RISKS AND RISK MANAGEMENT

JLEN has a comprehensive risk management framework overseen by the Risk Committee, comprising independent non-executive Directors.

The Company's approach to risk governance and its risk review process are set out in the risks and risk management section of the Annual Report 2022.

The principal risks to the achievement of the Company's objectives are reported on pages 41 to 48 of the Annual Report 2022.

Developments in relation to these principal risks, particularly those which could potentially have a short to medium-term impact during the period to 31 March 2023, are outlined below.

Energy prices and government intervention

Energy prices continue to be significantly elevated from the historical trend. A combination of factors, including disruption to supply chains in the wake of the Covid-19 pandemic and the effect of the Russian war in Ukraine, have contributed to this situation, with no obvious short-term catalyst for prices to return to a more normal lower level. Generating assets in JLEN's portfolio have been benefiting from these higher prices but their ability to continue to do so is at risk. Post the balance sheet date, but prior to publication of this Half-year Report, the UK government announced the Electricity Generator Levy, the means by which it intends to capture what it sees as excess profits being made in the wholesale electricity market by low carbon generators.

The Directors have made an assessment of the way in which the Levy will apply to assets within the Company's portfolio based on the information available as part of quantifying this post balance sheet event. The detailed legislation for the Levy has not yet been introduced, and there is a risk that the way in which the Levy is assumed to apply is incorrect.

Inflation

High inflation is emerging as a key risk in the global economy. In the UK, the latest annual CPI measure stands at 11.1%, while RPI (which is more relevant for the Company as its subsidy revenues and concession-based payments are linked to it) stands at 14.2%.

Governments around the world have reacted to the prospect of high inflation becoming embedded by aggressively raising interest rates from the historic lows that have persisted since the Global Financial Crisis in 2008. In the UK, base rates have increased from 0.1% at the end of 2021 to 3.0% at the time of writing, with further increases anticipated. UK Government bond rates have also moved significantly, with the yield on the 20 year gilt being up to a high of 4.9% towards the end of September 2022, before coming down to 3.4% more recently. This compares to c.1% 12 months ago and raises risks around the valuation of all infrastructure, including those of the Company (see overleaf).

Several other risks for the Company stem from inflation. The most direct risk, concerning variability of costs and revenues, is positively correlated with inflation.

The portfolio has a high proportion of revenues that are linked to RPI and these will exceed any negative cash flow impacts from inflation-linked costs. If higher than trend inflation is expected, then the earnings from the Company will increase, everything else being equal.

If higher inflation assumptions become embedded for the longer term, such that it becomes appropriate for the Company to revisit its long-term inflation assumption of 3% until 2030, then this will also benefit the NAV as future cash flows from the portfolio will be assumed to be higher.

Interest rates

While interest rates have risen, the large majority of JLEN's debt is project finance at the project level, fully hedged against interest rate rises and so this risk is mitigated. However, the Company's revolving credit facility ("RCF") is not hedged and so faces a higher cost of borrowing, although this is not particularly material to the Company.

REMA

The UK Government has launched a far-ranging consultation about the future of the GB electricity market (REMA), intended to ensure that market arrangements promote affordability for consumers and energy security as the GB system decarbonises. In some scenarios considered in the consultation, the basis on which GB electricity-generating assets and battery storage assets in the JLEN portfolio receive revenues could be profoundly changed.

The results of the consultation are not expected to be shared until 2023 and the government's intentions will not become clear until then. If government wishes to adopt some of the more radical changes, then realistic timelines for adoption will probably see the current system remaining in place until the late 2020s. Nevertheless, the assets in the Company's portfolio are long-term infrastructure assets and there is a risk that the current basis for valuing the assets over the long term will need to change to reflect the outcome of REMA.

Gilts/discount rates

As noted above, UK gilt yields have increased significantly in recent months, affected by fears about inflation and exacerbated by negative investor sentiment regarding the state of the UK public finances. This increase has carried across into expectations for discount rates used in the valuation of infrastructure assets, including those of the Company, as some analysts use the "risk-free rate" represented by the yield on government bonds as the starting point for determining discount rates, and then apply a further "risk premium" intended to reflect the risk characteristics of the asset.

This approach has been less prevalent in recent years as very low government bond yields and related risk premia have been harder to reconcile with actual valuations for assets seen in the market. Nevertheless, recent share price movements in the listed renewables sector indicate that investors expect an increase in discount rates and a corresponding decrease in asset values. The Directors have increased discount rates by 0.75% in response to this movement in interest rates, but this represents a judgement and the actual position will only become clear as new transaction data become available.