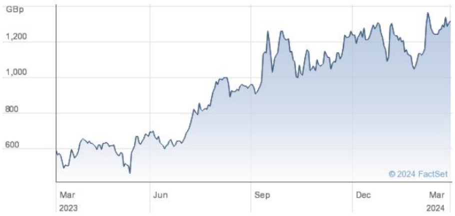
Non-Independent Research
MiFID II Exempt: Marketing Material
SP Angel provides research to YUG

19 March 2024

Stock Data	
Ticker (AIM)	YU. LN
Share Price	1358p
Market Cap	£224m
Yr High/Yr Low	1365/460p
Target Price	1900p
Rating	Buy

Price Chart



Source: hl.co.uk

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Yü Group Plc

50% growth guidance

Despite multiple upgrades, Yu Group has again exceeded our forecasts. FY23A has delivered +65% YoY organic growth and guidance for this year is +50%. Trading arrangements have been optimised in the new year with an agreement with Shell. This releases much working capital back into the business. The dividend has been hiked and management is flagging further potential returns to shareholders. The £100m+ net cash balance is driving the EV/EBITDA valuation down to unsustainable levels. Buy.

FY23A – key points:

- **Revenues +65% YoY.** Driven by a rapid expansion of meter points and higher average contracted revenue per meter, Group revenue climbed organically last year to £460m, 1.8% ahead of our already upgraded estimate of £452m.
- **Adjusted EBITDA +439% YoY.** Adj. EBITDA of £42.6m was ahead of our upgraded estimate of £38m. Favourable business mix, higher gross margin (+230bp YoY to 18.1%) and controlled expansion of operating costs facilitated a very efficient recovery of overhead costs leaving adj. EBITDA margins at 9.3% (+650bp YoY).
- **£32m net cash.** Net cash rose by over £13m YoY but excludes the £49.8m cash collateral on deposit with SmartestEnergy.
- **Dividend hike**. A final dividend of 37p has been announced representing a material hike from the 3p full year dividend paid last year.

Post balance sheet event – new counterparty

A new hedging agreement was signed in February 2024 with Shell Energy Europe Ltd, replacing the agreement with SmartestEnergy. This agreement not only provides Yu Group with greater market access and transparency but also provides the headroom for material expansion. Furthermore, the £49.8m cash collateral with SmartestEnergy will be released back to the Group in H1E leaving management in a position to consider various options around M&A and cash returns to shareholders.

PBT forecast upgraded

Management is guiding to 50% revenue growth this year. We are cautiously leaving our FY24E revenue forecast unchanged at £668m (+45% YoY) but raise our PBT forecast by 14% to £44.8m. We are forecasting c£100m of unrestricted net cash by the year end. Yu group has contracted revenue of £520m in FY24E, providing visibility over 78% of our revenue forecast.

Outlook

Continued momentum of the rate guided to could result in a revenue base in excess of £1.4bn within a couple of years. Assuming a sustainable 6% adjusted EBITDA margin, this could generate EBITDA of over £82m. If achieved, this could leave the stock trading on an EV/EBITDA rating of <2x. Buy.

Premium organic growth

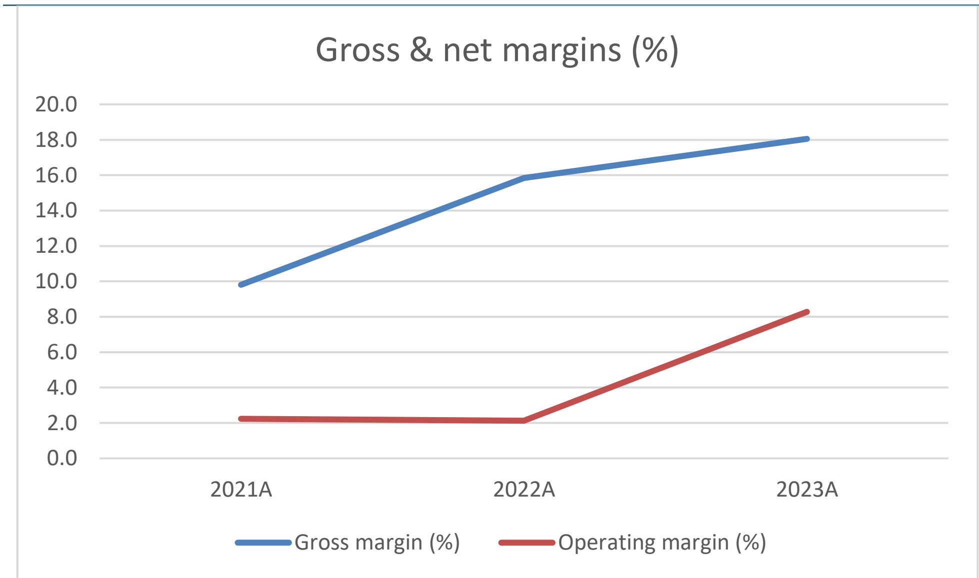
Big revenue base, tiny market share

The supply of gas and electricity to the SME market in the UK by the Big 6 energy suppliers has historically been characterised by poor service levels. In this context, we can define poor service levels as including customers receiving inaccurate billings, restricted service access and arduous customer journeys. A market has therefore opened up to a digitally native competitor which can offer higher service levels and bespoke offerings. Yu Group has taken advantage of this market opportunity with its 'Digital by Default' customer engagement model and a sophisticated approach to customer servicing. This strategy has enabled Yu Group to establish a revenue base of £460m in the twelve months to December 2023 and carve a market share in a £50bn+ market of 1.4%.

Financial returns correlated to top line growth

The very strong growth in Group revenue has been efficiently converted into a strong gross and net return on sales performance. The Group generated peak gross and net margins of 18.1% (+230bp YoY) and 8.3% (+620bp YoY) in FY23A respectively. The expansion in operating margin reflects the Group gaining sufficient scale to recover its overheads at a level to begin producing a mature margin profile.

Chart 1: Gross and net return on sales

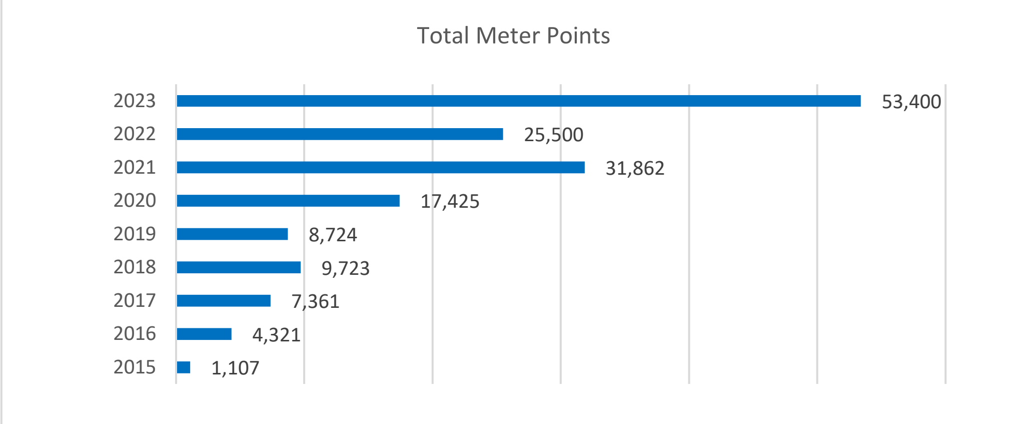


Source:: Company Accounts

53.4k meters installed

The rapid growth in energy supply sales in FY23A of +65% YoY has been driven by a rapid increase in total meter points serviced by the company. In FY23A, total meter points rose 109% to 53.4k:

Chart 2: Meters supplied



Source:: Company

New revenue segmentation

The supply of gas and electricity ('energy') to its B2B customers has been expanded by acquisition to include the supply and installation of smart meters and charging points. Yu Group's acquisition in May 2022 of the management team from Magnum Utilities, which had gone into administration, has enabled it to launch a smart metering services business (Yu Smart). Yu Smart generated revenue of over £5m in FY23A (c1% of Group sales but largely eliminated on consolidation) and can be regarded as a nascent operation. The FY23A segmental analysis has broken out this service line for the first time:

Table 1: revenue segmentation (2022-23A)

YE Dec (£m)	2022A	2023A
Retail	278.59	459.80
Smart	-	5.56
Meter Assets	-	0.08
Intra-segment trading	-	-5.43
Group revenue	**278.59**	**460.00**

Source:: Company accounts

Strategic significance of smart meters

The entry into a smart metering installation services business is a logical extension of Yu Group's existing activities but its strategic significance lies in enhancing the performance of the rest of the Group's operations. Smart meters, once installed, enable insight into customer usage and payment habits but Yu Smart's relevance to the Group comes in enabling a better risk management function. Specifically, we can highlight the following advantageous points:

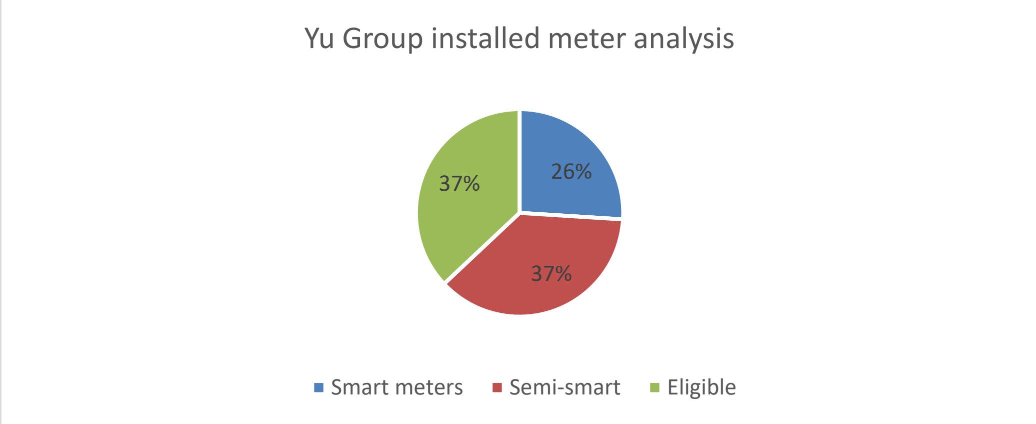
- The acquisition brings in-house an installation service otherwise outsourced and therefore captures lost value and margin;
- Near real-time data collection enables more accurate billing;
- More accurate demand estimation makes for more effective hedging; and
- Meters play a key role in debtor management.

The skill in managing an energy supply business lies in understanding customer payment profiles and pricing risk accordingly. The factors above should be gross margin positive over the medium to long term in our view.

Meter penetration is low

Not all customer sites are suitable for a smart meter and exceptions include remote areas without adequate connectivity. Yu Group estimates, however, that there are 2.4m customer sites in the UK eligible for a smart meter. Furthermore 46% of non-domestic meters still need upgrading (source: data.gov.uk). Yu Group installed 8.5k smart meters last year helping take the total penetration of smart meters in its portfolio to 26%. Yu Group estimates that a further 37% of its portfolio is eligible for installation.

Chart 3: Meter analysis



Source:: Company

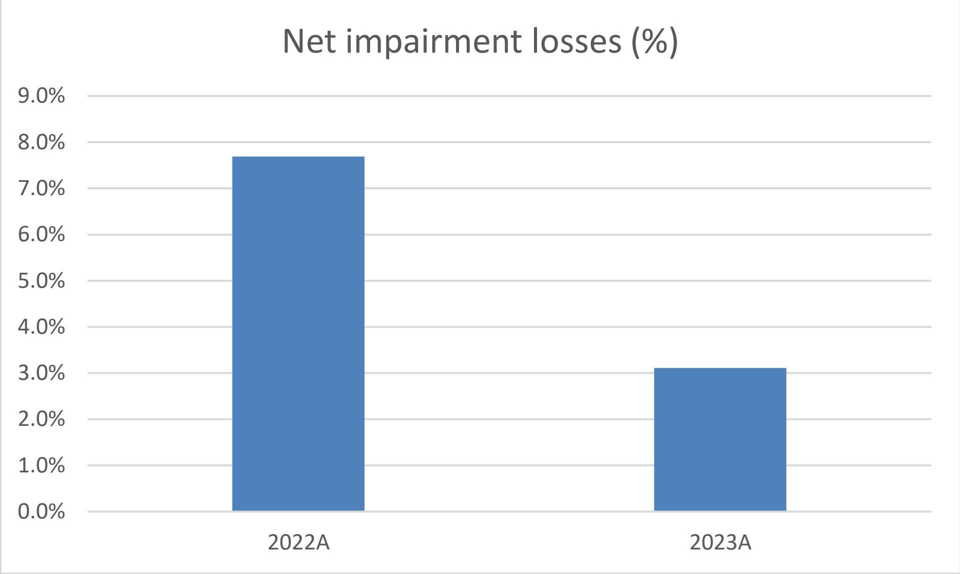
Resourcing smart meters

Yu Group currently has around 35 field engineers acting as installers. The Group's recruiting plans will likely see this figure rise to over 80 engineers by the end of April and a team of 200 is targeted by the year end. The ramping up of the cost base to support a broader field engineer capacity is necessary to both service new customers which are mandated to have smart meter installations under SMETS 2 regulations (Smart Metering Equipment Technical Specifications), and also convert existing customers to smart meters. Yu Group is targeting 25k smart metering installations by Dec-24 with the financial benefits of enhanced debtor management expected to self-finance the expansion of the engineering team.

Net impairment loss coming down

Managing debtors and debtor write-downs from the SME sector will be an ongoing feature of the business. While we expect the smart metering effect on debtors to manifest itself over the medium term as smart meter penetration improves, we can already see an improving debtor profile in the FY23A accounts. The net impairment loss stated in the Income Statement is the charge relating to Yu Group's bad debtors in the year. This reduced to 3% in FY23A from 7.7% last year, as the business took on less Supplier of Last Resort Agreements last year as the market stabilised.

Chart 4: Net impairment loss as % sales



Source:: Company Accounts

Forecasts

50% growth guidance

Management is guiding the market to 50% year-on-year organic growth in FY24E, supported by an ongoing expansion of meter points and market share. Given the contracted revenue figures as disclosed in the accounts, we can calculate that the average contracted revenue per meter reached almost £10k in FY23A:

Table 2: Revenue per meter calculation (2021-23A)

	2021A	2022A	2023A
Av contracted revenue per installed meter	7.04	9.72	9.75

Source:: Company accounts

For indicative forecasting purposes, 50% growth in FY24E would deliver Group revenue of £690m. At an average of £10k contracted income per meter, this revenue base could be achieved from an expansion in average meters of only 25% to c67k, meaning this growth guidance, while optically aggressive, could actually transpire to be conservative. We are taking a prudent approach to forecasting and estimate Group revenues of £668m in FY24E (+45% YoY).

Conservative view on business mix

The 9.3% adjusted EBITDA margin achieved in FY23A was, we believe, generated by a mix of benefits from a declining commodity market and a greater proportion of uncontracted supply volume in the business mix. This level of return is unlikely to be sustainable and we are factoring in an adjusted EBITDA margin of sub 7% going forward.

Table 3: Adjusted EBITDA calculation (2021-25E)

YE Dec (£000s)	2021A	2022A	2023A	2024E	2025E
Operating profit	**3,488**	**5,930**	**38,082**	**42,382**	**45,243**
Non-recurring operational costs	644	0	0	0	0
Loss on derivatives contracts	-3,344	926	3,046	0	0
Depreciation of property plant and equipment	335	405	808	1,004	1,058
Amortisation of intangibles	352	648	680	720	760
Adjusted EBITDA	**1,475**	**7,909**	**42,616**	**44,106**	**47,061**
margin	*0.9%*	*2.8%*	*9.3%*	*6.6%*	*6.6%*

Source:: Company accounts, SP Angel estimates

Sources of potential upside to trading forecasts

We believe two factors could lead to an improving earnings outlook over and above our projections:

- Increasing direct sales: 70% of sales are currently generated from channel partners who are incentivised to bring customers to Yu Group. Generating a greater proportion of sales in-house could lead to lower third party costs and therefore higher margins.
- Smart meters: greater penetration of smart meters in the business mix can potentially have a positive effect on reducing impairment charges, which is likely to have a positive effect on margins.

Strong underlying free cash flow

Yu Group generated free cash flow (FCF) in FY23A of £13.5m, or 3.2% of sales. This FCF figure is stated after hedging related cash collateral of £49.8m was posted to Yu group's prior trading partner, SmartestEnergy. As announced in February, Yu Group has agreed a new Hedging Facility with Shell Energy Europe Ltd. The new agreement carries no obligation to deposit cash as collateral which will release a material amount of working capital back to the Group in FY24E, thereby significantly improving underlying FCF generation.

Valuation

Ungeared balance sheet

We are forecasting Yu Group to have c£100m of net cash on the balance sheet post the return of cash from the old trading partner in H1E. This significant cash balance drives down the enterprise valuation of the Group to unsustainable levels in our view:

Table 4: Valuation

Valuation YE Sept	2021A	2022A	2023A	2024E	2025E
Sales (£m)	155.4	278.6	460.0	668.0	715.8
Adj. EBITDA (£m)	1.5	7.9	42.6	44.1	47.1
PBT (£m)	3.4	5.8	39.7	44.8	48.2
Basic EPS (p)	27.3	28.9	184.9	197.3	209.3
Dividend (p)	0.0	3.0	40.0	42.0	44.0
EV/Sales (x)	**0.8**	**0.5**	**0.3**	**0.2**	**0.2**
EV/adj. EBITDA (x)	**85.9**	**16.0**	**3.0**	**2.9**	**2.7**
P/e (x)	**49.7**	**46.9**	**7.3**	**6.9**	**6.5**
Yield (%)	0.0	0.2	2.9	3.1	3.2

Source: Company accounts, SP Angel estimates

Financial Statements

Table 5: Income Statements (2021-2025E)

YE Dec (£000s)	2021A	2022A	2023A	2024E	2025E
Revenue	**155,423**	**278,587**	**460,001**	**668,005**	**715,808**
growth YoY	-	*79.2%*	*65.1%*	*45.2%*	*7.2%*
Cost of sales	-140,180	-234,462	-376,959	-560,830	-601,278
Gross Profit	**15,243**	**44,125**	**83,042**	**107,175**	**114,529**
gross margin	*9.8%*	*15.8%*	*18.1%*	*16.0%*	*16.0%*
Operating costs	-14,206	-15,565	-26,347	-42,752	-45,812
Share option charge	-249	-284	-1,258	-2,000	-2,000
Net impairment losses	3,344	-21,420	-14,309	-20,040	-21,474
Gain / (loss) on derivatives	-644	-926	-3,046	0	0
Total operating costs	-11,755	-38,195	-44,960	-64,792	-69,286
Adjusted EBITDA	**1,475**	**7,909**	**42,616**	**44,106**	**47,061**
Operating profit	**3,488**	**5,930**	**38,082**	**42,382**	**45,243**
operating margin	*2.2%*	*2.1%*	*8.3%*	*6.3%*	*6.3%*
Finance Income	0	1	1,722	2,692	3,351
Finance costs	-96	-91	-105	-243	-353
Profit/(Loss) before tax	**3,392**	**5,840**	**39,699**	**44,831**	**48,242**
Taxation	1,059	-1,071	-8,839	-11,208	-12,060
Profit/(Loss) after tax	**4,451**	**4,769**	**30,860**	**33,623**	**36,181**
Earnings/(Loss) per share (GBp)					
Basic	**27.3**	**28.9**	**184.9**	**197.3**	**209.3**
Adjusted Basic	**19.7**	**32.1**	**197.8**	**206.2**	**218.0**
Basic diluted	25.6	26.2	169.4	179.2	190.3

Source: Company Accounts, SP Angel estimates

Table 6: Cash Flow Statements (2021-2025E)

Year End December (£'000)	2021A	2022A	2023A	2024E	2025E
Cash Flow from operating activities					
Profit/(Loss) for the financial period	4,451	4,769	30,860	33,623	36,181
Adjustments for:					
Depreciation of property, plant and equipment	255	325	400	596	650
Depreciation of right of use assets	80	80	408	408	408
Amorisation of intangible assets	352	648	680	720	760
Unrealised loss (gain) on derivative contracts	-3,344	926	3,046	0	0
Change in stock	0	-345	-201	0	0
Change in trade and other receivables	-19,700	-17,000	-27,848	-34,192	-7,858
Increase in cash collateral deposits lodged with tradi	0	0	-49,820	49,800	0
Change in trade and other creditors	17,468	23,889	49,584	16,461	3,576
Employee costs & benefits provisions	0	0	-108	0	0
Net finance income	0	-1	-444	2,692	3,351
Finance costs	96	91	105	-243	-353
Taxation	-1,059	1,071	8,839	11,208	12,060
Corporation tax paid	0	0	-627	-11,208	-12,060
Share based payment charge	249	284	1,258	300	300
Cash received on customer contracts	378	0	0	0	0
Net cash from operating activities	**-774**	**14,737**	**16,132**	**72,011**	**21,602**
Cash flows from investing activities					
Purchase of property, plant and equipment	-2,629	-215	-1,372	-500	-500
Payment of software development costs	-1,079	-2,210	-130	-1,000	-1,000
Purchase of Smart Meters	0	0	0	-2,025	-2,328
Acquisitions	0	-216	0	0	0
Net cash from investing activities	**-3,708**	**-2,641**	**-1,502**	**-3,080**	**-3,383**
Cash flows from financing activities					
Net proceeds from issue of new shares	-12	22	125	0	0
Net interest	-77	-76	-106	-243	-353
Equity dividends paid	0	0	-1,002	-8,689	-7,376
Debt facility Smart Meters - drawdown	0	0	0	2,025	2,328
Net change in borrowings & lease obligations	-120	-121	-140	0	0
Net cash from financing activities	**-209**	**-175**	**-1,123**	**772**	**953**
Net increase in cash and cash equivalents	**-4,691**	**11,921**	**13,507**	**69,703**	**19,172**
Gross cash and cash equivalents at start of the period	11,740	7,049	18,970	32,414	102,117
Gross cash and cash equivalents at end of the period	**7,049**	**18,970**	**32,477**	**102,117**	**121,289**
Net cash (debt)	**7,049**	**18,970**	**32,125**	**99,740**	**116,585**
Free cash flow	**-4,559**	**12,020**	**14,524**	**76,367**	**24,220**
Free cash flow margin	**-2.9%**	**4.3%**	**3.2%**	**11.4%**	**3.4%**

Source: Company Accounts, SP Angel estimates

Table 7: Balance Sheets (2021-2025E)

YE Dec (£000s)	2021A	2022A	2023A	2024E	2025E
CURRENT ASSETS					
Stock	0	345	546	546	546
Trade & other receivables	37,359	54,339	127,222	161,414	169,272
Financial derivative assets	3,102	1,484	0	0	0
Trade and other receivables	40,461	55,823	127,222	161,414	169,272
Cash and cash equivalents	7,049	18,970	32,477	102,117	121,289
Total Current Assets	**47,510**	**75,138**	**160,245**	**264,077**	**291,108**
NON CURRENT ASSETS					
Property, plant and equipment	3,751	3,641	4,613	4,517	4,367
Right-of-use asset	193	113	1,676	1,268	860
Intangible assets	1,333	3,111	2,561	2,281	2,041
Deferred tax	5,932	5,300	1,969	1,969	1,969
Financial derivative/other asset	870	1,562	5,231	5,231	5,231
TOTAL NON CURRENT ASSETS	**12,079**	**13,727**	**16,050**	**15,266**	**14,468**
TOTAL ASSETS	**59,589**	**88,865**	**176,295**	**279,343**	**305,575**
CURRENT LIABILITIES					
Trade payables	-3,690	-4,636	-6,492	-22,953	-26,529
Accrued expenses and deferred income	-34,545	-55,281	-88,737	-86,841	-76,949
Other payables	-11,508	-13,943	-32,635	-16,581	-17,393
TOTAL CURRENT LIABILITIES	**-49,743**	**-73,860**	**-127,864**	**-126,375**	**-120,871**
Trades & other payables	-541	-206	-1,281	-158	-158
Borrowings	0	0	-352	-2,377	-4,705
NON CURRENT LIABILITIES	**-541**	**-206**	**-1,633**	**-2,535**	**-4,863**
TOTAL LIABILITIES	**-50,284**	**-74,066**	**-129,497**	**-128,910**	**-125,734**
NET ASSETS	**9,305**	**14,799**	**46,798**	**150,434**	**179,842**

Source: Company Accounts, SP Angel estimates

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