Dividend Policy

Affinity Water Limited

September 2020

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1 Policy Date and Review

This Dividend policy (referred to as the ‘policy’) has been approved by the Board of Affinity Water Limited (the ‘company’) and is effective from 30 September 2020. All dividends must be declared and paid in accordance with this policy.

This approved policy replaces the previous policy that became effective from 1 September 2019. There have been no significant changes to the policy, with the key changes being to remove the reference to Asset Management Plan 6 (‘AMP6’) and modification of the licence condition from Condition F to Condition P in July 2020.

The policy will be reviewed by the Board at least annually. Any changes in the policy will be clearly signalled in the company’s Annual Performance Report.

2 Dividend Policy Summary and Reporting

The dividend policy of Affinity Water Limited is to pay a dividend commensurate with the long-term returns and performance of the business and allowing shareholders to earn an appropriate return from an investment in the company, whilst not impairing the company's longer term financeability and taking into account commitments to its stakeholders and customers.

In determining the level of dividend, the financial performance of the appointed and non-appointed businesses are considered separately. The base dividend for the appointed business will be in reference to the company's internal business plan and will not exceed a nominal 5% yield on equity as an annual average over the Asset Management Plan ('AMP'), based on the company's actual financial structure. This is in line with Ofwat's expectations and the allowance for the cost of equity in the Retail Price Index ('RPI') Weighted Average Cost of Capital ('WACC') for Asset Management Plan 7 ('AMP7'). This will apply for the period from the effective date of this policy. Dividends can be increased or lowered from the base depending on the actual performance of the company.

An assessment will be completed by the Board to determine if the payment or part payment of the dividend reflects and/or would compromise the long-term social, financial and operational commitments made to stakeholders, which includes the following areas: customer service; operational commitments; community commitment; and employees and the health of the pension schemes. This assessment will also demonstrate that the dividend policy for 2020-25 will take account of obligations and commitments to customers and other stakeholders, including performance of delivery against the final determination for AMP7. This will include in particular assessment of performance commitments with associated ODI's as set in the final determination and any ODI penalties or rewards earned. It will also require an assessment of the long term financial resilience of the company as per section 5 of this policy.

Finally, the Board should test any proposed dividend payments against legal and regulatory requirements and restrictions, including the management of economic risk and compliance with financial covenants.

The dividends declared or paid in a year are to be reported in the Annual Performance Report of the company. This should include how they relate to the policy and any changes in the policy.

3 Calculating the Value of the Dividend

Dividends for the appointed business are declared after considering a holistic view of the company's performance. The Board should assess the value of the dividends to be paid for the appointed and non-appointed businesses separately. The value of the dividend declared will depend on the performance of each business.

3.1 Non-Appointed Dividend

The policy is to pay dividends in respect of the non-appointed business reflecting the profitability and performance of this business. A dividend can be paid, if required, from the non-appointed business to satisfy the debt service needs of the Daiwater Investment Group, subject to the financial consideration, licence requirements and legal requirements detailed in sections 5, 6 and 7 of this document.

3.2 Appointed Dividends

The base dividend of the appointed business is set in line with the company's internal business plan approved by the Board following the determination of the price controls for each asset management period and will not exceed a nominal 5% yield on equity as an annual average over the AMP, based on the company's actual financial structure. This is in line with Ofwat's expectations and the allowance for the cost of equity in the RPI WACC for AMP7. This will include any sharing mechanism within the price controls related to the financing structure of the company.

The Board will assess the financial performance against this base dividend and accordingly increase or decrease the dividend to be paid as appropriate. This assessment will consider the whole asset management period, and demonstrate that the dividend policy for 2020-25 will take account of obligations and commitments to customers and other stakeholders, including performance of delivery against the final determination for AMP7. This will include in particular assessment of performance commitments with associated ODI's as set in the final determination and any ODI penalties or rewards earned. It will also require an assessment of the long term financial resilience of the company as per section 5 of this policy.

4 Assessment of Service and Commitments to Stakeholders

The Board should consider if the payment or part payment of the dividend reflects or would compromise the long-term social, financial and operational commitments made to stakeholders, including customers, employees and pensioners. The Board should exercise judgement in four areas:

1. **Customer Service –** The company's performance in the round on customer delivery. This is assessed against the targets the company sets on its customer performance. This would include but is not limited to:
   - C-MEX
   - D-MEX
   - Complaints

2. **Operational Commitments –** The company's performance in the round on the Performance Commitments levels set in the company's business plan. This includes but is not limited to:
   - Leakage
   - Residential Water Consumption
   - Water Quality
   - Interruptions to Supply
   - Pressure

3. **Community Commitments –** The company's performance in the round on the Performance Commitments levels set in the company's business plan. This includes but is not limited to:
   - Vulnerable customers
   - Sustainable abstraction
   - Community investment
   - Environmental innovation

4. **Employees and Pensions –** The company's performance in respect of its employees. This will include but is not limited to:
   - Safety
   - The health of the pension schemes

5 Financeability Considerations

In assessing the dividend to be paid, the Board is required:

- to ensure that sufficient liquidity is maintained after a dividend payment to enable the business to, for at least 15 months, meet its financial obligations and finance its operations, including the payment of its creditors as they fall due.

- to make a reasonable judgment as to the amount of the distributable profits of the company when determining both whether a dividend should be declared and its value. This will consider the latest balance sheet position and forecast.

- to assess the long-term viability of the company. This is assessed through the viability tests maintained by the company, reviewing the cash facilities available to the company.

- to ensure that the company maintains ratios that are in line with a credit rating equal to or above investment grade and to maintain the headroom target set for gearing as measured by the Regulated Asset Ratio covenant and the Interest Cover Ratio covenant over a two-year period.

6 Licence Condition Requirements

Licence Condition P provides that:

"The Appointee shall declare or pay dividends only in accordance with a dividend policy which, has been approved by the Board of the Appointee and which complies with the following principles:

1 The dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and

2 Under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk."

Further, in assessing the dividend to be paid, directors are required to ensure that:

a) "The dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk"; and

b) "no director of the Appointee should vote on any contract or arrangement or any other proposal in which he has an interest by virtue of other directorships."

7 Legal Requirements

The company must comply with all legal requirements with respect to the declaration and payment of dividends including, but not limited to, Part 23 of the Companies Act 2006.

In declaring and paying dividends, the directors must meet their duty under Section 172 of the Companies Act 2006 to act in the way they consider most likely to promote the success of the company for the benefit of the company's members as a whole, having regard to:

- the likely consequences of any decision in the long term
- the interests of the company's employees
- the need to foster the company's business relationships with suppliers, customers and others
- the impact of the company's operations on the community and the environment
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.

8 Dividend Frequency

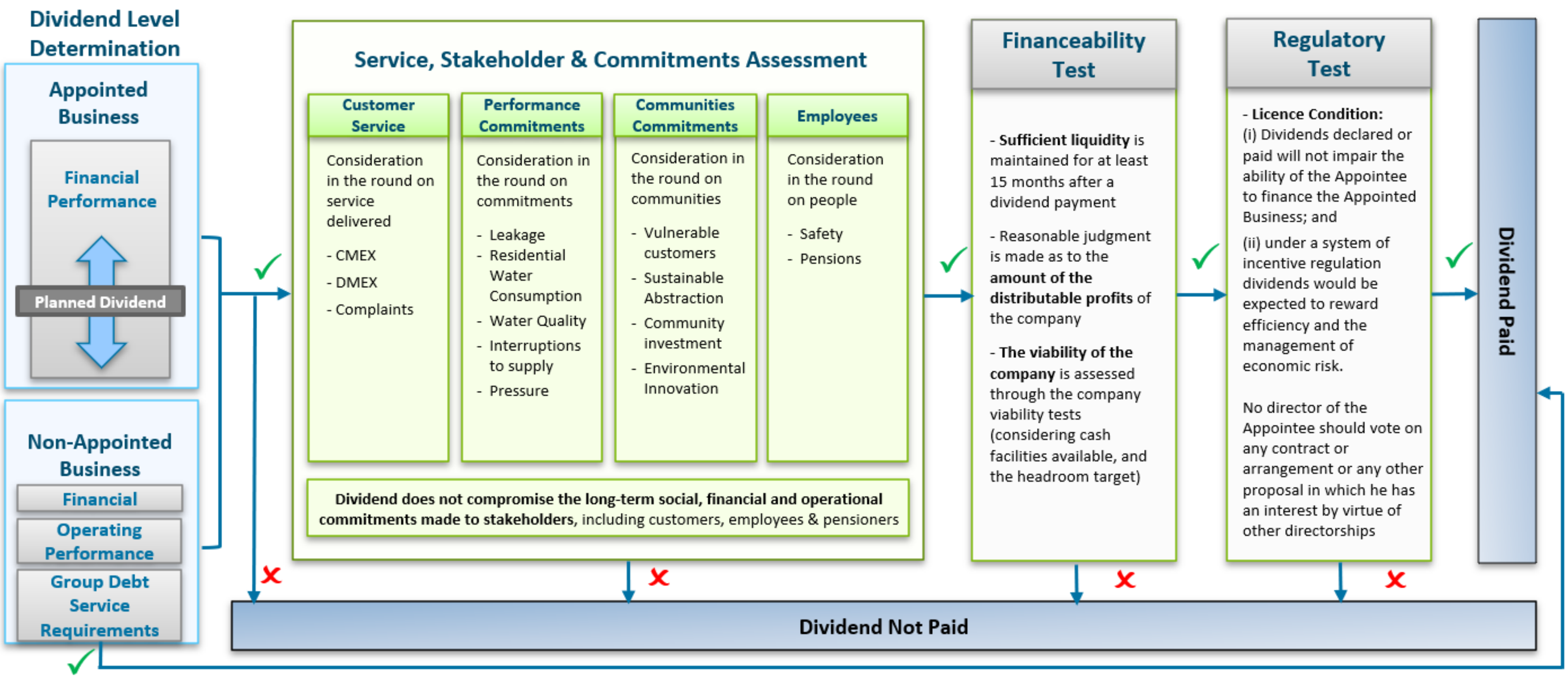
A maximum of one dividend can be paid per quarter.

9 Special Dividend

A special dividend can be approved by the Board. This could for example relate to the sale of an asset or part of the business.

Appendix one

Dividend Policy Summary



Dividend Level Determination
Appointed Business
Financial Performance
Planned Dividend
Non-Appointed Business
Financial
Operating Performance
Group Debt Service Requirements
Service, Stakeholder & Commitments Assessment
Customer Service
Consideration in the round on service delivered
- CMEX
- DMEX
- Complaints
Performance Commitments
Consideration in the round on commitments
- Leakage
- Residential Water Consumption
- Water Quality
- Interruptions to supply
- Pressure
Communities Commitments
Consideration in the round on communities
- Vulnerable customers
- Sustainable Abstraction
- Community investment
- Environmental Innovation
Employees
Consideration in the round on people
- Safety
- Pensions
Dividend does not compromise the long-term social, financial and operational commitments made to stakeholders, including customers, employees & pensioners
Financeability Test
- Sufficient liquidity is maintained for at least 15 months after a dividend payment
- Reasonable judgment is made as to the amount of the distributable profits of the company
- The viability of the company is assessed through the company viability tests (considering cash facilities available, and the headroom target)
Regulatory Test
- Licence Condition:
(i) Dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and
(ii) under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk.
No director of the Appointee should vote on any contract or arrangement or any other proposal in which he has an interest by virtue of other directorships
Dividend Paid
Dividend Not Paid