

# Jersey Electricity

Annual update

## Updated modelling of net zero implications

Jersey Electricity (JEL) has consistently delivered a 5% increase in its DPS, which we expect to continue. Its cautious approach to financial risks means its wholesale electricity market-based exposure is materially hedged until FY25, which helps maintain relative price stability for its customers. It has a strong balance sheet, with cash of £43.1m, and its grid infrastructure is well invested. Electrification of Jersey's heating and transport systems to achieve the government's net zero ambitions provides an opportunity for growth. Based on our detailed modelling and the government of Jersey's (GoJ's) consultation draft of the Carbon Neutral Roadmap, we estimate full electrification of these two areas could increase electricity demand by 454GWh pa (454m units of electricity), representing a 71% increase on the 639m units sold by JEL in FY21.

Year end	Revenue (£m)	EBIT* (£m)	EPS* (p)	DPS (p)	P/E (x)	FCF yield (%)
09/20	112	16.1	37.6	16.5	12.1	11.2
09/21	119	16.3	38.8	17.4	10.3	7.9
09/22e	118	12.5	28.4	18.3	18.7	0.3
09/23e	127	16.4	38.4	19.2	13.8	3.6

Note: \*EBIT and EPS are normalised, excluding exceptional items, one-off items, revaluation gains/(losses) and share-based payments.

## Market-based exposure is materially hedged to FY25

Europe has seen unprecedented increases in energy prices in H221, which are exacerbated by Russia's invasion of Ukraine. French wholesale electricity prices have been amplified by unforeseen nuclear outages, resulting in a fourfold increase in prices since the start of October (on a year-on-year basis). Fortunately, JEL adopts a cautious approach to financial risk and its wholesale electricity price exposure is largely hedged until FY25. This should help maintain relative price stability for its customers.

## Carbon neutrality: JEL well placed to benefit

In December 2021, GoJ published a consultation draft of the Carbon Neutral Roadmap, which sets out proposed targets and policies for Jersey becoming carbon neutral. We believe JEL is well placed to benefit from an increasing drive to electrify the island of Jersey. We model potential additional electricity demand based on the consultation draft. JEL could see electricity sales increase by 114m units (114GWh) by 2030. We believe this can be supplied through its well-invested existing grid infrastructure (with some enhancements to the on-island network), importing the electricity through the existing subsea cables.

## Valuation: Significant upside to modest share price

JEL trades at a discount to our asset-based sum-of-the-parts and discounted cashflow (DCF) valuations. Our overall valuation analysis (based on sum-of-the-parts and DCF) suggests a share valuation of 800p. We cross-check this with a peer valuation of 817p. The current share price appears modest for a company that offers the prospect of consistent increases in DPS, possesses balance sheet flexibility and is well positioned to benefit from decarbonisation initiatives.

### Utilities

4 July 2022

**Price** **530p**
**Market cap** **£162m**

 Net cash (£m) at 31 March 2022, after deducting long-term IFRS 16 lease liabilities of £3.3m **9.8**

 Shares in issue **30.6m**

 Free float **38%**

 Code **JEL**

 Primary exchange **LSE**

 Secondary exchange **N/A**

### Share price performance


 % **1m** **3m** **12m**

 Abs **(0.5)** **(14.2)** **(10.9)**

 Rel (local) **5.2** **(8.5)** **(8.2)**

 52-week high/low **627.5p** **515.0p**

### Business description

Jersey Electricity is the sole supplier of electricity to Jersey. It also operates businesses in retail, property and business services on the island.

### Next events

 FY22 preliminary results **20 December 2022**

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*Jersey Electricity is a research client of Edison Investment Research Limited*

## Investment thesis

### Electricity supplier to Jersey

JEL is the sole supplier of electricity to the island of Jersey. The electricity business is responsible for generating around 75% of group revenues and operating profits. JEL also operates a range of other businesses including property rental, retail and business services. GoJ remains the largest shareholder, with 62% of the ordinary share capital and 86.4% of the voting rights.

### Decarbonisation provides growth opportunities

In March 2021, GoJ appointed an advisory panel for the Citizens' Assembly on Climate Change. Throughout the rest of 2021, the panel consulted with Jersey residents and reviewed technical documentation to inform policy decisions and ultimately net zero targets to be ratified by GoJ. In December, GoJ published a consultation draft of the Carbon Neutral Roadmap. A significant part of Jersey's decarbonisation strategy will be based on the electrification of heating systems and road transport. This presents an opportunity for JEL to grow its unit sales. Greater clarity on policy initiatives could provide impetus to JEL's share price; our indicative valuation of 800p, which takes account of decarbonisation scenarios, is 51% above JEL's share price of 530p.

We model potential additional electricity demand based on our assessment of the feasibility of the government targets, corresponding policies and funding for incentives in the consultation draft of Carbon Neutral Roadmap. We cross-check our projections against two scenarios, net zero by 2050 and net zero by 2040, that we modelled in [our June 2021 outlook report](#).

**Exhibit 1: Incremental electricity demand pa by 2030 (GWh or m units)**

Scenario	Heating	Road transport	Energy efficiency	New builds	Other**	Total	Increase on JEL's FY21 units sold
1. Base case	71	36	(16)	28	(31)	88	14%
2. Net zero by 2050*	58	29	(17)	26	(31)	65	10%
3. Net zero by 2040*	114	58	(26)	26	(31)	141	22%

Source: Edison Investment Research. Note: \*Adjusted from previous outlook report for FY21 and medicinal cannabis. \*\*A decrease of 36m units compared to the FY21 base year due to the impact of a mild winter (in FY22), less working from home and consumers reducing their energy usage in response to three tariff increases, partially offset by an increase of 5m units due to demand from the new medical cannabis industry.

### Financials: Stable returns, solid cash flow and DPS growth

- Profits and returns: we forecast that JEL maintains profitability within its targeted range of 6–7% (pre-tax) return on regulated assets, except for FY22 where we estimate a return of 5%. This is because of a decrease in units sold due to the impact of a mild winter (in FY22), less working from home and consumers reducing their energy usage in response to three tariff increases (including two planned). The planned tariff increases in July 2022 and January 2023 should increase returns back into the 6–7% range and are intended to smooth the trajectory of tariff increases towards FY25 when JEL becomes more materially exposed to wholesale electricity prices.
- The continued strong performance by JEL's retail business, due to COVID-related restrictions, in FY21 and a second consecutive profitable year for its Building Services division have demonstrated that JEL's non-energy businesses can contribute solid earnings, which should feed through to cash flow. As COVID-related restrictions are eased, we expect the property business to become a stable earnings base for the non-energy businesses.
- Balance sheet: JEL's balance sheet has a net cash position of £9.8m (end-H122), which comprises cash of £43.1m, long-term debt of £30m (expiring in 2034 and 2039) and is after deducting long-term IFRS lease liabilities of £3.3m.

- **Cash flow:** we forecast an average free cash flow (FCF) yield of 2% in FY22–24, due to additional capex of £20m for a new gas turbine, which is higher than our previous estimate of £12m and reflects JEL's objective of enhancing energy security. From FY25, FCF yield increases to 6–7% as capex normalises. JEL's balance sheet capacity would allow for debt redemption or special dividend payments, but our forecasts do not assume either.
- **DPS:** we believe that, despite a decrease in profits in FY22, JEL can continue to deliver 5% pa increments to its annual DPS payments, with coverage (from earnings) remaining above 1.5x even projecting out to 2031, with the dividend yield increasing to 5% by then.

## Sensitivities: Net zero pathway, pricing and security of supply

- **Net zero pathway:** JEL's strategic investment plans are dependent on the net-zero emissions pathway the GoJ decides to ratify. If the net zero pathway is notably more aggressive than our base-case projections, then significant strategic investment would be required over an accelerated timeframe. This may lead to reduced returns on investment unless tariffs are increased.
- **Pricing:** JEL imports c 95% of its electricity from France through Électricité de France (EDF); a sustained upward movement in French wholesale prices and/or deterioration in the FX rate would require JEL to raise tariffs to preserve its rate of return. Increasing prices could elicit regulatory scrutiny. JEL has a longstanding relationship with EDF. Its existing 15-year agreement runs until the end of FY27. JEL does not expect any change to its arrangement with EDF as a result of Brexit.
- **Regulation:** JEL's dominant energy business is self-regulated. An imposed reduction in returns by an independent regulatory body of 1.0pp would reduce operating profits by £1.8m pa.
- **Interconnector failure:** in the absence of lower cost imports, in the case of an interconnector failure, JEL would be forced to rely on more expensive and more environmentally polluting on-island generation. However, spare cable lengths are held in Holland, so a repair would likely be possible within a known timeframe.
- **Minority:** GoJ owns 86.4% of the voting rights of the company. Other shareholders continue to bear the risk associated with their position as minority shareholders.

## Stable profits, strong cash flow and a solid platform

In this report we analyse JEL's efforts to fulfil its core objective of secure, affordable and sustainable electricity, review the initiatives it has taken that are designed to help the island achieve a zero-carbon future and analyse the opportunities that could arise from Jersey's ongoing consultation relating to a 'carbon neutral roadmap'.

### Solid FY21 results but some weakness in H122

Revenue for FY21 was £119m, an increase of 6% over FY20 (£112m). The revenue growth was driven by higher unit sales of electricity (639m versus 619m in FY20), due to a recovery in retail and hospitality sectors as COVID-19 restrictions eased, increased working from home and colder than normal weather, combined with a 2.5% tariff rise from October 2020. However, revenue for H122 was down 3% versus H121 (£65.0m versus £67.1m). This was due to milder-than-usual weather combined with less working from home resulting in lower domestic consumption, causing a 4% decrease in unit sales to 359m in H122 (375m in H121). In contrast, cost of sales and operating costs increased by c 3% and c 2% respectively in H122 versus H121, resulting in a decrease in recurring operating profit margin to 11.8% in H122 from 16.8% in H121. This led to a 34% decrease in net income to £5.5m in H122 (£8.3m in H121). On the other hand, PBT for FY21 was £19.1m,

which is 29% ahead of FY20 (£14.8m). However, adjusting for a revaluation gain of £6.1m and a non-recurring (and non-cash) ex-gratia award for pensions in service (£1.8m), gives underlying PBT of £14.8m, which is a slight increase on FY20 (£14.7m). Similarly, adjusted operating profit for FY21 (£16.3m) was slightly ahead of FY20 (£16.1m).

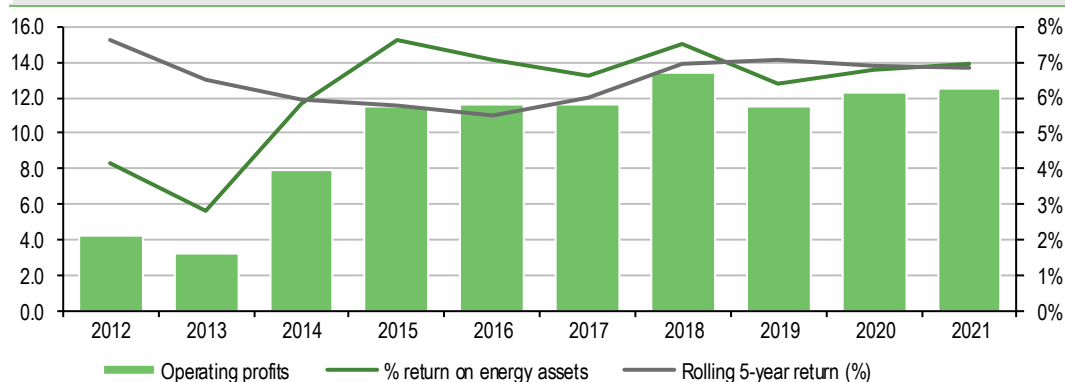
On a divisional basis, adjusted (recurring) operating profit for Energy (£12.5m) was 2% ahead of FY20 (£12.3m). This was due to the increase in volume sales, but was partially offset by higher energy costs that were not fully passed on to the consumer during the period. For H122, as unit costs decreased compared to H121, and due to energy costs continuing to rise, reported operating profit decreased by 31% y-o-y. For FY21, Retail had another stellar year with 11% revenue growth to £20m and margin expansion from 6.6% in FY20 to 7.7% in FY21, giving rise to a 30% increase in operating profit to £1.5m. The strong performance in retail has been driven by its online business and increased demand from people staying at home due to COVID-19 restrictions. For H122, this trend has started to reverse, which has seen revenue decrease by 12% y-o-y and operating margin decrease from 9.4% in H121 to 6.9% in H122. This resulted in a 35% decrease in operating profit year-on-year. For FY21, Building Services' operating profit remained steady at just over £0.2m following its turnaround in FY20. This steadiness continued in H122 with reported operating profit of £0.1m. Operating profit for Property was £1.4m, which is below FY20 (£1.7m) when adjusted for £0.4m of accelerated depreciation. However, similarly, Property remained steady in H122 with reported operating profit of £0.7m. Other businesses were also below FY20 on an operating profit basis (£0.6m vs £0.8m).

For FY21, operating cash flow (pre-tax, pre-interest) was £26.5m, which is £4.5m lower than FY20 (£31.0m), mostly due to a swing in working capital movement (by £4.7m). Capex was £9.3m, which is £2m below FY20, due to deferred investment on items such as the new transformer for Queen's Road. FCF was £7.6m, which increased JEL's net cash to £10.0m (from £2.6m at end FY20), after deducting long-term IFRS 16 lease liabilities of £3.1m (FY20: £2.9m). By the end of H122, net cash had decreased slightly to £9.8m (including lease liabilities of £3.3m). JEL increased its final dividend by 5%, to give a total dividend for the year of 17.4p per share (FY20: 16.5p), and has also increased its interim dividend (for H122) by 5% to 7.6p.

## Regulation

In our March 2019 outlook note on JEL, we [outlined in some detail](#) the potential changes being considered for the regulatory system. Up to this point there have been no concrete proposals for change and no move on the part of the GoJ to amend the Electricity Law of 1937, which it remains committed to reviewing. JEL therefore continues to operate on a self-regulated basis, aiming to meet two self-imposed regulatory targets. That is, JEL seeks a return of 6–7% (pre-tax and interest) on its energy business (operating fixed assets net of customer contributions) on a rolling five-year basis and ensure its tariffs remain within  $\pm 10\%$  of the EU-15 average (inclusive of all taxes).

In FY21, JEL's reported return on assets was 5.9%, which on adjustment for non-recurring (and non-cash) past service costs of £1.8m becomes 7.0% (up from 6.8% in FY20). It is within JEL's targeted range and the current rolling five-year average rate of return remains below 7.0% (at 6.9%). The five-year return figure reflects a period of steady profitability following the volatility caused by the interconnector failure in 2012–13.

**Exhibit 2: JEL energy business – operating profit (LHS, £m) and estimated return on assets**


Source: Edison Investment Research, JEL

In comparison, Ofwat used a rate of return (pre-tax nominal) of c 5.0% for the UK water companies in its latest periodic review of the sector (PR19). Ofwat's allowed rates of return are below those used by JEL, although we would caution against an over-simplistic comparison of headline rates of return. The method for calculating invested regulatory capital can differ significantly between industries and, in addition, the UK water sector benefits from an annual inflation-linked increase in its regulatory capital value; JEL does not. However, by way of illustration a 1.5pp (from 6.5% to 5.0%) reduction in allowed pre-tax returns would result a reduction in operating profit of c £2.7m pa (FY21 recurring operating profit was £16.3m, excluding revaluation of investment properties).

## Customer service performance remains strong

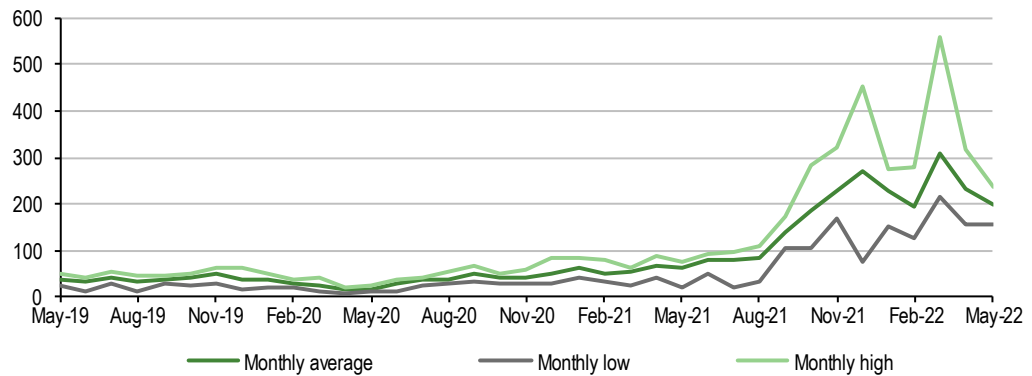
Although JEL remains a self-regulated entity, delivery of satisfactory standards of service for customers remains another key benchmark. JEL has taken part in the UK Customer Satisfaction Index for the last three years (2019–21). In 2021, it gained a rating of 78.4%, which is above the average for utilities of 73.5%. It positions JEL fifth out of 34 utilities, with only two power utilities (Octopus Energy and UK Power Networks) scoring higher. It is JEL's highest score yet; it compares to 77.0% in 2020 and 78.0% in 2019. According to previous surveys of customer opinion carried out for JEL, the three most important elements of customer service are cost and price stability, security of supply and environmental performance. We examine JEL's track record in each of these three areas below. In particular, we review in greater detail JEL's environmental performance in light of the impact it has had in reducing the island's carbon emissions, the declaration by the GoJ of a climate emergency (May 2019), and the business opportunities that might arise from further decarbonisation.

## French wholesale pricing

On a monthly average basis, the day-ahead wholesale electricity price in France increased fivefold y-o-y from €51/MWh in December 2021 to c €272/MWh in December (peaking daily at €455/MWh in December); it reduced to c €200/MWh, on average, in January and February before reaching a new high in early March (€560/MWh), following Russia's invasion of Ukraine. On average, from October 2021, monthly average prices have equated to a fourfold increase y-o-y. The strong increase in prices since the end of H121 can be attributed to unprecedented increases in natural gas prices combined with unexpected maintenance of nuclear reactors. In total, 17 of the country's 56 nuclear power plants were undergoing planned or unexpected maintenance during H221. This has caused France, which has been one of Europe's largest exporters of electricity over the last few years, to become a net importer over November 2021 to January 2022, although we understand levels of imports are decreasing due to mild weather since the start of the year. As many of the nuclear outages are now expected to last well into 2022, to prevent power outages France is increasing its utilisation of domestic coal fired plants. It expects to exceed its self-imposed

limits (for climate change reasons) on coal usage and despite high European carbon price, this should help alleviate wholesale prices, to some extent. However, as there appears to be no end to the gas crisis, we struggle to envisage long-term wholesale electricity prices below €60–70/MWh (real).

**Exhibit 3: France – wholesale electricity price (€/MWh)**



Source: Edison Investment Research, Bloomberg

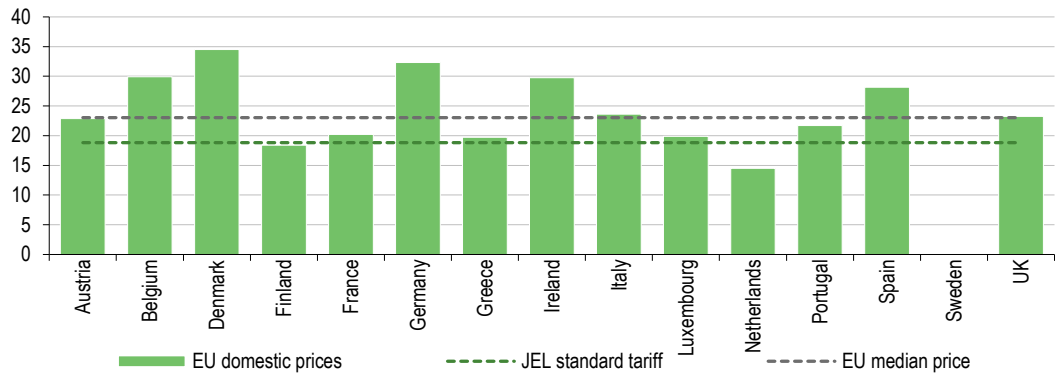
JEL's pricing mechanism with EDF is split between a fixed price element (roughly one-third) and a market-exposed element. In addition, there are transport costs payable to RTE (the grid operator). Fortunately, JEL has always been cautious in hedging its market exposure and, we are informed by management, is materially hedged over FY22–24 with a capped price mechanism likely kicking in during FY23 and FY24. The hedges (and capped price mechanisms) are significantly below prevailing market prices and more akin to the wholesale price before the energy crisis, in H121. We assume JEL's wholesale price exposure is €70/MWh (real) from FY25, which is a c 25% increase above our estimated cost for FY24 (in real terms). This is notably above the average wholesale price (using day ahead prices) over the period May 2019 to May 2021 of €40/MWh, however, is inherently subjective to forecast. Although JEL seeks price stability, any cost increases are ultimately passed to the consumer. We believe that JEL's recently announced tariff increases will help mitigate against this projected discontinuous jump in electricity costs in FY25. We estimate that a further tariff increase of 4% (in real terms) would be required by FY25, in order to maintain return on capital for FY25 above 6%. This rise would be notably higher were it not for our forecast increase in volume sales and is significantly lower than price increases in the UK and expected increases elsewhere in Europe (discussed below).

## Pricing

JEL increased tariffs by 4% from 1 January 2022, and recently announced a tariff increase of 5% from 1 July 2022 and an intention to implement a further 5% rise from 1 January 2023. These tariff increases are a result of unprecedentedly high wholesale prices and JEL wanting to smooth the trajectory of tariff increases towards FY25 when it becomes more materially exposed to wholesale electricity prices. This tariff increase is modest compared to the increase in the French wholesale electricity price (discussed in the sub-section above) and is a testament to JEL's cautious approach to hedging.

Exhibit 4 shows EU-15 retail electricity prices for H221, which are the latest available data from Eurostat. These are prices from during the start of the European energy crisis, and do not factor in more recent price hikes. For a like-for-like comparison, we use JEL's domestic price from H121, before the 4% increase in January 2022, of 15.7p/kWh (or 18.8c/kWh). JEL's tariff is 18% below the EU median price.

**Exhibit 4: JEL's standard domestic tariff (inclusive of taxes) versus EU-15 (c/kWh) for H221\***



Source: Edison Investment Research, Eurostat, JEL. Note: \*Latest available data.

As an indication of how prices have increased during the energy crisis, based on UK energy price cap data, which has an impact on c 22 million customers, the average price cap for 1 October 2021 to 30 September 2022 implies a 49% increase over a year earlier (in nominal terms). In addition, Reuters has reported that German electricity bills will go up by an average of 63.7% in 2022.

Another factor that is mitigating against JEL's requirement to increase tariff prices is the increase in volume sales (we forecast a 10-year CAGR of 2%). The upwards pressure on volume sales from Jersey's decarbonisation is particularly significant from FY25, when JEL becomes exposed to market prices. It should help mitigate against the need for further significant tariff increases beyond those planned in July 2022 and January 2023. However, if GoJ's policy support for electric vehicles (EVs) and heating do not result in decarbonisation as quickly as our projections (which are significantly below GoJ's own 'aspirational' targets) then there would be additional upwards pressure on tariffs.

## Security of supply

JEL imports 95% of its electricity from EDF (through undersea cabling to mainland France). In the absence of significant on-island power generation, JEL is heavily reliant on this supply. France has set a legally binding target of net zero by 2050 and will itself see a significant increase in electricity demand due to the electrification of road transport in the coming years, although it hopes to offset a significant portion of this by reducing electricity consumption by 40%. Until October 2021, France was one of Europe's largest electricity exporters. Based on data from Ember, in 2021, France produced 528TWh and exported 42TWh (c 8% of production); the net exports include 3TWh of net imports in November and December. Based on data from the National Low Carbon Strategy, published by France's Ministère de la Transition Ecologique et Solidaire in March 2020, France's total projected energy requirement in 2050 is 1,060TWh, of which 55% is expected to be met from carbon-free electricity, equating to an electricity requirement of 583TWh. To meet this and maintain its current level of exports, we estimate France will need to increase electricity production by 97TWh pa and replace 51TWh pa of existing fossil fuel generation capacity (coal, oil and gas). This equates to required new electricity production of 148TWh pa, which is a 28% increase in existing production. This estimate does not take into account any underutilised capacity implicit in the 2021 production figure, including the nuclear outages, nor does it account for the replacement of any ageing non-fossil fuel power generation sources that reach the end of their useful economic life before 2050.

JEL's metric for measuring security of supply is customer minutes lost (CML). In FY21, according to JEL, only five minutes were lost, the same as in FY20 and better than all other years over the last 10 years (Exhibit 5). With the exception of a spike in minutes lost in 2012 due to the failure of the

interconnector, the extent of interruptions has remained low (10-year average of nine minutes). In comparison, in 2019/20 UK distributors averaged roughly 35 CML, based on data from OFGEM.

**Exhibit 5: Annual customer minutes lost 2012 to 2021 (for JEL)**

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Customer minutes lost	293	13	10	7	24	8	6	6	5	5

Source: Edison Investment Research, JEL

The success in restricting CML can be attributed to the efficacy of JEL's capital expenditure programme, which has entailed average annual capital expenditure of c £19m (depreciation c £10m per year over the same period) over the last 10 years, including strengthening and upgrading of the interconnectors with France. Total interconnector capacity totals 202MW versus a record peak demand figure of 178MW (March 2018) (peak of 170MW in FY21). Most recently JEL brought into service (December 2018) the St Helier West Primary Substation (£17m cost), which relieves pressure on supplies to St Helier and is designed to 'future proof' the network.

Interconnector capacity of 202MW allows up to 1,770GWh (or 1,770m units) of peak demand electricity. Based on this, combined with the historical peak demand to annual sales ratio (see Exhibit 6), we estimate that JEL could increase imported electricity to up to around 800GWh (or 800m units) without overstressing the system at peak demand; 800GWh implies a ratio of peak demand to annual sales of 2.2x. This compares to forecast units sold in 2030 of 766m units.

**Exhibit 6: Peak demand to annual sales ratio for 2012–21 (for JEL)**

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Peak demand capacity (MW)	161	155	139	148	149	154	178	150	141	170
Date	02-Feb	28-Feb	03-Feb	05-Feb	19-Jan	26-Jan	01-Mar	15-Dec	04-Dec	11-Feb
Peak demand (GWh)	1,410	1,358	1,218	1,296	1,305	1,349	1,559	1,314	1,235	1,489
Annual sales (GWh)	637	663	621	627	625	621	634	627	619	639
Ratio of peak demand to annual sales	2.2x	2.0x	2.0x	2.1x	2.1x	2.2x	2.5x	2.1x	2.0x	2.3x

Source: Edison Investment Research, JEL

Only in FY18, which was an outlier, was the ratio higher (at 2.5x); using this ratio instead implies potential imported electricity of just 720GWh (or 720m units).

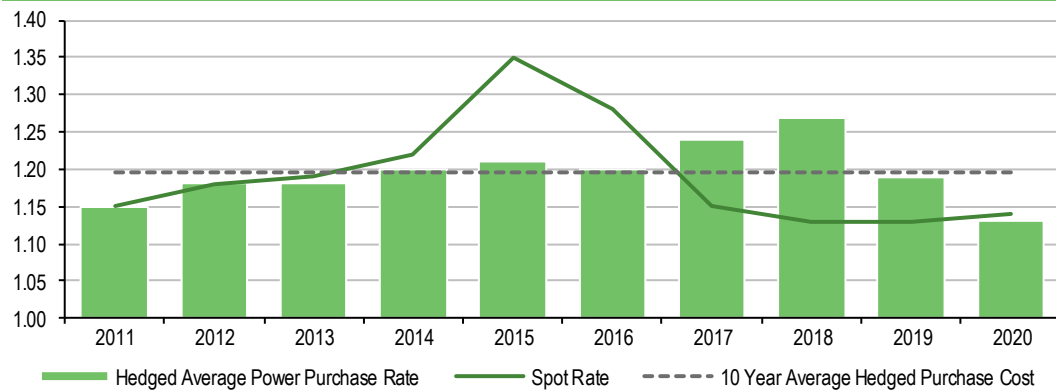
## Foreign exchange

In addition to the risks associated with the movement in the French wholesale price, JEL must also manage the currency risk related to the purchase of its power (in euros) but with a sales price denominated in sterling. To manage this, JEL enters into forward currency contracts (on a rolling three-year basis) to reduce exposure and assist in tariff planning. In broad terms, over the last 10 years, JEL has matched the effective exchange rate of its underlying electricity purchases with the average prevailing spot rate for £/€ (both average c 1.19).

However, as can be seen in 2017 and 2018 (Exhibit 7), JEL was able to lock in average power purchase exchange rates significantly above the spot rate thanks to the prevailing strength of sterling in 2015 and 2016 (mostly before Brexit-related currency weakness). However, in 2019 the hedging position began to unwind, with the £/€ rate associated with the purchase of electricity declining from a relatively favourable 1.27 in 2018 to 1.17 at the end of 2019. The current £/€ spot rate of around 1.15 is slightly below the 10-year average. All else being equal, a strengthening of sterling would reduce energy purchase costs for JEL. In its 2020 annual report, JEL stated it was 'materially', but not fully, hedged for 2021–23.



**Exhibit 7: Hedged average power purchase rate versus average spot rate 2012–21 (£/€)**



Source: Edison Investment Research, JEL

## Environmental performance and targets

As we have noted in previous reports, JEL imports around 95% (FY20: 95%) of its electricity through three undersea supply cables from France. Although the majority of the imported power is sourced from nuclear stations, a third of the imports are from renewable hydro sources. The mix of nuclear and hydro provides JEL (and the island) with very low carbon electricity and, at a carbon intensity of 23g CO<sub>2</sub>e/kWh, it is c 10% of the carbon intensity of the emissions of the UK's electricity system as a whole (233g CO<sub>2</sub>e/kWh) based on figures produced by the Department for Business, Energy and Industrial Strategy. The carbon intensity of JEL's electricity is also c 90% below that of local gas and heating oil and the company has played a key role in reducing the greenhouse gas emissions of the island (by 47% between 1990 and 2017).

Beyond the importation of low-carbon electricity, JEL continues with other environmental initiatives. It now owns and operates four rooftop solar plants, under long-term power purchase agreements (PPAs), with a combined capacity of nearly 1MW. The largest of the solar plants were both commissioned during FY21 at Jersey Dairy and Woodside Farm (combined 805kWp). During FY20 JEL installed Jersey's first Solar Hub, combining a 53kWp solar photovoltaic (PV) array and two 22kW EV charge points, which followed the installation (in partnership with SunWorks) of a photovoltaic array at La Collette (81kWp) in FY19. In total, the four plants are estimated to generate c 1,000,000kWh pa).

JEL has appointed a dedicated solar project officer to its energy solutions team to seek out more suitable sites for solar PV installations and has said it is happy to enter long-term PPAs with local developers to help facilitate the financing of projects. Promotion of energy efficiency also forms part of JEL's environmental strategy and a key part of this is the island-wide roll out of smart meters, which JEL completed during FY20; around 51,000 smart meters have now been installed in Jersey. JEL has also entered a tree-planting project with Jersey Water (a National Trust initiative), planting 6,000 trees on a 20-acre site in the Mourier Valley over a three-year period.

## Decarbonisation of Jersey: A growth opportunity

This section should be read in conjunction with the same section of our June 2021 outlook report. In March 2021, GoJ appointed an advisory panel for the Citizens' Assembly on Climate Change. Throughout the rest of 2021, the panel consulted with Jersey residents and reviewed technical documentation to inform policy decisions and ultimately net zero targets to be ratified by GoJ. In December, a consultation draft of Carbon Neutral Roadmap was published by GoJ. A significant part of Jersey's decarbonisation strategy will be based on the electrification of heating systems and road transport. These two sources of emissions account for about two-thirds of total emissions in

Jersey. We estimate that c 45% of residential properties (c 20,000) use non-electric heating, mostly fuel oil but also liquified petroleum gas (LPG), and just over 1% of vehicles are electric.

Based on our detailed modelling, we estimate that full electrification of these two areas could increase electricity demand by 454 GWh (or 454m units of electricity), representing a 71% increase on the 639m units sold by JEL in FY21. This is slightly less than our estimate of 477GWh in our previous [June 2021 outlook report](#), as we now assume that commercial customers switching from fossil fuel heating to electric heating use a higher proportion of heat pumps than residential customers (and therefore consume less electricity). In our modelling, we also take into account the impact of energy efficiency measures and increased demand from new housing builds and medicinal cannabis. We formulate our projections based on our assessment of the feasibility of the government targets and corresponding policies in the consultation draft of Carbon Neutral Roadmap. We cross-check our projections against two scenarios, net zero by 2050 and net zero by 2040, that we modelled in our June 2021 outlook report. We do not cross-check against our net zero by 2030 scenario from that report, as it is clear from the consultation draft of Carbon Neutral Roadmap that carbon neutrality by 2030 is unattainable without the purchase of carbon offsets (which are not included in our modelling).

**Exhibit 8: Incremental electricity demand pa by 2030 (GWh or m units)**

Scenario	Heating	Road transport	Energy efficiency	New builds	Other**	Total	Increase on JEL's FY21 units sold
1. Base case	71	36	(16)	28	(31)	88	14%
2. Net zero by 2050*	58	29	(17)	26	(31)	65	10%
3. Net zero by 2040*	114	58	(26)	26	(31)	141	22%

Source: Edison Investment Research. Note: \*Adjusted from previous outlook report for FY21 and medicinal cannabis. \*\*A decrease of 36m units compared to the FY21 base year due to the impact of a mild winter (in FY22), less working from home and consumers reducing their energy usage in response to three tariff increases, partially offset by an increase of 5m units due to demand from the new medical cannabis industry.

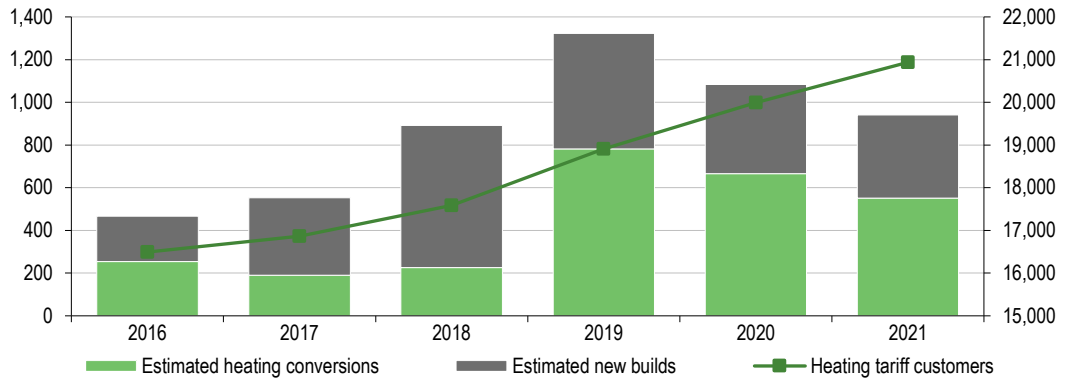
## Heating

Proposed policies relating to heating set out in the consultation draft, dated December 2021, of Carbon Neutral Roadmap include:

- Providing a subsidy to enable both householders and commercial businesses to transition to low-carbon heating systems. The scheme will run from 2022 until 2025.
- Prohibiting new fossil fuel boilers being installed in any property after 1 January 2026.

In recent years JEL has actively sought to assist islanders in switching from fossil fuel heating to electricity via its expanded energy solution team. In July 2018, to augment the rate of switching, JEL opened a Smarter Living hub and customer information centre within its Powerhouse retail outlet. We estimate new electric heating conversions during the year from the change in the number of customers using JEL's discounted heating tariff adjusted for the number of new builds (estimated from JEL's increase in new supply customers), which we assume all use electric heating from 2019; 50% had electric heating in 2016–17 and 75% in 2018.

**Exhibit 9: Estimated number of residential heating conversions and new builds (LHS) and number of customers using JEL's heating tariff (RHS)**



Source: Edison Investment Research, JEL

In 2021, 941 customers were added to JEL's heating tariff, which, adjusted for estimated new builds of 390, suggests there were an estimated 551 heating conversions; JEL's energy solutions team retrofitted 316 of these homes to electric heating (225 in 2020). The decrease in customers switching to JEL's heating tariff compared since 2019 is mostly due to restrictions relating to the COVID-19 pandemic.

In the consultation draft of Carbon Neutral Roadmap, GoJ is targeting 16,000 residential boilers and 1,700 commercial boilers are switched to electric heating systems by 2030 and all remaining boilers by 2034. In our view, this is aggressive not least because GoJ is budgeting to subsidise just under 1,000 residential heating system replacements, in total, over the next four years (2022–25), at a cost of £5.7m, compared to an average of 2,000 replacements per year required to meet the government's 2030 target. Furthermore, GoJ is proposing to prohibit new fossil fuel boilers being installed from 2026 (and inconsistently on p52, para 7.26 of the consultation draft of Carbon Neutral Roadmap, it suggests prohibiting them from 2030); with an average life of a boiler of 15 years, presumably these properties would not want to switch to an electric heating system by 2034, unless sufficiently incentivised. In addition, we believe the number of boilers to be switched in such a short period (17,700 by 2030) far exceeds the current on-island technical resource, thus heating engineers would need to be recruited from outside of Jersey and housed.

As such, we are cautious in our projections and assume that new electric heating systems are installed on a linear basis of 838 per year to 2050. This is still notably higher than 2021 and above the highest-ever level of 781 conversions in 2019 (pre-COVID-19). We would need to see significant impact from GoJ's policies, assuming they are passed into law, before we become more aggressive in our projections. Our annual heating conversion assumption comprises 727 residential heating systems and 112 more complex commercial heating systems. We estimate that commercial heating customers consume more than three times the residential heating customers. Thus, the incremental increase in electricity units for this (base case) scenario is higher than the net zero by 2050 scenario in our previous outlook report, which assumed only residential conversions to 2030 (followed by an accelerated pathway including commercial conversions beyond 2030). We assume the average electricity consumption per residential conversion steadily decreases from c 8,500kWh (or units) in 2021 to c 6,400kWh by 2030 due to a higher proportion of heat pumps being installed, particularly in larger residential properties. We assume the share of heating pumps in new residential conversions increases steadily from 5% in 2021 to 40% by 2030. For the same reason, we assume a reduction for commercial customers from c 29,000kWh in 2021 to c 19,000kWh by 2030, on average. We assume the share of heating pumps in new commercial conversions increases steadily from 40% of new conversions in 2021 to 80% by 2030. This assumption is highly subjective and cannot be easily substantiated.

## EVs

Proposed policies relating to EVs set out in the consultation draft of Carbon Neutral Roadmap include:

- Prohibiting the importation and registration of petrol and diesel cars and small vans that are new from 2030 at the latest and extend this to other categories of vehicle at subsequent dates between 2030 and 2040.
- Introducing a vehicle scrappage scheme to target the most polluting vehicles. Owners of petrol or diesel cars or small vans that are over 10 years old will receive a £500 credit for scrapping their vehicles. The £500 credit can be used on public transport, shared mobility or to buy/access bicycles.
- Subsidising the cost of an EV at the point that it is first registered in Jersey, for both new and imported second-hand vehicles.
- Working with Jersey Electricity to agree a scale-up plan for EV charging infrastructure. JEL continues to invest in extending and improving Jersey's EV charging infrastructure, with 95 public EV charge points installed by the end of 2021 (2020: 53).

At the end of 2021, there were c 1,250 pure EVs on Jersey (2020: c 850), representing c 1.1 % of the estimated licensed vehicle base ('parc') of roughly 115,000 vehicles (2020: c 0.8%). We estimate a licensed vehicle base from the registered vehicle base in Jersey of 127,661 vehicles (GoJ data at 31 December 2021), by assuming 10% of registered vehicles are not in use. This is consistent with data from the UK Department for Transport, which imply that between 8% and 12% of vehicles were declared off road (SORN) on an annual basis over 2015–21. Based on our estimates, new EV sales as a percentage of total new vehicle sales have been increasing annually from under 1% in 2016 (based on 56 EVs sold) to 8% in 2021 (based on 426 EVs sold). We define new vehicle sales as new vehicle registrations in Jersey and thus they can include older vehicles imported to the island. We use the two terms interchangeably.

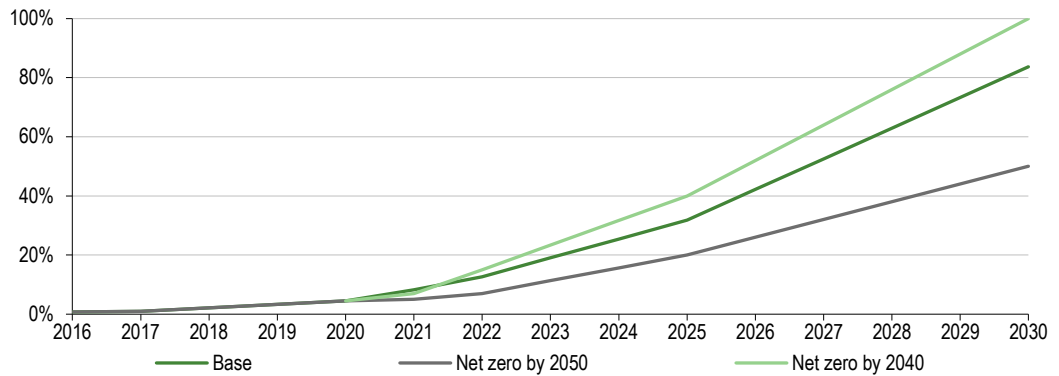
In our base case, from 2030 we assume only non-petrol or diesel cars and small vans are newly registered, in line with GoJ's proposed policy. As Jersey is a small island, battery range anxiety should be less of an issue than elsewhere, thus we assume all newly registered vehicles from this point are pure EVs, rather than a mix of plug-in hybrids and pure EVs. Similarly, for larger vehicles, we assume only pure EVs are newly registered from 2035 (in reality, some of these could be hydrogen vehicles; however, GoJ's stance on hydrogen infrastructure is not yet fully developed). Our assumed profile for new EV sales as a percentage of new vehicles sales is closer to our previously modelled net zero by 2040 pathway than net zero by 2050 (see Exhibit 10).

We assume the parc of vehicles (and total registered vehicles) increases by 0.5% per year, which equates to an increase of 585 vehicles per year (650 pa for total registered vehicles), on average, over the period to 2030. The annual increase in total registered vehicles equates to new vehicles sales less vehicles scrapped (which includes removals and exports). GoJ is proposing to set aside c £6.1m for incentives to speed up the adoption of EV. This is intended to incentivise the purchase of 1,606 EVs and 1,031 EV chargers. Based on our assumed profile of new EV sales as a percentage of new vehicles sales, we estimate new EV sales of c 7,000 vehicles over the five-year period to 2026 and by 2030 annual EV sales of c 4,500 vehicles (which equates to c 85% of new vehicle sales). On this basis, arguably the GoJ's incentive scheme might need to be extended.

We note that the consultation draft of Carbon Neutral Roadmap provides an 'aspirational' target of 59,000 EVs on the road by 2030. This compares to c 23,000 EVs in our base projections, which are derived from GoJ's policy measure of prohibiting petrol and diesel cars and small vans from 2030 and all other vehicles at subsequent dates between 2030 and 2040 (which assume by 2035). To achieve 59,000 EVs on the road by 2030 (which equates to new EV registrations of c 7,375 per year over the next eight years), in our view all fossil fuel vehicles would need to be banned

immediately and the proposed EV incentive scheme funding pool increased to at least c £200m, amongst other things.

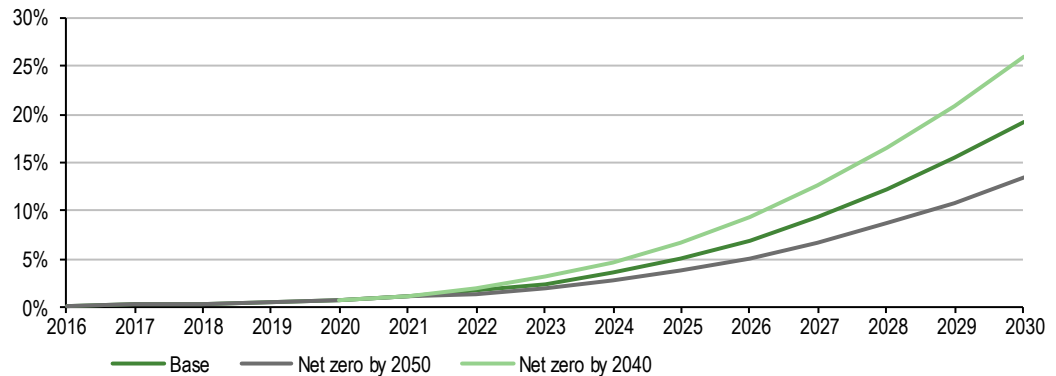
**Exhibit 10: New EV sales as a percentage of new vehicle sales**



Source: Edison Investment Research, GoJ

Due to the size of the existing parc and adopting a current vehicle 'scrappage' rate (including removals and exports as well as scrapped vehicles) of roughly 4% of parc per year, even with new EV sales as a percentage of total vehicle sales over 80% by 2030. As shown in Exhibit 11, in our base projections EVs only account for c 20% of the total parc by 2030, which is roughly halfway between our net zero by 2050 and net zero by 2040 scenarios. Even in our net zero by 2040 scenario, EVs only account for c 25% of the total parc by 2030 and this is despite new EV sales as a percentage of total vehicle sales reaching 100% by then. This is due to the sheer size of the existing parc coupled with the current vehicle 'scrappage' rate (including removals and exports as well as scrapped vehicles) being in the region of 4–5% of parc per year. This implies the existing parc would take 20–25 years to be replaced with EVs, unless scrappage rates dramatically increase. GoJ's proposed vehicle scrappage scheme, while a starting point, only extends to the scrappage of 500 vehicles; this removes just 0.4% of the existing parc (of 115,000 vehicles).

**Exhibit 11: Total EVs as a percentage of total parc**



Source: Edison Investment Research

## Energy efficiency and new builds

See our [June 2021 outlook report](#). We have made no changes to our assumptions.

**Exhibit 12: Estimated new build properties and corresponding contribution to electricity demand (in m units)**

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2021–30e
JEL supply customers	48,452	48,623	48,941	49,320	49,532	49,894	50,561	51,103	51,522	51,912	
% y-o-y increase	1.0%	0.4%	0.7%	0.8%	0.4%	0.7%	1.3%	1.1%	0.8%	0.8%	0.5% pa
Estimated new builds	462	171	318	379	212	362	667	542	419	390	263 pa*
Estimated new demand	4	1	3	3	2	3	7	7	5	5	3 pa

Source: Edison Investment Research, JEL. Note: \*On average.

## Medical cannabis

Authorised growing of cannabis for medical reason is now possible on Jersey. Cultivation of cannabis is energy intensive, primarily driven by the need for UV lighting. Based on conversations with JEL, we estimate this could increase volume sales by 5m units in FY22. We await data relating to the initial success (or otherwise) of the industry before forecasting any growth beyond this; we thus assume a flat 5m units pa for now.

## Board, management and shareholder structure

The most recent board changes are the retirement of Aaron Le Cornu, who retired at the 2021 AGM, and the resignation of Peter Simon who stood down due to a new business opportunity. As part of succession planning, Mr Le Cornu's retirement from the board had already been anticipated by the recruitment of Amanda Iceton in June 2020. Kayte O'Neill, who works with National Grid was appointed at the March 2022 AGM. The board has eight members, the chairman, five other non-executive directors and two executives, Chris Ambler (CEO since 2008) and Martin Magee (CFO since 2002).

JEL's three-tiered shareholding structure, including ordinary, 'A' shares and preference shares, remained unchanged in FY21. The ordinary shares (19m in issue) entitle the holder to one vote for every 20 shares held, whereas the 'A' Shares carry the right to one vote for every 100 shares held. Due to this shareholding structure, the States of Jersey (SoJ) continues to hold all the ordinary shares and owns 62% of the total capital but possesses 86.4% of the total voting rights.

## Risks and sensitivities

Below we list the principal sensitivities determining JEL's profitability:

- **Regulation:** JEL's dominant energy business (c 80% of operating profits) is self-regulated. As we have written, in recent years there has been much discussion of the efficacy of the current regulatory system, although no firm proposals for amending the system have been made so quantifying the extent of any potential change remains difficult. However, by way of illustration, a 1.5% reduction (from 6.5% to 5.0%) in pre-tax returns would lead to a reduction in operating profit of c £2.7m (FY21 recurring operating profit was £16.3m, excluding revaluation of investment properties).
- **Security of supply:** JEL imports 95% of its electricity from EDF (through undersea cabling to mainland France). In the absence of significant on-island power generation, JEL is heavily reliant on this supply. Furthermore, we estimate (earlier in this report) that France requires 148TWh pa of new electricity production capability (including bringing its nuclear fleet back to typical utilisation levels) by 2050 to meet its legally binding net zero by 2050 target (and still be able to fulfil the same level of electricity exports); this equates to a 28% increase in existing production. JEL has a longstanding relationship with EDF that spans more than 35 years. Its existing 15-year agreement runs until the end of FY27. JEL does not anticipate any issues in negotiating another long-term contract, nor does it expect any change to its arrangement with EDF as a result of Brexit. There is an ongoing dispute relating to French fishing vessels in Jersey waters and the French maritime minister has previously made reference, within the French parliament, to implementing retaliatory measures, including the possibility of cutting off electricity supplies to Jersey. JEL considers this a political issue to be resolved between the governments. As noted above, JEL has a strong relationship with EDF (as supplier) and RTE (as network operator). Both RTE and EDF have confirmed JEL's existing supply arrangements are unlikely to be affected.

- Interconnector failure has the potential to cause reputational damage (in the event of interruption to supply) and financial loss. In the absence of cheap imports, JEL would be forced to rely on more expensive and more environmentally polluting on-island generation. Although JEL would have the capacity, at least under the current regulatory system, to recoup the extra cost of generation through the tariff system, the potential adverse publicity might prevent JEL from raising tariffs to the full extent required to preserve the rate of return in any one year as happened in the period 2012 to 2013.
- Wholesale pricing: although JEL regularly hedges the purchase cost of electricity, an upward movement in French wholesale prices would place pressure on JEL to raise tariffs to preserve its rate of return. An upward revision of tariffs could invite additional political and regulatory scrutiny and would undermine JEL's relative position in its benchmarking of international tariffs. Our sub-section on French wholesale pricing (above) discusses the recent unprecedented increase in wholesale electricity prices and concludes that if prices do not come down sufficiently by FY25, then JEL would have to increase tariffs. JEL is materially hedged over FY22–24.
- Tariff pricing: we estimate JEL would need to increase tariff prices in real terms by 4% (in total) by FY25 to keep returns above 6%. There would be upwards pressure on this tariff estimate from a number of factors including: sustained higher wholesale prices above our long-term forecast of €70/MWh (real) from FY25; lower than expected volume sales forecasts; a higher than expected utilisation of low comfort heat rate by new heating customers (we assume 70% utilisation of the comfort heat rate, on average); and higher than expected capex.
- FX: as we have demonstrated, the value of the pound relative to the euro remains important for JEL, independent of the level of French wholesale pricing in euros, as it imports c 95% of its electricity from France.
- Minority: there has been no significant change in the shareholding structure of the company in recent years and, as we have already noted, the SoJ owns 86.4% of the voting rights of the company. Other shareholders continue to bear the risk associated with their position as minority shareholders.

## Valuation

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We have enhanced our traditional valuation approach for JEL by including a 10-year DCF analysis, which better considers the longer-term impact of the energy transition. We place less emphasis on the peer valuation, using it only as a cross-check.

Overall, the valuation, which is an average of our DCF and SOTP valuations, is 800p (rounded), which is up 15p (2%) versus our last published valuation (in June 2021). The uplift in valuation can be attributed mostly to an improvement in net cash position and increase in value of the property business offset by a slightly lower valuation for the core energy business and other businesses.

**Exhibit 13: JEL valuation metrics (p/share)**


Source: Edison Investment Research estimates, Refinitiv (29 June 2022) (for peer valuation)

## SOTP

We estimate regulatory assets to be in the region of c £180m (and assume JEL earns a return on these assets equal to its cost of capital on these assets). We value the property business (rental properties owned by JEL) using balance sheet carrying value and the other businesses (retail, business services, other) at 7x prospective EBITDA (UK 250: 7x; UK 350 retailers: 7x). Overall, the SOTP valuation has risen 18p since we published in June 2021. The principal factors behind the increase in valuation are the property business +20p (due to revaluation gain), improvement in net cash position +22p and other adjustments +13p, partially offset by declines in estimated asset base -7p and other businesses -30p (due to derating of UK indices from 10x to 7x EBITDA).

**Exhibit 14: SOTP valuation**

Components	£m	p/share	Comments
Energy business	178	581	Estimated net regulatory assets
Property business	28	91	Balance sheet valuation
Other businesses	16	51	Multiple of 7x EBITDA
<b>Enterprise value</b>	<b>221</b>	<b>723</b>	
Net cash/(debt)*	10	32	
Other adjustments	19	61	Financial assets, pension surplus, preference shares, minority interest
<b>Total equity value</b>	<b>250</b>	<b>816</b>	

Source: Edison Investment Research. Note: \*After deducting long-term IFRS 16 lease liabilities of £3.3m (end-H122).

## DCF

We update our DCF methodology to better reflect the longer-term energy transition; we adopt a 10-year cash flow forecast period followed by terminal value. Our valuation for JEL is based on our adjusted decarbonisation scenario (base case), which takes account of GOJ's proposed policies and funding allocated to incentives, but does not go as far as adopting GoJ's proposed targets for EVs and electric fuel heating conversions.

Key assumptions and drivers for our cash flow model are as follows:

- Incremental electricity demand forecasts for each scenario (see decarbonisation section).
- Electricity prices adjusted to ensure pre-tax return on capital for the energy business stays at c 6.5% over FY25–31. For FY22–24, we calculate returns based on the company's proposed tariff increases.
- Modelled market-based exposure, taking into account JEL's hedges over FY22–24 and assuming a long-term wholesale electricity price of €70/MWh (see French wholesale pricing sub-section).



- We assume growth capex (in real terms) of £27m, in total, spread over FY24–31. On a per incremental unit basis, this is consistent with the net zero by 2050 and net zero by 2040 scenarios in our previous outlook report, where we assumed growth capex (real) of £18m and £27.5m respectively over FY23–30.
- For other capex assumptions, see the financials section below.
- WACC of 6.0%, based on a beta of 0.9x, cost of equity of 6.3% and cost of debt of 4.5% (with total debt at c 15% of capital).
- We model terminal value separately for the energy and non-energy businesses. To reflect the constraint that pre-tax capital remains flat at 6.5%, we keep the terminal value constant for the energy business, setting it using terminal growth rate (TGR) = 0% (and capex/depreciation = 1.0x). The non-energy businesses have no such constraints, thus the terminal value increases as TGR increases.

**Exhibit 15: Sensitivities of DCF valuation to WACC and terminal growth rates**

Share valuation (p)	WACC							
	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%	
0.0%	900	816	746	687	636	593	555	
0.5%	911	825	753	692	641	596	558	
1.0%	925	835	761	698	646	600	561	
Terminal growth rate	1.5%	943	849	771	706	651	605	565
2.0%	967	865	783	715	658	610	569	
2.5%	1001	888	799	727	667	617	574	
3.0%	1051	919	819	741	678	625	580	
Enterprise valuation at TGR = 2% (£m)	WACC							
	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%	
Energy business	190	170	153	138	126	116	107	
Non-Energy business	78	67	59	52	47	43	39	
Total	268	237	211	190	173	158	146	

Source: Edison Investment Research

Our DCF valuation of 783p per share is based on a WACC of 6% and a TGR of 2% and includes an energy business valuation of £153m and other businesses valuation of £59m. The energy business valuation is lower than the £178m in our SOTP valuation, which was estimated using a regulated assets approach. The difference between the two valuations can be explained by converting the pre-tax return of 6.5% (targeted on the regulatory assets) to a post-tax return of 5.2% (adjusting for a 20% tax rate) and using this as the WACC in the DCF valuation; 5.0% WACC = £190m for the energy business; 5.5% WACC = £170m (Exhibit 15 above). Other businesses are valued 31% higher using our DCF methodology compared with the SOTP (£59m versus £45m); this is due to a combination of the DCF reflecting longer-term growth prospects (not always captured using peer multiples) along with a relatively low WACC of 6%.

## Peer valuation

We use peer valuation as a cross-check, rather than driving our valuation, due to a lack of comparable companies to JEL. In our approach, we use P/E and EV/EBITDA multiples, which imply a valuation of 817p per share (see Exhibit 16 below). This is above our DCF- and SOTP-based valuation for JEL of 800p per share. National Grid, Terna and Red Eléctrica, which are electricity grid operators, are the most comparable companies to JEL; we use an average of multiples from these companies in our peer valuation. We use 2023 multiples only because also using 2022 multiples (and averaging) would distort the implied valuation, as JEL's return is just 5% in FY22, significantly below its target range of 6–7%, which we expect it to achieve in all subsequent years. We note the P/E is distorted by significantly higher net debt to equity ratios among JEL's peer group; EV/EBITDA removes this distortion, so is arguably a better metric. EV/EBITDA alone implies a valuation of 1,021p per share, which is considerably above our valuation.

**Exhibit 16: Peer group multiple analysis**

	Currency	Price	EV/EBITDA (x) 2023	P/E (x) 2023
<b>UK regulated utilities</b>				
National Grid	p	1,164	12.1	14.6
Pennon	p	1,011	13.3	20.5
Severn Trent	p	2,939	12.3	21.4
United Utilities	p	1,044	13.8	22.6
<b>Median</b>			<b>12.8</b>	<b>20.9</b>
<b>European regulated utilities</b>				
Terna	€	8.02	13.1	18.3
Snam	€	5.48	13.6	14.7
Enagas	€	21.72	11.8	16.6
Red Electrica	€	19.42	5.4	15.0
<b>Median</b>			<b>12.5</b>	<b>15.8</b>
<b>Multiple used in peer valuation *</b>			<b>10.2</b>	<b>16.0</b>
JEL earnings:				
EBITDA (£m)			27.9	
Clean EPS (p)				38.4
<b>Implied valuation of JEL shares (p)</b>			<b>1,021</b>	<b>613</b>
<b>Average of the above (p)</b>		<b>817</b>		

Source: Edison Investment Research, Refinitiv. Note: Priced at 29 June 2022. \*Based on average of National Grid, Terna and Red Eléctrica.

## Financials

**Profitability and returns:** we base our forecasts for FY22 and FY23 on the assumption that the core energy business delivers profitability in the range of the targeted return. In FY21, reported return on electricity assets was 5.9%, which on adjustment for non-recurring (and non-cash) past service costs of £1.8m becomes 6.98%. We forecast a return of 5.0% in FY22, which includes the recently announced tariff increase of 5% from 1 July 2022. This results in a dip in profitability in FY22 (forecast recurring operating profit of £12.5m vs £16.3m in FY21), before returning to profitable growth from FY23, assisted by a further planned tariff increase of 5% from 1 January 2023.

For FY23–25 we forecast returns of 6.9%, 6.7% and 6.0%, which assumes a further c 4% tariff increase in real terms in FY25, when JEL becomes unhedged against wholesale price exposure. For FY26–31, assuming wholesale prices remain at an estimated €70/MWh (real) and given our projected volume sale increases, we believe an average c 6.5% return can be achieved without any tariff increases (in real-terms).

**Capex:** JEL has spent c £22.5m pa (in real terms) on average over the last 10 years, but with the substantial investment programme largely complete, we expect capex to remain below this, on average, for the period 2022–31 (£17.0m pa, real). We forecast capex (real) of £15.9m in FY22 and £21.6m in FY23 (FY21: £9.6m), which equates to nominal capex of £15.9m in FY22 and £22.2m in FY23 (FY21: £9.3m). The increase in capex in FY22 is due to an estimated £4m investment in a new transformer at Queen's Road. We had previously assumed this investment would be spread equally over FY21 and FY22; however, it has mostly been deferred from FY21. The further increase in capex in FY23 is mostly due to an estimated £10m pa investment in a new gas turbine spread over FY23 and FY24. The total investment of £20m is larger than our previous estimate of £12m and reflects JEL's objective of enhancing energy security. We estimate growth capex (real) of £27m (in total) spread over FY24–31 to bolster the on-island grid infrastructure to support our forecast increase in volume sales resulting from GoJ's net zero targets.

**Exhibit 17: JEL capex and depreciation 2012–21 (£m)**

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Capex (nominal)	18.8	26.9	32.5	16.8	32.4	15.1	14.9	13.9	11.3	9.3
Depreciation	8.3	8.2	8.3	9.9	10.3	10.7	11.2	11.6	11.4	10.9
Capex/depreciation	2.3x	3.3x	3.9x	1.7x	3.1x	1.4x	1.3x	1.2x	1.0x	0.9x

Source: Edison Investment Research, using JEL data

**Pensions:** we assume that the pension surplus of £21.4m at end-H122 reverses back to £18.8m by end-FY22, and that payments are c £2.1m less than the charge to the P&L over FY23–31, such that the surplus is unwound by end-FY31. Although we include the impact of this on the cash flow statement, we exclude these adjustments from FCF in our DCF valuation and instead adjust for the pension surplus in our enterprise value to equity value adjustment.

**Tax:** for tax payable (P&L) we assume an effective tax rate of 20% for FY21 and FY22 (FY21: 15%). The effective rate in FY21 was lower due to the £6.0m property revaluation gain not being taxable. For tax paid we make approximate adjustments for accelerated capital allowances and assume payment in the following year.

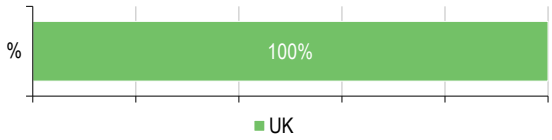
**Dividends:** our forecasts assume a 5% per year increase in the DPS for FY22 and FY23, with a cash impact from payments of £5.5m in FY22 (FY21 final dividend plus FY22 interim dividend) and £5.7m in FY23 (FY22 final dividend plus FY23 interim dividend). The DPS is forecast to be well covered by earnings: 1.6x in FY22 and 2.0x in FY23, despite the recent unprecedented increases in wholesale energy prices in Europe.

**Cash flow and balance sheet:** in the absence of any repayment of outstanding long-term debt of £30m (which expires in 2034 and 2039) or a special dividend, we forecast that cash decreases slightly to £38.2m in FY22 and £35.5m in FY24 (FY21: £43.1m). This is primarily due to higher capex because of the investment in a new transformer at Queen's road in FY22 and a new gas turbine in FY23 and FY24.

**Exhibit 18: Financial summary**

	£'000s	2019	2020	2021	2022e	2023e
30 September		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue		110,709	111,747	118,608	118,090	127,420
Cost of Sales		(69,282)	(69,695)	(74,159)	(75,768)	(79,755)
Gross Profit		41,427	42,052	44,449	42,323	47,665
EBITDA		26,247	27,516	27,182	23,586	27,871
Operating Profit (before except.)		14,643	16,092	16,258	12,507	16,358
Exceptionals		1,439	115	4,255	0	0
Other		0	0	0	0	0
Operating Profit		16,082	16,207	20,513	12,507	16,358
Net Interest		(1,262)	(1,377)	(1,428)	(1,464)	(1,463)
Profit Before Tax (norm)		13,381	14,715	14,830	11,044	14,895
Profit Before Tax (reported)		14,820	14,830	19,085	11,044	14,895
Tax		(2,969)	(3,090)	(2,794)	(2,209)	(2,979)
Profit After Tax (norm)		10,412	11,625	12,036	8,835	11,916
Profit After Tax (FRS 3)		11,851	11,740	16,291	8,835	11,916
Average Number of Shares Outstanding (m)		30.6	30.6	30.6	30.6	30.6
EPS - normalised (p)		33.7	37.6	38.8	28.4	38.4
EPS - normalised and fully diluted (p)		33.7	37.6	38.8	28.4	38.4
EPS - reported (p)		38.4	37.9	52.7	28.4	38.4
Dividend per share (p)		15.7	16.5	17.4	18.3	19.2
Gross Margin (%)		37.4	37.6	37.5	35.8	37.4
EBITDA Margin (%)		23.7	24.6	22.9	20.0	21.9
Operating Margin (before GW and except.) (%)		13.2	14.4	13.7	10.6	12.8
<b>BALANCE SHEET</b>						
Fixed Assets		249,982	250,966	267,588	272,734	281,683
Intangible Assets		683	3,378	4,046	4,643	5,213
Tangible Assets		217,046	217,936	216,550	221,099	231,563
Investments		32,253	29,652	46,992	46,992	44,907
Current Assets		49,125	59,153	68,045	62,999	65,140
Stocks		6,018	6,028	6,909	6,879	7,422
Debtors		17,995	15,745	18,000	17,921	19,337
Cash		24,915	35,520	43,136	38,199	38,381
Other		197	1,860	0	0	0
Current Liabilities		(20,332)	(21,143)	(22,721)	(21,742)	(23,897)
Creditors		(20,332)	(21,078)	(22,649)	(21,670)	(23,825)
Short term borrowings		0	(65)	(72)	(72)	(72)
Long Term Liabilities		(79,231)	(83,037)	(87,471)	(86,492)	(88,380)
Long term borrowings		(30,000)	(32,879)	(33,035)	(33,035)	(33,035)
Other long term liabilities		(49,231)	(50,158)	(54,436)	(53,457)	(55,345)
Net Assets		199,544	205,939	225,441	227,499	234,546
<b>CASH FLOW</b>						
Operating Cash Flow		31,401	31,019	26,525	21,225	32,039
Net Interest		(1,253)	(1,237)	(1,283)	(1,464)	(1,463)
Tax		(2,300)	(2,714)	(2,742)	(3,020)	(2,121)
Capex		(13,940)	(11,259)	(9,318)	(16,225)	(22,547)
Acquisitions/disposals		2	24	6	0	0
Financing		(59)	(311)	(557)	0	0
Dividends		(4,671)	(4,917)	(5,178)	(5,454)	(5,727)
Net Cash Flow		9,180	10,605	7,453	(4,937)	182
Opening net debt/(cash)		14,265	5,085	(2,576)	(10,029)	(5,092)
HP finance leases initiated		0	(2,944)	0	0	0
Other		0	0	0	0	0
Closing net debt/(cash)		5,085	(2,576)	(10,029)	(5,092)	(5,274)

Source: Jersey Electricity, Edison Investment Research

Contact details	Revenue by geography
Jersey Electricity The Powerhouse PO Box 45 Queen's Road St Helier Jersey JE4 8NY + 44 (0) 1534 505460 <a href="http://www.jec.co.uk">www.jec.co.uk</a>	 <p>A horizontal bar chart titled 'Revenue by geography' showing 100% of revenue from the UK. The bar is green and labeled '100%' inside. A legend below the bar shows a green square next to 'UK'.</p>

Management team	
<b>Chairman: Phil Austin (from February 2019)</b> Phil Austin became chairman of JEL in February 2019 having served as a non-executive director since 2016. From 1997 to 2001 Mr Austin was deputy CEO of HSBC's Offshore Island business and in 2001 became founding CEO of Jersey Finance. In 2006 Mr Austin joined Equity Trust as CEO and since 2009 he has held a number of non-executive positions and is a non-executive of Octopus Renewables Infrastructure Trust, Blackstone/GSO Debt Funds (Europe) and Ravenscroft Cash Management.	<b>Chief executive: Chris Ambler</b> Chris Ambler has served as chief executive since 2008, having previously held senior positions in the utility and materials sectors. He is a chartered engineer with the Institution of Mechanical Engineers and holds an MBA from Insead. Mr Ambler is a non-executive director of Apax Global Alpha and Foresight Solar Fund.

Finance director: Martin Magee
Martin Magee is a qualified accountant and previously worked for Stakis and Scottish Power in a variety of senior financial roles. He joined JEL as finance director in 2002 and has served in this role since that date. Mr Magee is also a non-executive director of Jersey Post International.

Principal shareholders – listed shares only* (JEL)	(%)**
Huntress (CI) Nominees	17.4
Finda Oy	4.3

Note: \*Explanatory note taken from page 53 of the FY21 Reports & Accounts – 62% of the ordinary share capital of the Company is owned by the Government of Jersey with the remaining 38% held by around 600 shareholders via a full listing on the London Stock Exchange. Of the holders of listed shares, Huntress (CI) Nominees Limited owns 5.3m (46%) of our 'A' Ordinary shares representing 17% of our overall Ordinary shares and around 5% of voting rights. \*\*Percentage of total ordinary share capital (including non-listed shares).

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