Spec Sits Research

Non-Independent Research
MiFID II Exempt: Marketing Material
SP Angel provides research to YUG

27 September 2022

Stock Data

Ticker (AIM)	YU. LN
Share Price	215p
Market Cap	£35.7M
Yr High/Yr Low	320/165p
Target Price	610p fr/590p
Rating	Strong Buy

Price Chart

SOURCE: Bloomberg

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Yü Group Plc

Outlook Stronger Than Ever

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.

Key Performance Indicators:

- **Average Monthly New Bookings** increased to £14.3m for H122, compared to £13m +81% in the first four months of the year. This is 49% higher than H121 of £9.6m, and ahead of the full year average for 2021 of £13.8m.
- **Net Customer Contribution (NCC)** for H122 was 6.7%, in line with the year 2021 at 6.72%, and down slightly from H121 at 6.85%.
- **General overheads** for H122 were 4.6%, down from 5.6% for the year 2021 (2019: 6.3% and 2018: 7.4%). In order to drive growth, YUG is investing in sales and marketing, which is sized to handle the current growth plans.
- **Contracted Revenue** as at August 31, 2022 for delivery in F2023E stood at £119m (+31% y/y). This is still expected to increase for the year as new bookings are added monthly.

H122 Financial Results:

- **Revenue**: H122 revenue was £129.2m, up 96% over H121 revenue of £65.8m. This dramatic increase was driven by strong organic growth, the result of integrations from the SoLR books added in 2021 and early in 2022, and the increased contribution from customers that remain uncontracted.
- **General Overheads/Bad Debt:** H122 general overheads were 4.6% of revenue, 1.1% lower than H121 and 1% lower than that for 2021. Economies of scale are expected to continue driving low cost of service and administrative expenses, particularly given tight controls in place, streamlined processes and further investment in the Group's digital platform. Bad debt provisions have prudently increased to 7.4% in H122 from 3.1% for 2021, given the current macroeconomic environment.
- **Profit/Loss and Adj. EBITDA:** Adjusted EBITDA for H122 was £2.7m, compared to £1.7m reported for 2021. Net profit for the period was £4.4m or £0.26/shr, compared to net profit in 2021 of £4.45m or £0.27/shr.
- **Cash:** Cash at the end of H122 was £15.7m, with no debt. Following the payment for YUG's Renewable Obligation made in August, cash resources remain solid, and are expected to increase well above 2021.

Forecasts: We have revised our forecasts upward with revenue of £239m from £215.5m in 2022E, increasing to £302m (previously £257.8m) in 2023E and £368m (previously £294.9m) in 20224E. This results in positive adjusted EBITDA in each year of £4.8m (from £3.7m) in 2022E, £6.8m (from £5.7m) in 2023E and £10.7m (from £8.1m) in 2024E. Net profits for the year 2022E are £7.5m or £0.46/shr (from £2.98m or £0.18/shr), for 2023E are £6.3m or £0.39/shr (from £4.99m or £0.31/shr), and for 2024E are £10.1m or £0.62/shr (from £7.4m or £0.46/shr). With positive EBITDA and positive net profits we expect cash at year-end to be £12.25m in 2022E, and £15.7m in 2023E.

Significant upside in Valuation: We use a DCF (10% WACC; 4.0% TG) to derive a price target for YUG. We have accounted for higher interest rates and higher inflation, but this has been offset by lower relative company risks. The result is an equity value of ~£99.5m, translating to a share value of 610p.

Outlook: YUG is continuing to report outstanding results, with better-than-expected H122 performance. Management has established a strong core business, which will be augmented by the new Yü Smart division, driving revenue higher and reducing bad debt. The Board is reviewing the potential for a regular dividend payment, given increasing levels of profitability.

Revised 2022E Forecasts – Outlook Stronger Than Ever

As reported in the trading updates for H122, YUG has reported very strong financial performance for the period, far outpacing our expected forecasts. All KPIs support continued strong performance by the company into H222, with growth in both contracted and uncontracted revenue and a 25% y/y increase in meter points during H122. Strong bookings performance so far this year, with contracted revenue of £119m for 2023E at the end of August 2022, and average monthly bookings of £14.3m this year, give us confidence in increasing our forecasts for the full year 2022E.

- **Revenue**: 2022E increased to £239.2m from £215.5m (+11%)
  Management indicated that revenue for 2022 will be at least ~50% higher than the £155.4m reported in 2021. This translates to a baseline expectation of ~£234m. The announcement from the UK government last week to provide support to businesses for their energy bills for the next 6 months, with a higher level of support for those on-contract, suggests that more businesses will move to fixed rate contracts.
- **Adjusted EBITDA**: 2022E increased to £4.8m from £3.7m (+31.9%)
  Management has previously indicated that the Adj. EBITDA margin is expected to be in excess of £4.7m or greater than a 2% margin. Adj. EBITDA margin was 2.1% in H1 2022 compared to 1.3% in H221. The Group remains on track to achieving the +4% target Adj EBITDA margin on revenue of £500m.
- **Cash**: 2022E forecast of £12.25m
  Cash at the end of H122 was £15.7m and was still ahead of expectations even after the ROC payment that was due in August. Operational cash inflow in H122 was £10.3m, after considering £1.2m investment in digital, £0.4m in Yü Smart in H122, final settlement of the COVID VAT deferral (was £1.4m in total), and the full ROC payments in August 2022.

While performance remains strong, YUG is closely monitoring macro conditions and the volatility in energy markets against customers' ability to afford their energy bills. The second half of the year, ahead of the winter season, is a time when customers typically renew their energy contracts and enter into longer term contracts if they have not been locked in. Though with such volatility in energy prices, uncertainty in how to manage energy costs has been growing. The energy support package announced last week should provide some relief through the winter season and will likely encourage many to move to fixed-priced contracts, at least for the next 6 months.

Energy Relief Scheme: UK businesses have been given an emergency package of government support to reduce energy prices for 6 months from 1st October. For all non-domestic (I.E., businesses, charities, public sector) energy users in Great Britain the government supported price has been set at:

- £211 per MWh for electricity
- £75 per MWh for gas

This is in the context of wholesale costs in England, Scotland and Wales which are currently expected to be the following during this coming winter:

- £600 per MWh for electricity
- £180 per MWh for gas

How it works

- Suppliers will apply a reduction to the bill of any eligible customer and the government will compensate suppliers for the reduction in the wholesale gas and electricity prices.

- For fixed contracts the discount will reflect the difference between the government supported price (above) and the wholesale price on the day the contract was signed – the government has included all contracts signed after 1 April 2022
- For variable, deemed and other contracts the difference will be between the government support price and relevant wholesale price. These contracts will be subject to a 'maximum discount' that will be determined at the start of the scheme.

The maximum discount will be calculated by comparing the government supported price with the average of expected wholesale prices for delivery across the 6 months of the scheme. The maximum discount will be confirmed on 30 September, but it is expected to be around £405/MWh for electricity and £115/MWh for gas, subject to wholesale market developments.

Note the scheme is intended to be cash neutral to energy suppliers.

TABLE 1: FORECAST REVISIONS UPWARDS

Income Statement				Previous forecasts			%change		
YE Dec (£000s)	**2022E**	**2023E**	**2024E**	**2022E**	**2023E**	**2024E**	**2022E**	**2023E**	**2024E**
Revenue	239,224.71	302,241.42	368,144.03	215,492.96	257,770.01	294,885.04	11.0%	17.3%	24.8%
Cost of sales	(206,032.28)	(272,017.28)	(329,672.98)	(194,266.90)	(232,250.77)	(265,396.54)	6.1%	17.1%	24.2%
Gross Profit	**33,192.43**	**30,224.14**	**38,471.05**	**21,226.06**	**25,519.23**	**29,488.50**	**56.4%**	**18.4%**	**30.5%**
	13.88%	10.00%	10.45%	9.85%	9.90%	10.00%			
Operating costs before exceptionals and IFRS 2	(28,793.90)	(23,632.03)	(27,953.77)	(17,997.68)	(20,283.29)	(21,814.17)	60.0%	16.5%	28.1%
Operating costs- non-recurring items	-	-	-	-	-	-			
Operating costs- unrealised losses on derivative cont	3,355.00	-	-	-	-	-			
Operating costs - exceptional IPO costs	-	-	-	-	-	-			
Operating Costs - IFRS 2 share option charge	(250.00)	(250.00)	(250.00)	(250.00)	(250.00)	(250.00)	0.0%	0.0%	0.0%
Total operating costs	**(25,688.90)**	**(23,882.03)**	**(28,203.77)**	**(18,247.68)**	**(20,533.29)**	**(22,064.17)**	**40.8%**	**16.3%**	**27.8%**
NCC	6.88%	7.00%	7.58%	7.10%	7.40%	7.75%	-3.2%	-5.4%	-2.3%
Profit/(Loss) from operations	**7,503.53**	**6,342.11**	**10,267.28**	**2,978.38**	**4,985.94**	**7,424.34**	**151.9%**	**27.2%**	**38.3%**
Non-recurring operational costs	-	-	-	-	-	-			
Non-recurring mutualisation costs	-	-	-	-	-	-			
Impact of first-time adoption of IFRS 9	-	-	-	-	-	-			
Unrealised loss on derivative contracts	(3,355.00)	-	-	-	-	-			
Equity-settled share based payment charge	-	-	-	250.00	250.00	250.00			
Depreciation of property plant and equipment	335.00	335.00	335.00	335.00	335.00	335.00			
Amortisation of intangibles	350.00	100.00	100.00	100.00	100.00	100.00			
Adjusted EBITDA	**4,833.53**	**6,777.11**	**10,702.28**	**3,663.38**	**5,670.94**	**8,109.34**	**31.9%**	**19.5%**	**32.0%**
Finance Income	-	-	-	-	-	-			
Finance costs	-	-	-	-	-	-			
Profit/(Loss) before tax	**7,503.53**	**6,342.11**	**10,267.28**	**2,978.38**	**4,985.94**	**7,424.34**	**151.9%**	**27.2%**	**38.3%**
Taxation	-	-	(96.23)	-	-	-			
Profit/(Loss) after tax	**7,503.53**	**6,342.11**	**10,171.05**	**2,978.38**	**4,985.94**	**7,424.34**	**151.9%**	**27.2%**	**37.0%**
Earnings/(Loss) per share (GBp)									
Basic	0.46	0.39	0.62	0.18	0.31	0.46	149.5%	26.9%	36.7%
Adjusted Basic	0.46	0.39	0.62	0.18	0.31	0.46	149.5%	26.9%	36.7%
Diluted	0.43	0.36	0.58	0.17	0.29	0.43	149.6%	26.9%	36.7%
Weighted Average Shares	16,316.22	16,316.22	16,316.22	16,281.06	16,281.06	16,281.06			
Effect of shares issued in the year	125.00	-	-	-	-	-			
Ordinary shares for basic earnings calculation	**16,441.22**	**16,316.22**	**16,316.22**	**16,281.06**	**16,281.06**	**16,281.06**			
Dilutive effect of outstanding options	1,099.15	1,099.15	1,099.15	1,099.15	1,099.15	1,099.15			
Ordinary shares for diluted earnings calculation	**17,540.37**	**17,415.37**	**17,415.37**	**17,380.21**	**17,380.21**	**17,380.21**			
Dividend/share	-	-	-						

Outlook

Overall, the Group is stronger than ever and still improving, driven by the strength of its commodity hedging position and the positive impact on margins of its Digital by Default strategy. As such, investors should be seriously looking at the potential of an investment in this stock, with its stable risk profile and strong growth potential.

With these upward revisions, our DCF based valuation (10% WACC; 4% TG) increases to an expected share price of at least 610p. As such, this stock is truly undervalued and warrants a Strong Buy.

Key Performance Indicators – Ongoing Measures of Success

While there are a number of operating metrics and procedural controls that are regularly tracked and monitored in order to drive profitability of the business, the key performance indicators that have been identified include the following:

- **Average Monthly New Bookings** – This is the annualised value of contracts secured during a period. The monthly average bookings during H122 reached £14.3m, +3.6% over 2021 monthly average bookings of £13.8m. The momentum is expected to continue through the balance of the year, supporting high organic growth rates. The Group's continued focused on developing its digital platform to support efficiency in quoting, onboarding and supplying to business customers seeking greater control from a more self-service platform, is driving growth in new digital sales channels.

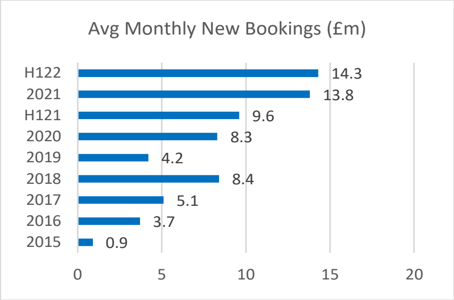
- **Total Meter Points:** Rather than tracking customer numbers, YUG tracks total meter points, as one customer can have multiple meters (multiple locations/multiple utility services) and each meter can have different volume demands/loads. Not all meter connections are the same. At the end of H122 total meter points reached 26,100, up 25% from H121. The decline from year-end 2021 was due to churn from the contracted Ampower book under the SoLR programme. With roughly 3.5m meter points for gas and electricity across the UK business market, there clearly remains significant opportunity for market share capture, even with such extreme volatility in current prices.

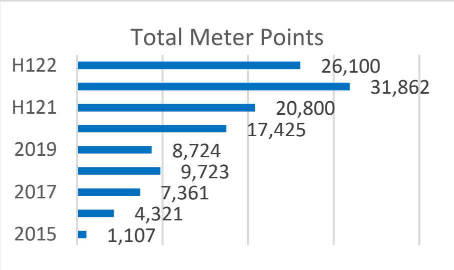
- **Net Customer Contribution (NCC):** This KPI measures the profit contribution from customer contracts in terms of gross margin, less bad debt and expected credit losses charged in overhead expenses. NCC for H122 was 6.7%, in line with 2021. Enhancing the life cycle value of customers, improvements to the credit control cycle and the expiry of low margin legacy contracts are contributing to continuous improvements.

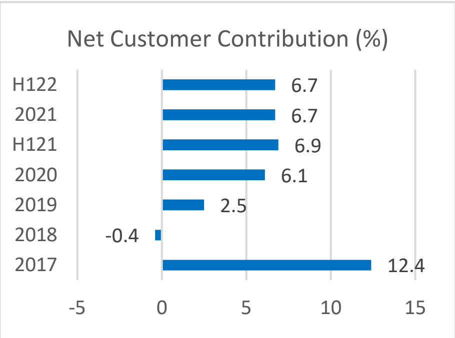
- **General Overheads (%)**: The percentage of revenue that is charged to adjusted EBITDA on a normalised, recurring basis is included in this metric. This excludes exceptional/one-time items, as well as non-cash items and any bad debt write-downs (which are included in NCC). General overheads for H122 were 4.6%, a significant reduction from 2021 of 5.6% which management notes is due to investment in digital. In order to drive growth, YUG is investing in sales and marketing, which is currently sized to handle the current growth plans. One of the targets for the company is to reduce the ratio of general overheads in support of driving increased economies of scale. This being achieved by enhancing the Group's digital platform – creating growth in digital sales channels while sustaining high levels of customer service; driving cost efficiencies and reducing overheads; and using data analytics to identify opportunities for value creation.

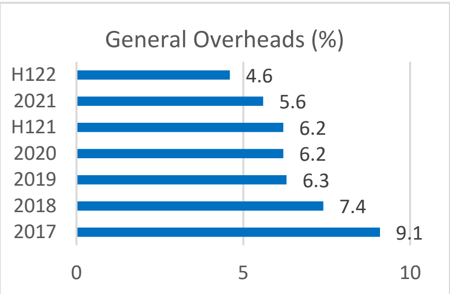
- **Receivables:** Overdue receivables from customers, net of provisions, beyond the standard one-month billing cycle is an indicator of risks to the income statement. A target of ten days, the industry benchmark, has been set as a maximum goal for overdue receivables. In H122 this KPI remained stable at 7 days.

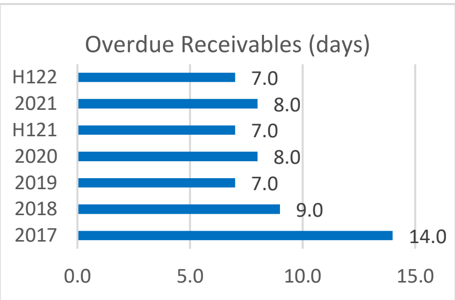
- **Contracted Revenue:** This represents revenue that is expected to be generated from signed customer contracts over the next financial year. As at August 31, 2022 the 2023E contracted revenue book stood at £119m, ~31% higher than it stood at the same time last year. This is still expected to increase for the year as new bookings are added monthly.

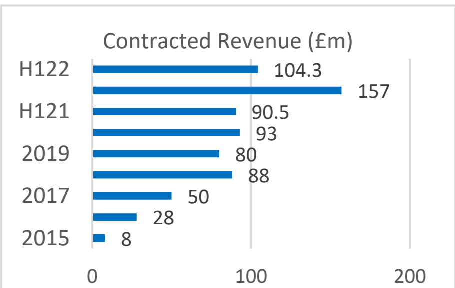












H1 2022Financial Results

YUG is well positioned to execute is corporate strategy, despite increased volatility in commodity markets. The Group remains a key player in the B2B energy supply market, with an experienced team in place to successfully execute core strategies, driving growth for shareholders. YUG reported financials for the half-year ended 30 June 2022:

- **Revenue:** H122 revenue was £129.2m, up 96.3% over H121 revenue of £65.8m and stands at ~83% of full year 2021 revenue. If we exclude the exit from the £7m unprofitable contract in 2021, growth was 120% in H122. Contracted revenue reached £104.3m in the period, with uncontracted revenue at £23.4m, or 18.1% of total revenue. Strong organic growth is supported by high monthly bookings, the addition of customers from the SoLR books added in 2021 and earlier in 2022, and increased contribution from customers who have remained on variable tariffs.
- **Gross margin:** H122 gross margin was 14.1%, a significant improvement over H1 2021 of 7.8%. The increase reflects the Group's strong hedging book and a larger than normal uncontracted customer base. The bottom end of the contracted range is mid-single digits for very high volume and bundled contracts while the top end of the range is low-to-mid double digits for more tailored and specialized contracts, whilst uncontracted margins can be higher. The Board continues to focus the Group's strategy on smaller and medium sized businesses which strategically provide a greater value opportunity, while diversifying exposure to bad debt. **GM is not expected to be impacted by the Energy Bill Relief scheme announced by the government last week.**
- **General Overheads:** H122 general overheads were 4.6% of revenue, well below that of H121 of 6.7%. Economies of scale are expected to drive cost of service and administrative expenses lower, particularly given the reinvigorated platforms in place with advanced technology and streamlined processes that have been implemented. There are plans to further automate processes across the digital platform reducing the chances for error and creating additional efficiencies in sales and marketing.
- **Bad Debts:** Provisions for bad debts have been increased to 7.4% during the period to reflect the increased energy tariffs faced by customers. While this is a prudent move by the Group, we expect the Energy Relief Scheme and the Group's drive to install additional smart meters will help lower the bad debt expenses for the full year in 2022.
- **Profit and EBITDA:** Adjusted EBITDA for H122 was £2.7m (2.1% margin), well ahead of management expectations and forecasts. Net profits after tax were £4.4m or £0.26/shr, compared to net profits in H121 of £0.06m or £0.05/shr. This includes a £3.3m gain in the hedge book position, from increased energy prices through the period.
- **Cash and Equivalents:** Cash at the end of H122 was £15.7m, with no debt. This compares to cash holdings at the end of 2021 of £7.0m. As at the end of August 2021, the payment to Ofgem for YUG's Renewable Obligation was completed. The Group's current cash position remains robust, and management have noted it is above expectations.
- **Yü Smart division**: The launch of the Yü Smart Division is expected to drive additional long-term growth for the Group, improving debtor control and margins. This business unit will provide metering services to the Group's energy supply business and others, with additional growth opportunities provided by the certification from the Retail Energy Code (REC) a well as the ability to operate as a Meter Equipment Manager (MEM) and Meter Installer (MI) for gas and electricity customers. This division is expected to install its first smart meters during H222 and become profitable during 2023 unlocking new margin growth opportunities. The Board is assessing its options for expansion of this division, without recourse to equity – including the possibility of a £2.3m debt facility on the Leicester property. Management also notes the potential for a new significant annuity income from the ownership of smart meter assets.

FINANCIAL SUMMARY

Current Forecasts Financials (£000)	2019	2020	2021	2022E	2023E	2024E	2025E
Revenue	111,613.0	101,527.0	155,423.0	239,224.7	302,241.4	368,144.0	407,826.8
Gross Margin (%)	4.9%	7.6%	9.8%	13.9%	10.0%	10.5%	10.7%
Operating Income	(5,898.0)	(1,574.0)	3,488.0	7,503.5	6,342.1	10,267.3	12,773.3
Operating Margin (%)	-5.3%	-1.6%	2.2%	3.1%	2.1%	2.8%	3.1%
Adjusted EBITDA	(4,242.0)	(1,714.0)	1,724.0	4,833.5	6,777.1	10,702.3	13,208.3
Net Income	(4,968.0)	(1,165.0)	4,451.0	7,503.5	6,342.1	10,171.1	9,483.7
Earnings per Share (£) basic	(0.305)	(0.072)	0.273	0.456	0.389	0.623	0.581
Adjusted Net Income	(3,950.0)	(1,725.0)	4,451.0	7,503.5	6,342.1	10,171.1	9,483.7
Adj. EPS (£) diluted	(0.29)	(0.07)	0.26	0.43	0.36	0.58	0.54
Diluted Shares (000s)	17,065.2	17,210.9	17,398.8	17,540.4	17,415.4	17,415.4	17,415.4
Net Cash in/(Out)-flow	(12,235.0)	9,363.0	(4,691.0)	5,202.0	3,427.9	9,918.5	10,847.0
Debt	-	-	-	-	-	-	-

Growth Rates (%)	2019	2020	2021	2022E	2023E	2024E	2025E
Revenue	38.4%	-9.0%	53.1%	53.9%	26.3%	21.8%	10.8%
EBITDA	32.5%	59.6%	200.6%	180.4%	40.2%	57.9%	23.4%
Net Income	20.7%	76.5%	482.1%	68.6%	-15.5%	60.4%	-6.8%
Adjusted Net Income	28.9%	56.3%	358.0%	68.6%	-15.5%	60.4%	-6.8%

Financial Health	2019	2020	2021	2022E	2023E	2024E	2025E
Working Capital (£000)	187.00	(1,423.00)	(2,253.00)	5,712.41	13,725.05	26,797.92	39,909.98
Current Ratio	(1.01)	(1.0)	(1.0)	(1.1)	(1.3)	(1.6)	(1.9)
Long-term Debt (£m)	-	-	-	-	-	-	-
Total Equity (£m)	5.30	4.5	9.3	17.0	23.6	34.1	43.8
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	12,251.0	15,678.8	25,597.4	36,444.3
Inventory	-	-	-	-	-	-	-
Debtors	25,886.0	18,267.0	40,441.0	36,961.7	37,336.6	45,149.6	45,857.6
Creditors	(28,076.0)	(31,430.0)	(49,743.0)	(43,500.3)	(39,290.4)	(43,949.0)	(42,391.9)
Total Assets	33,822.0	37,052.0	59,569.0	61,080.8	63,463.1	78,542.7	86,719.3
Total Liabilities	(28,524.0)	(32,539.0)	(50,284.0)	(44,041.3)	(39,831.4)	(44,490.0)	(42,932.9)
Total Equity	5,298.0	4,513.0	9,285.0	17,039.5	23,631.6	34,052.7	43,786.4

Profitability	2019	2020	2021	2022E	2023E	2024E	2025E
ROE	-93.8%	-25.8%	47.9%	44.0%	26.8%	29.9%	21.7%
ROA	-14.7%	-3.1%	7.5%	12.3%	10.0%	12.9%	10.9%

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