

## **Dividend Policy**

Affinity Water Limited

September 2023

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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 26 September 2023. All dividends must be declared and paid in accordance with this policy.

This approved policy replaces the previous policy that became effective from 30 September 2022. The main change included in this update relates to inclusion of the new licence wording regarding dividends.

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 consider and, if appropriate, pay a dividend commensurate with appropriate long-term returns and aligned with business performance. Providing shareholders with an appropriate return from their investment in the company whilst not impairing the company's financial resilience, taking into account current and future investment needs and 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 4% 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 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.

The Board will complete an assessment 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; 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 an assessment of performance commitments with associated Outcome Delivery Incentives ('ODI's) as set in the final determination and any ODI penalties or rewards earned. It will also require an assessment of the company's short and long term financial resilience 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.

This policy and any 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

The Board will consider and quantify the value of the potential dividends to be paid from the appointed and non-appointed businesses separately. The quantum of any dividend will depend on the performance of each business. Dividends for the appointed business are declared after considering a holistic view of the company's performance. No dividend will be paid relating to either the appointed or non-appointed business that would compromise the financial resilience of Affinity Water Limited.

### 3.1 Non-Appointed Dividend

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The policy is to pay dividends in respect of the non-appointed business reflecting the profitability and performance of this business. Dividends from the non-appointed business may be paid subject to the company's economic gearing being below that of its internal business plan.

A dividend can also be paid, if required, from the non-appointed business to satisfy the debt service needs of the Daiwater Investment Group.

Distributions from the non-appointed business will be subject to the financial considerations, licence requirements and legal requirements detailed in sections 5, 6 and 7 of this document.

### 3.2 Appointed Dividends

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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 4% 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 WACC for AMP7. This will include any sharing mechanism within the price controls related to the financing structure of the company.

The Board will undertake a holistic assessment of the company's performance and accordingly increase or decrease the recommended dividend as appropriate. This assessment will consider the entire Asset Management Period (AMP) and demonstrate that the dividend policy will take account of obligations and commitments to customers and other stakeholders, including delivery of the Final Determination. This will include an assessment of performance commitments with associated Outcome Delivery Incentives ('ODIs), and enhancement expenditure as set in the final determination and any penalties or rewards earned. It will also require an assessment of the company's short and long-term financial resilience 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 12 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:*

- *that dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business, taking account of current and future investment needs and financial resilience over the longer term; and*
- *that dividends declared or paid take account of service delivery for customers and the environment over time, including performance levels, and other obligations; and*
- *that dividends declared or paid reward efficiency and the management of risks to the Appointed Business.*

*For the purpose of this licence condition, dividends refers to any distributions declared or paid in respect of any ordinary shares or preference shares.”*

In addition, Licence Condition P contains cash lock up provisions which are based on credit ratings. The requirement is to hold a credit rating that is above the minimum level. The minimum level pre 1<sup>st</sup> April 2025 is Baa3/BBB- and being subject to negative watch or outlook.

From 1 April 2025 the minimum level will be Baa2/BBB and being subject to negative watch or outlook.



## 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

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## Dividend Policy Summary





