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

22 March 2022

# Spec Sits Research

# Yü Group Plc

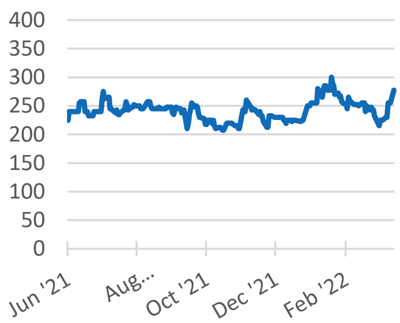
## Driving Profitability Higher in 2022+

Yü Group Plc (YU. LN) listed on the AIM Exchange in London is a multi-utility provider to SMEs, as well as larger corporates across the UK. As a direct supplier of electricity, gas, water, and other solutions such as EV charge points, smart meter installations and green energy solutions, Yü Group (YUG) provides a simple approach to 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 solidifying YUG as a trusted supplier in the £50b+ UK B2B utility market.

### Stock Data

| | |
|---|---|
| Ticker (AIM) | YU. LN |
| Share Price | 277.5p |
| Market Cap | £45.3M |
| Yr High/Yr Low | 380/187.50p |
| Target Price | 590p (fr/500p) |
| Rating | Buy |

### Price Chart




SOURCE: Bloomberg

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**Event:** Following the release of significantly better-than-expected full year results for 2021, we are revising our forecasts materially upwards for 2022E+.

**Revised Forecasts**: We expect 2022E revenue of £215.5m, increasing to £257.8m in 2023E and £294.9 in 20224E. This results in positive adjusted EBITDA in each year of £3.7m in 2022E, £5.7m in 2023E and £8.1m in 2024E. Net profits for the year 2022E are £2.98m or £0.18/shr, for 2023E are £4.99m or £0.31/shr, and for 2024E are £7.4m or £0.46/shr. With positive EBITDA and positive net profits we expect cash to increase to £9.1m in 2022E, £12.6m in 2023E.

Our previous estimates for 2022E included revenue of £159.9m and adj. EBITDA of £2.6m; and for 2023E included revenue of £188.4m and adj. EBITDA of £3.9m.

**Forecast Assumptions:**

- **Average Monthly Bookings:** For 2022E, we expect average monthly billings to trend to over ~£16.5m vs. the £13.8m reported in 2021A. In addition, we have increased our estimates for off-contract revenue to 5-10% of contracted revenue, given current commodity price levels and movement of customers due to energy supplier failures. We expect this to reduce back to more normalised levels (<5% of contracted revenue) as commodity price volatility stabilises perhaps next year.
- **Net Customer Contribution (NCC):** NCC has been trending upwards with tight controls over new contracts. We estimate 2022E NCC to reach 7.1% (from 6.7% in 2021), with bad debt provisions reducing to 2.75% from 3.1% in 2021. We forecast NCC to continue trending upwards to 7.4% and 7.8% in 2023E and 2024E with bad debt levels reducing down to ~2.25% over time.
- **General overheads:** Recall that general overheads for 2021 were down to 5.6% with costs to acquire lower than both costs to serve and general & admin. For 2022E we expect general overheads to reduce to ~5.4% and continue a downward trend in 2023E and 2024E to 5.2% and 5.0% respectively. We expect general overheads to trend down as a percent of revenue despite continued investment in sales & marketing, as the balance of overhead costs are largely fixed.
- **Contracted Revenue:** As at 31 December 2021 the 2022E contracted revenue book stood at £157m. This already represents 75.9% of our expected forecast for 2022E revenue. The contracted revenue book is still expected to increase for the year as new bookings are added monthly.

**Valuation:** We are currently using a DCF valuation to derive a price target for YUG. In this calculation, our WACC has stayed roughly the same as before – we've accounted for higher market risks and higher inflation, but this has been offset by lower relative company risks. The result is an equity value of ~£95.6m, translating to a share value of 590p after adjusting for cash, ~1.12x higher than the current share price. With this type of potential return, and the improved risk profile of the Group, the stock clearly warrants a Buy rating.

**Outlook:**
YUG reported outstanding results for 2021, especially given the turbulent market environment. The KPI improvements and overall financial performance really demonstrate the strength of the Group's operational foundation. We believe there remains significant upside potential for investors as the Group challenges the remaining incumbent energy providers with superior efficiency of operations, innovative products, and strong levels of customer service.

### Forecasts: Assumptions and Estimates

Following the release of the 2021 financial results, we are revising our financial forecasts for YUG for 2022E and 2023E materially upwards. The strong performance during the year, particularly as many of the Group's peers began to fail, underscores the strength and durability of the platform that has been built by management and the Board. The focus on quality first in acquiring new customers under strict take-on guidelines, combined with a commitment to superior customer service and the expansion of the Digital by Default programme to assist with sales and marketing have been key drivers of this strength, in addition to the secure backdrop of the hedging program in place.

Management is continuing to focus on the scaling of its business model, leveraging the strong foundation to accelerate organic and acquisition growth.

- Monthly bookings are expected to be well ahead of 2021, with revenues trending in the same direction. The target for renewal rates has been set to at least 70% for 2022E.
- Net Customer Contribution which measures the normalised profit contribution as a percentage of revenue has a target of 7% or more for 2022E.
- Efficiencies from scaling the business which operates on largely fixed general admin costs are expected to become more visible in 2022E, particularly with low costs of customer acquisition from the investment in the Group's Digital by Default programme. As such, general overheads are expected to continue to decline in 2002E+.
- We expect additional investment of ~£2m in the sales and marketing platform in 2022E with enhanced digital tools to improve client take-on, customer service, and collections processes. This should further enhance the customer life cycle journey with a deeper understanding of customer needs and how best to serve those needs.
- With a turn to profitability and positive adjusted EBITDA in 2021, the Group is well positioned to build additional scale through organic and acquisition growth.

We expect that after a challenging 2021 and the continued impacts of turbulent commodity market prices, there may be additional energy supplier failures. YUG remains in a strong position to support Ofgem as a supplier of last resort (SOLR) should this be the case. There are also likely to be additional customer books that become available for sale later in the year as companies potentially reassess their risk positions and exit the sector.

Overall, we believe that YUG Management and Board have performed extremely well in challenging markets and the Group is well positioned for the future. The share price has clearly been trading below estimated levels and should re-base higher with these results and revised forecasts. Notably, we still believe there is significant upside in our forecasts, given where the Group currently stands with respect to contracted revenue for 2022E.

### 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 31 December 2021 the 2022E contracted revenue book stood at £157m. 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 2022E will be impacted by any organic growth and augmented by any acquisition growth or SOLR take-on. Our revenue estimates have now been revised upwards to £215.5m for 2022E (from £159.9m; +34.8%), increasing to £257.8m in F2023E (from £188.4m; +36.8%).

- **Average Monthly Bookings** – This is the annualised value of contracts secured during a period. The monthly average bookings during 2021 reached £13.8m, up from £8.3m in 2020. For 2022E, we expect average monthly bookings to reach over £16.5m by the end of the year. 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. Of course, higher commodity prices will also impact this KPI. Given the market environment, our assumptions for off-contract revenue (typically at higher price points) have increased for the year to 5-10%, from <5%.

  We anticipate that many customers will revert back to signing onto fixed contract pricing terms once commodity price volatility begins to stabilise.

- **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. 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 2021 were down to 5.6% with costs to acquire lower than both costs to serve and general and admin. For 2022E and 2023E we forecast general overheads at 5.4% and 5.2%.

- **Net Customer Contribution (NCC):** This KPI 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 2021 reached 6.7%, including a bad debt charge of 3.1%. 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. We expect bad debt provisions to remain 2-3% each year, and NCC to grow to 7.1% and 7.4% in 2022E and 2023E.

- **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 2021 this KPI remained within management's target at 7 days. Our forecasts maintain receivable days outstanding about 7-8 days.

## Forecasts

Table 1 depicts the results of our analysis. We now expect revenue of ~£215.5m in 2022E, followed by £257.8m in 2023E. This results in positive adjusted EBITDA in each year of £3.7m in 2022E and £5.7m in 2023E. Net profits for the year 2022E are £2.98m or £0.18/shr and 2023E are £4.99m or £0.31/shr.

Our previous estimates for 2021E included revenue of £159.9m, adj. EBITDA of £2.6m and net profit of £1.9m of £0.12/shr; for 2023E included revenue of £188.4m, adj. EBITDA of £3.9m, and net profits of £3.2m or £0.20/shr.

### TABLE 1: Financial Forecasts

| **Income Statement** | | | | | | **Previous forecasts** | | **%change** | |
|---|---|---|---|---|---|---|---|---|---|
| **YE Dec (£000s)** | **2019A** | **2020A** | **2021A** | **2022E** | **2023E** | **2022E** | **2023E** | **2022E** | **2023E** |
| Revenue | 111,613.00 | 101,527.00 | 155,423.00 | 215,492.96 | 257,770.01 | 159,852.10 | 188,361.41 | 34.8% | 36.8% |
| Cost of sales | (106,128.00) | (93,858.00) | (140,180.00) | (194,266.90) | (232,250.77) | (144,826.01) | (170,561.26) | 34.1% | 36.2% |
| **Gross Profit** | **5,485.00** | **7,669.00** | **15,243.00** | **21,226.06** | **25,519.23** | **15,026.10** | **17,800.15** | 41.3% | 43.4% |
| | 4.91% | 7.55% | 9.81% | 9.85% | 9.90% | 9.40% | 9.45% | | |
| **Total operating costs** | **(11,383.00)** | **(9,243.00)** | **(11,755.00)** | **(18,247.68)** | **(20,533.29)** | **(13,175.46)** | **(14,645.74)** | 38.5% | 40.2% |
| NCC | 2.48% | 6.09% | 6.72% | 7.10% | 7.40% | 7.40% | 7.45% | | |
| **Profit/(Loss) from operations** | **(5,898.00)** | **(1,574.00)** | **3,488.00** | **2,978.38** | **4,985.94** | **1,850.63** | **3,154.41** | 60.9% | 58.1% |
| Non-recurring operational costs | 378.00 | - | 644.00 | - | - | - | - | | |
| Non-recurring mutualisation costs | 236.00 | - | - | - | - | - | - | | |
| Impact of first-time adoption of IFRS 9 | - | - | - | - | - | - | - | | |
| Unrealised loss on derivative contracts | 518.00 | (1,011.00) | (3,344.00) | - | - | - | - | | |
| Equity-settled share based payment charge | 125.00 | 320.00 | 249.00 | 250.00 | 250.00 | 100.00 | 100.00 | | |
| Depreciation of property plant and equipment | 397.00 | 419.00 | 335.00 | 335.00 | 335.00 | 307.00 | 307.00 | | |
| Amortisation of intangibles | 2.00 | 132.00 | 352.00 | 100.00 | 100.00 | 300.00 | 300.00 | | |
| **Adjusted EBITDA** | **(4,242.00)** | **(1,714.00)** | **1,724.00** | **3,663.38** | **5,670.94** | **2,557.63** | **3,861.41** | 43.2% | 46.9% |
| Finance Income | 33.00 | 74.00 | - | - | - | 74.00 | 74.00 | | |
| Finance costs | (112.00) | (39.00) | (96.00) | - | - | - | - | | |
| **Profit/(Loss) before tax** | **(5,977.00)** | **(1,539.00)** | **3,392.00** | **2,978.38** | **4,985.94** | **1,924.63** | **3,228.41** | 54.8% | 54.4% |
| Taxation | 1,009.00 | 374.00 | 1,059.00 | - | - | - | - | | |
| **Profit/(Loss) after tax** | **(4,968.00)** | **(1,165.00)** | **4,451.00** | **2,978.38** | **4,985.94** | **1,924.63** | **3,228.41** | 54.8% | 54.4% |
| **Earnings/(Loss) per share (GBp)** | | | | | | | | | |
| Basic | (0.31) | (0.07) | 0.27 | 0.18 | 0.31 | 0.12 | 0.20 | | |
| Adjusted Basic | (0.24) | (0.11) | 0.27 | 0.18 | 0.31 | 0.12 | 0.20 | | |
| Diluted | (0.29) | (0.07) | 0.26 | 0.17 | 0.29 | 0.11 | 0.19 | | |
| Weighted Average Shares | 16,267.56 | 16,281.06 | 16,281.06 | 16,281.06 | 16,281.06 | 16,281.06 | 16,281.06 | | |
| Effect of shares issued in the year | 11.13 | - | 18.59 | - | - | - | - | | |
| **Ordinary shares for basic earnings calculation** | **16,278.69** | **16,281.06** | **16,299.65** | **16,281.06** | **16,281.06** | **16,281.06** | **16,281.06** | | |
| Dilutive effect of outstanding options | 786.55 | 929.83 | 1,099.15 | 1,099.15 | 1,099.15 | 929.83 | 929.83 | | |
| **Ordinary shares for diluted earnings calculation** | **17,065.24** | **17,210.89** | **17,398.80** | **17,380.21** | **17,380.21** | **17,210.89** | **17,210.89** | | |
| Dividend/share | - | - | - | - | - | - | - | | |
| *Note: Restated values for 2018* | | | | | | | | | |

*SOURCE: Company reports and SP Angel forecasts*

Cash generation from operations is expected to increase in the coming years. A net decrease in cash in 2021 was the direct result of investment in capital expenditure. YUG's cash balances are stable, with deferred VAT payments during COVID being repaid, as well as accruals for the energy supplier mutualisation payments being recognised and paid. Working capital movements have increased with a step-up in revenue combined with increased commodity prices towards the end of 2021. The Group remains in a solid position going into 2022E, with strong cash collection conversion and declining bad debt levels.

## Valuation

We are currently using a discounted cash flow valuation to determine the 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 ~1.6%
- Long-term growth rate including an estimate for 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 12%

The result is an equity value of ~£95.6m, translating to a share value of 590p, ~1.12x 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 the story has been de-risked for investors and that the share price will no longer trade at current levels. 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 its competing incumbents.

**TABLE 2: Discounted Cash Flow**

| | | | 31/12/22 | 31/12/23 | 30/12/24 | 30/12/25 | 30/12/26 |
|---|---|---|---|---|---|---|---|
| **YE Dec (£m)** | | | **2022** | **2023** | **2024** | **2025** | **2026** |
| WACC | | | 11.7% | 11.7% | 11.7% | 11.7% | 11.7% |
| Time (yrs) | 31/3/22 | | 0.75 | 1.75 | 2.75 | 3.75 | 4.75 |
| Revenue | | | 215,493.0 | 257,770.0 | 294,885.0 | 335,815.2 | 382,426.6 |
| *Growth* | | | | *19.6%* | *14.4%* | *13.9%* | *13.9%* |
| FCF | | | 2,050.9 | 3,544.9 | 14,100.2 | 15,455.6 | 7,866.2 |
| Discount factor | | | 0.92 | 0.82 | 0.74 | 0.66 | 0.59 |
| DCF | | | 1,886.9 | 2,920.2 | 10,399.9 | 10,206.5 | 4,650.9 |
| | | | | | | | |
| **EV/EBITDA (x)** | | | **24.3** | **15.7** | **11.0** | **9.3** | **7.9** |
| EBITDA | | | 3663.4 | 5670.9 | 8109.3 | 9570.7 | 11281.6 |
| **Terminal value** | 58,779.2 | | | | | | |
| **Net cash / (debt)** | 6,782.0 | | | | | | |
| **PV of equity £'000** | 95,625.7 | | | | | | |
| **Price per share (p)** | **587.3** | ***+ 111.7%*** | | | | | |
| **Current price (p)** | **277.5** | | | | | | |

*SOURCE: Company reports and SP Angel forecasts*

## FINANCIAL SUMMARY

| Current Forecasts<br>Financials (£000) | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|
| Revenue | 111,613.0 | 101,527.0 | 155,423.0 | 215,493.0 | 257,770.0 | 294,885.0 | 335,815.2 |
| Gross Margin (%) | 4.9% | 7.6% | 9.8% | 9.9% | 9.9% | 10.0% | 10.1% |
| Operating Income | (5,898.0) | (1,574.0) | 3,488.0 | 2,978.4 | 4,985.9 | 7,424.3 | 8,885.7 |
| Operating Margin (%) | -5.3% | -1.6% | 2.2% | 1.4% | 1.9% | 2.5% | 2.6% |
| Adjusted EBITDA | (4,242.0) | (1,714.0) | 1,724.0 | 3,663.4 | 5,670.9 | 8,109.3 | 9,570.7 |
| Net Income | (4,968.0) | (1,165.0) | 4,451.0 | 2,978.4 | 4,985.9 | 7,424.3 | 8,749.1 |
| Earnings per Share (£) basic | (0.305) | (0.072) | 0.273 | 0.183 | 0.306 | 0.456 | 0.537 |
| Adjusted Net Income | (3,950.0) | (1,725.0) | 4,451.0 | 2,978.4 | 4,985.9 | 7,424.3 | 8,749.1 |
| Adj. EPS (£) diluted | (0.29) | (0.07) | 0.26 | 0.17 | 0.29 | 0.43 | 0.50 |
| Diluted Shares (000s) | 17,065.2 | 17,210.9 | 17,398.8 | 17,380.2 | 17,380.2 | 17,380.2 | 17,380.2 |
| Net Cash in/(Out)-flow | (12,235.0) | 9,363.0 | (4,691.0) | 2,050.9 | 3,544.9 | 14,100.2 | 15,592.2 |
| Debt | - | - | - | - | - | - | - |

| Growth Rates (%) | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|
| Revenue | 38.4% | -9.0% | 53.1% | 38.6% | 19.6% | 14.4% | 13.9% |
| EBITDA | 32.5% | 59.6% | 200.6% | 112.5% | 54.8% | 43.0% | 18.0% |
| Net Income | 20.7% | 76.5% | 482.1% | -33.1% | 67.4% | 48.9% | 17.8% |
| Adjusted Net Income | 28.9% | 56.3% | 358.0% | -33.1% | 67.4% | 48.9% | 17.8% |

| Financial Health | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|
| Working Capital (£000) | 187.00 | (1,423.00) | (2,253.00) | 54.98 | 6,372.40 | 15,987.82 | 27,393.39 |
| Current Ratio | (1.01) | (1.0) | (1.0) | (1.0) | (1.2) | (1.4) | (1.7) |
| Long-term Debt (£m) | - | - | - | - | - | - | - |
| Total Equity (£m) | 5.30 | 4.5 | 9.3 | 12.5 | 17.7 | 25.4 | 34.4 |
| LT Debt/Assets | - | - | - | - | - | - | - |
| LT Debt/Equity | - | - | - | - | - | - | - |

| Financial Position (£000) | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|
| Cash | 2,377.0 | 11,740.0 | 7,049.0 | 9,099.9 | 12,644.8 | 26,745.0 | 42,337.2 |
| Inventory | - | - | - | - | - | - | - |
| Debtors | 25,886.0 | 18,267.0 | 40,441.0 | 33,598.9 | 32,701.7 | 29,001.4 | 25,893.5 |
| Creditors | (28,076.0) | (31,430.0) | (49,743.0) | (42,643.8) | (38,974.0) | (39,758.5) | (40,837.3) |
| Total Assets | 33,822.0 | 37,052.0 | 59,569.0 | 55,698.2 | 57,264.3 | 65,723.2 | 75,801.1 |
| Total Liabilities | (28,524.0) | (32,539.0) | (50,284.0) | (43,184.8) | (39,515.0) | (40,299.5) | (41,378.3) |
| Total Equity | 5,298.0 | 4,513.0 | 9,285.0 | 12,513.4 | 17,749.3 | 25,423.7 | 34,422.8 |

| Profitability | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|
| ROE | -93.8% | -25.8% | 47.9% | 23.8% | 28.1% | 29.2% | 25.4% |
| ROA | -14.7% | -3.1% | 7.5% | 5.3% | 8.7% | 11.3% | 11.5% |

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