55m in 2022E. Net profits for the year 2021E are £0.05m or £0.00/shr and 2022E are £2.15m or £0.13/shr. With positive net profits and continued careful management of cash we expect cash flow generation to increase in the coming years.

Our previous estimates for 2021E included revenue of £116.9m and adj. EBITDA losses of £0.7m; for 2022E included revenue of £150.1m and adj. EBITDA of £1.2m.

**Valuation:** We are currently using a DCF valuation to derive a price target for YUG. In this calculation, we remain somewhat conservative as the country comes out of lockdown with post-COVID impacts still relatively unknown. The result is an equity value of ~£81m, translating to a share value of 500p, ~78% higher than the current share price. With this type of potential return, the stock warrants a Buy rating.

**Outlook**

The 2020 full year results demonstrate the successful reorganisation of the Group operations by management. The KPI improvements and overall financial performance of the past year highlight the strength of the foundation that has been built and sets the stage for the next steps in the execution of the corporate strategy. Management can now turn to scaling the core business, by leveraging the strong foundation in place to accelerate organic and acquisition growth. We believe there remains significant upside in the stock for investors as the Group challenges the incumbent energy providers with innovative products and very high levels of customer service.

## Forecasts: Assumptions and Estimates

Following the release of the 2020 financial results, we are revising our financial forecasts for YUG for 2020E and 2021E upward. The better than expected performance in H220 provides confidence in the strong foundation that has been established, particularly as commodity prices were increasing, and the third lockdown was imposed closing most businesses across the UK. The focus on quality first in acquiring new customers under strict take-on guidelines, combined with a commitment to superior customer service and the launch of new digital tools to assist with sales and marketing have been key drivers of this turnaround. The management and Board are comfortable that it has the required risk controls in place to manage any additional impacts related to COVID and to appropriately address any market shocks in the future. The hedging policy for commodity supply is being actively monitored such that any mark to market losses are mitigated as much as possible.

Management is now turning to scaling of its business model, leveraging from the solid momentum that has been established in H220 to increase profitability and capture market share in the expansive energy supply market for SMEs.

- Monthly bookings are expected to be well ahead of 2020, with revenues trending in the same direction. The target for renewal rates has been set to no lower than 70% for 2021.
- Customer volume usage which has recovered to over 90% of pre-COVID levels. We anticipate that as businesses reopen across the country, volumes will continue to rebound and stabilise.
- Net Customer Contribution which measures the normalised profit contribution as a percentage of revenue has a target of 7% or more for 2021.
- Efficiencies from scaling the business which operates on fixed general admin costs are expected to become more visible in 2021E+, particularly with low costs of customer acquisition from the digitised take-on platform. As such, general overheads are expected to be lower than the 6.2% reported in 2020.
- Adjusted EBITDA and net profit are expected to be positive for the full year 2021.

Growth targets will be supported by additional investment in the sales and marketing platform with enhanced digital tools to improve client take-on, customer service, and collections processes. A key priority for the year is to step-up growth in the customer book through accretive acquisitions – though we do not include acquisitions in our forecasts. We expect that after a challenging 2020 and some post COVID effects, there are likely to be additional customer books that become available for sale. As demonstrated in the past, YUG is well positioned to acquire and integrate such books in an efficient manner for the Group and for the customers.

## Key Forecast Drivers

The primary assumptions used to build our forecasts are based on the key performance indicators that the Group 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 31 December 2020 the 2021E contracted revenue book stood at £93m (up from £71.7m at the end of August 2020). This is still expected to increase for the year as new bookings are added monthly. During regular market environments this metric can vary by up to +/-10%. The contracted revenue at the end of 2021E will be impacted by COVID-19 recovery, any organic growth and stepped-up with any acquisition growth.

  Our estimates translate to total revenue of £128.4m for 2021E, increasing to £159.9m in F2022E. Recall that 2020 contracted revenue was £80m at the start of the year, and revenue in a COVID environment was still nearly 30% higher at year-end.

- **Average Monthly Bookings** – This is the annualised value of contracts secured during a period. The monthly average bookings during 2020 reached £8.3m. While new bookings in H120 reached £6.2m, H220 averaged £10.3m reaching a new high. 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. As new contracts are added and as renewal rates for expiring contracts increase, we expect average monthly bookings to increase over time. Note 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 2021E, we expect average monthly bookings to increase from £10.3m to around £11m by the end of the year. 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. With higher commodity prices in recent weeks, we anticipate that many customers are choosing to be on fixed contract pricing terms, so off-contract revenue is likely lower than last year.

- **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). 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. 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. Recall that general overheads for 2020 were down slightly to 6.2% with costs split equally between cost to acquire, costs to serve and general and admin. For 2021E and 2022E we forecast general overheads at 6.1% and 5.8%. The investment in digital tools for sales and marketing expected to be made in 2021, should help to reduce general overheads further in 2022+.

- **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 2020 was 6.1%, up ~3.6% y/y, on a pre-COVID basis but also including a bad debt charge of 3.1%. NCC for H220 was higher at 6.3%, representing a commitment to maintaining quality of contracts. Enhancing the life cycle value of customers, improvements to the credit control cycle and the commitment to quality contracts are contributing to continuous improvements across the business. While we are still cautious on the COVID recovery expectations post lockdown, keeping bad debt provisions at 2-3% each year, we forecast NCC to increase to reach 6.5% in 2021E (below management's target of 7%) and to 7.4% in 2022E.

- **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 2020 this KPI remained within management's target at 8 days. Our forecasts maintain receivable days outstanding about 7-8 days. Cash conversion levels have remained strong through the COVID lockdowns of 2020/21 and we continue to remain cautious with a conservative bad debt provision for 2021E of ~3%, decreasing to ~2% in 2022E.

## Forecasts

Table 1 depicts the results of our analysis. We now expect revenue of ~£128.4m in 2021E, followed by £159.9m in 2022E. This results in positive adjusted EBITDA in each year of £0.45m in 2021E and £2.55m in 2022E. Net profits for the year 2021E are £0.05m or £0.00/shr and 2022E are £2.15m or £0.13/shr.

Our previous estimates for 2021E included revenue of £116.9m, adj. EBITDA losses of £0.7m and net losses of £1.0m of £(0.06)/shr; for 2022E included revenue of £150.1m, adj. EBITDA of £1.2m, and net profits of £0.7m or £0.04/shr.

### TABLE 1: Financial Forecasts

| Income Statement<br>YE Dec (£000s) | 2018A | 2019A | 2020A | 2021E | 2022E |
|---|---|---|---|---|---|
| Revenue | 80,635.00 | 111,613.00 | 101,527.00 | 128,397.09 | 159,852.10 |
| Cost of sales | (77,387.00) | (106,128.00) | (93,858.00) | (116,584.56) | (144,826.01) |
| **Gross Profit** | **3,248.00** | **5,485.00** | **7,669.00** | **11,812.53** | **15,026.10** |
| | 4.03% | 4.91% | 7.55% | 9.20% | 9.40% |
| **Total operating costs** | **(12,843.00)** | **(11,383.00)** | **(9,243.00)** | **(11,840.14)** | **(12,945.46)** |
| NCC | | 2.48% | 6.09% | 6.45% | 7.40% |
| | | | | | |
| **Profit/(Loss) from operations** | **(9,595.00)** | **(5,898.00)** | **(1,574.00)** | **(27.61)** | **2,080.63** |
| 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 | (1,011.00) | - | - |
| Equity-settled share based payment charge | 685.00 | 125.00 | 320.00 | 100.00 | 100.00 |
| Depreciation of property plant and equipment | 291.00 | 397.00 | 419.00 | 245.00 | 245.00 |
| Amortisation of intangibles | 2.00 | 2.00 | 132.00 | 132.00 | 132.00 |
| **Adjusted EBITDA** | **(6,283.00)** | **(4,242.00)** | **(1,714.00)** | **449.39** | **2,557.63** |
| | | | | | |
| Finance Income | 21.00 | 33.00 | 74.00 | 74.00 | 74.00 |
| Finance costs | (63.00) | (112.00) | (39.00) | - | - |
| **Profit/(Loss) before tax** | **(9,637.00)** | **(5,977.00)** | **(1,539.00)** | **46.39** | **2,154.63** |
| Taxation | 3,370.00 | 1,009.00 | 374.00 | (8.81) | - |
| **Profit/(Loss) after tax** | **(6,267.00)** | **(4,968.00)** | **(1,165.00)** | **37.58** | **2,154.63** |
| **Earnings/(Loss) per share (GBp)** | | | | | |
| Basic | (0.42) | (0.31) | (0.07) | 0.00 | 0.13 |
| Adjusted Basic | (0.37) | (0.24) | (0.11) | 0.00 | 0.13 |
| Diluted | (0.40) | (0.29) | (0.07) | 0.00 | 0.13 |
| | | | | | |
| Weighted Average Shares | 14,054.06 | 16,267.56 | 16,281.06 | 16,281.06 | 16,281.06 |
| Effect of shares issued in the year | 787.37 | 11.13 | - | - | - |
| **Ordinary shares for basic earnings calculation** | **14,841.43** | **16,278.69** | **16,281.06** | **16,281.06** | **16,281.06** |
| Dilutive effect of outstanding options | 768.03 | 786.55 | 929.83 | 929.83 | 929.83 |
| **Ordinary shares for diluted earnings calculation** | **15,609.45** | **17,065.24** | **17,210.89** | **17,210.89** | **17,210.89** |
| | | | | | |
| Dividend/share | 0.03 | - | - | - | - |

*SOURCE: Company reports and SP Angel forecasts*

Cash generation from operations is expected to increase in the coming years. 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 payments are always made in August, cash balances are still expected to be stable, supported by a turn to profitability. This leaves the Group in a solid position going into 2021E, particularly since receivables collections have been much better than expected through the COVID period (billing to cash conversion was noted to be 99.5%). This suggests that small-scale acquisitions are achievable from existing assets, though larger M&A activity would require some additional financing (debt and/or equity) depending on the acquisition story.

Note that we have included the remaining payment for the acquisition of the new sales and marketing offices located in Leicester, in the first quarter of 2021E. We expect that the Group may be able to refinance this acquisition with some debt at some point in the near-term but have not included this in our estimates for now. We also included the payment of the HMRC deferrals permitted during 2020 related to COVID-19, that are to be made in 2021E and 2022E.

## Valuation

We are currently using a discounted cash flow valuation in order to determine target price for the Group. 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 ~0.75%
- Long-term growth rate estimated by the rate of inflation is ~3.5%
- YUG beta according to Bloomberg is 0.97 against the LSE AIM 100 Index
- The market return for the UK is around 14%

The result is an equity value of ~£81m, translating to a share value of 500p, ~78% higher than the closing share price. With this type of potential return, the stock overwhelmingly fits into our Buy category. We expect the Group performance will continue in the years to come as management remains committed to carefully manage cash flows, paying close attention to the commodity markets, and by attempting to disrupt the energy supply market with a high-quality service model that treats customers as a priority.

We believe it is worthwhile for investors to watch this stock closely as management challenges 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 Dec (£m) | | | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|
| WACC | | | 13.6% | 13.6% | 13.6% | 13.6% | 13.6% |
| Time (yrs) | 31/3/21 | | 0.75 | 1.75 | 2.75 | 3.75 | 4.75 |
| Revenue | | | 128,397.1 | 159,852.1 | 188,361.4 | 210,670.9 | 231,931.2 |
| *Growth* | | | | *24.5%* | *17.8%* | *11.8%* | *10.1%* |
| FCF | | | (97.8) | 4,832.3 | 11,225.3 | 8,192.6 | 8,621.4 |
| Discount factor | | | 0.91 | 0.80 | 0.70 | 0.62 | 0.55 |
| DCF | | | (88.8) | 3,864.0 | 7,901.2 | 5,076.1 | 4,702.2 |
| | | | | | | | |
| **EV/EBITDA (x)** | | | **181.1** | **31.8** | **21.1** | **17.6** | **15.9** |
| EBITDA | | | 449.4 | 2557.6 | 3861.4 | 4634.8 | 5102.5 |
| **Terminal value** | 48,173.5 | | | | | | |
| **Net cash / (debt)** | 11,740.0 | | | | | | |
| **PV of equity £'000** | 81,368.1 | | | | | | |
| **Price per share (p)** | **499.8** | ***+ 78.5%*** | | | | | |
| **Current price (p)** | **280.0** | | | | | | |

*SOURCE: Company reports and SP Angel forecasts*

## FINANCIAL SUMMARY

| Current Forecasts Financials (£000) | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 16,264.0 | 45,631.0 | 80,635.0 | 111,613.0 | 101,527.0 | 128,397.1 | 159,852.1 | 188,361.4 | 210,670.9 | 231,931.2 |
| Gross Margin (%) | 21.2% | 14.9% | 4.0% | 4.9% | 7.6% | 9.2% | 9.4% | 9.5% | 9.5% | 9.5% |
| Operating Income | (1,518.0) | 784.0 | (9,595.0) | (5,898.0) | (1,574.0) | (27.6) | 2,080.6 | 3,384.4 | 4,157.8 | 4,625.5 |
| Operating Margin (%) | -9.3% | 1.7% | -11.9% | -5.3% | -1.6% | 0.0% | 1.3% | 1.8% | 2.0% | 2.0% |
| Adjusted EBITDA | (1,518.0) | 1,537.0 | (6,283.0) | (4,242.0) | (1,714.0) | 449.4 | 2,557.6 | 3,861.4 | 4,634.8 | 5,102.5 |
| Net Income | (1,359.0) | 711.0 | (6,267.0) | (4,968.0) | (1,165.0) | 37.6 | 2,154.6 | 3,458.4 | 4,231.8 | 4,699.5 |
| Earnings per Share (£) basic | (0.1029) | 0.0506 | (0.4223) | (0.3) | (0.0716) | 0.0023 | 0.1323 | 0.2124 | 0.2599 | 0.2886 |
| Adjusted Net Income | 136.0 | 1,413.0 | (5,555.0) | (3,950.0) | (1,725.0) | 37.6 | 2,154.6 | 3,458.4 | 4,231.8 | 4,699.5 |
| Adj. EPS (£) basic | 0.0103 | 0.1005 | (0.3743) | (0.2426) | (0.1060) | 0.0023 | 0.1323 | 0.2124 | 0.2599 | 0.2886 |
| Basic Shares (000s) | 13,212.2 | 14,054.1 | 14,841.4 | 16,278.7 | 16,281.1 | 16,281.1 | 16,281.1 | 16,281.1 | 16,281.1 | 16,281.1 |
| Net Cash in/(Out)-flow | 5,150.0 | (1,822.0) | 9,725.0 | (12,235.0) | 9,363.0 | (589.0) | 4,832.3 | 11,225.3 | 8,192.6 | 8,621.4 |
| Debt | - | - | - | - | - | - | - | - | - | - |

| Growth Rates (%) | | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | | 180.6% | 76.7% | 38.4% | -9.0% | 26.5% | 24.5% | 17.8% | 11.8% | 10.1% |
| EBITDA | | 201.3% | -508.8% | 32.5% | 59.6% | 126.2% | 469.1% | 51.0% | 20.0% | 10.1% |
| Net Income | | 152.3% | -981.4% | 20.7% | 76.5% | 103.2% | 5634.1% | 60.5% | 22.4% | 11.1% |
| Adjusted Net Income | | 939.0% | -493.1% | 28.9% | 56.3% | 102.2% | 5634.1% | 60.5% | 22.4% | 11.1% |

| Financial Health | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|
| Working Capital (£000) | 4,748.00 | 7,021.00 | 6,664.00 | 187.00 | (1,423.00) | (3,673.61) | (906.60) | 3,411.91 | 8,650.71 | 14,446.09 |
| Current Ratio | (1.89) | (1.65) | (1.31) | (1.01) | (1.0) | (0.9) | (1.0) | (1.1) | (1.1) | (1.2) |
| Long-term Debt (£m) | - | - | - | - | - | - | - | - | - | - |
| Total Equity (£m) | 5.41 | 8.81 | 10.44 | 5.30 | 4.5 | 4.7 | 6.9 | 10.5 | 14.8 | 19.6 |
| LT Debt/Assets | - | - | - | - | - | - | - | - | - | - |
| LT Debt/Equity | - | - | - | - | - | - | - | - | - | - |

| Financial Position (£000) | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash | 5,197.0 | 4,887.0 | 14,612.0 | 2,377.0 | 11,740.0 | 11,151.0 | 15,983.4 | 27,208.6 | 35,401.3 | 44,022.7 |
| Inventory | - | - | - | - | - | - | - | - | - | - |
| Debtors | 4,891.0 | 13,011.0 | 13,569.0 | 25,886.0 | 18,267.0 | 21,797.9 | 26,806.1 | 31,345.2 | 34,897.3 | 38,282.3 |
| Creditors | (5,340.0) | (10,877.0) | (21,517.0) | (28,076.0) | (31,430.0) | (36,622.6) | (43,696.0) | (55,142.0) | (61,647.8) | (67,858.9) |
| Total Assets | 10,821.0 | 20,061.0 | 31,955.0 | 33,822.0 | 37,052.0 | 41,882.1 | 51,210.2 | 66,214.6 | 77,052.2 | 88,062.7 |
| Total Liabilities | (5,412.0) | (11,248.0) | (21,517.0) | (28,524.0) | (32,539.0) | (37,231.6) | (44,305.0) | (55,751.0) | (62,256.8) | (68,467.9) |
| Total Equity | 5,409.0 | 8,813.0 | 10,438.0 | 5,298.0 | 4,513.0 | 4,650.6 | 6,905.2 | 10,463.6 | 14,795.4 | 19,594.9 |

| Profitability | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|
| ROE | -25.1% | 8.1% | -60.0% | -93.8% | -25.8% | 0.8% | 31.2% | 33.1% | 28.6% | 24.0% |
| ROA | -12.6% | 3.5% | -19.6% | -14.7% | -3.1% | 0.1% | 4.2% | 5.2% | 5.5% | 5.3% |

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