

WaterShare+

Investor Summary

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Investor Summary

Highlights

Key messages

Innovative voluntary mechanism for sharing regulatory outperformance with South West Water customers, endorsed by Ofwat

Making the interests of customers and investors more aligned

Evolution of existing WaterShare approach introduced in 2015

c. £20m - £25m of accrued benefits from the PR14 (2015-20) WaterShare mechanism already due to go back to customers will be offered to South West Water customers in the form of Pennon shares, a reduction in their bill or a rebate – for eligible customers to choose

WaterShare+ share scheme to be set up in such a way that ensures no dilution of existing shareholdings and voting rights in Pennon

Pennon 2019 AGM resolutions required to enact the mechanism; Pennon 2020 AGM resolution required to authorise the Board to proceed with the share alternative for South West Water customers

First shares to eligible customers post 2020 AGM.

WaterShare

WaterShare has been central to our engagement with South West Water customers since 2015. WaterShare has always given our customers reassurance about the transparency and openness of our business, with our performance being reported to customers through the WaterShare scorecard and framework, overseen by an independent WaterShare panel. This review and scrutiny of performance and engagement with customers has also been undertaken by the independent Customer View Group at Bournemouth Water.

South West Water's WaterShare commitments involve regular meetings with the WaterShare panel to review and scrutinise our progress against agreed performance commitments and promises made to customers. Financial benefits resulting from our performance are discussed with customers via focus groups and regular surveys to ascertain their preferences on how they would like to receive the benefit. Options discussed with customers every year include:

- Re-investment in improving services for customers
- Reduction in customers' bills
- Deferral of benefits for the future.

We anticipate that c. £20m - £25m of benefits in respect of the 2015-20 regulatory period will be available to share with customers in 2020.

WaterShare+

Building a closer relationship with our water customers

For South West Water's 2020-25 business plan, we reviewed the established WaterShare approach to ensure we continue to build on our relationship with our customers and look at how we can better embed our sharing of regulatory outperformance benefits.

Our WaterShare mechanism allows for us to share gains as a result of changes in market assumptions for both the cost of new debt and taxation. We were pleased to see that Ofwat adopted this in the base methodology for PR19 (2020-25) for the benefit of all customers.

Aligning investor and customer objectives

As our voluntary sharing mechanism for 2015-20 was successful and we are forecasting net benefits to share with customers, we undertook customer research to better understand how customers would like to receive the financial benefits that are due to them.

Options included bill reductions (immediate and deferred), monetary rebates, reinvestment in services and the option of being given an enduring 'financial stake' in the business in the form of shares in Pennon Group plc (the 'Company').

Aligning investor and customer objectives continued

Our customer research showed that whilst 77% of customers did not own shares or have a financial stake in any company, 79% believed share ownership would be a positive step as:

- Customers' interests would be more aligned with those of investors – customers would receive a share of the company profits as and when shareholders do, in addition to owning a capital stake in the company
- Customers would have a vote and an opportunity to air their views through shareholder general meetings.

We have therefore concluded that despite the lack of familiarity with share ownership, there is perceived value in it. Based on our research, many customers are aware of schemes that are available for employees and believe these are positive.

Further increasing trust and legitimacy

The Business Plan commitment is therefore to offer eligible South West Water customers the choice, alongside bill reductions, rebates and reinvestment, of taking a financial stake in the business via equity shares in Pennon, South West Water's parent company. Subject to confirmatory votes from Pennon shareholders at the 2019 and 2020 AGMs, from 2020 eligible household customers will have the proposed option of receiving the rebate due to them in the form of Pennon shares.

The customer shares would be purchased in the market, **avoiding any dilution of existing shareholdings**, with the purchase to be funded by the benefits of regulatory outperformance that South West Water has already committed to return to customers via the WaterShare sharing mechanism.

As shareholders, participating customers would then:

- Receive a share of company profits, in the form of dividends, just as shareholders do as and when dividends are paid;
- Be able to direct how their shares are voted and have their say at the Pennon Annual General Meeting (AGM); and
- Receive Pennon's annual reports and financial statements.

In addition, all customers will be invited to attend a customer AGM and quarterly public customer meetings chaired by the independent WaterShare+ panel.

South West Water customers already have a say in our business through the extensive engagement we have with them every day. As new shareholders in Pennon, we believe this will be enhanced by offering them a tangible stake in our business.

Key features

c. £20m - £25m of accrued benefits from the PR14 (2015-20) WaterShare mechanism due to customers will be offered in the form of Pennon shares, a reduction in their bill or a cash rebate – for eligible customers to choose

All eligible customers will be able to choose a rebate or bill reduction, however only household customers meeting specific criteria will be able to receive Pennon shares

South West Water is committed to sharing the accrued benefits with customers

Total value per eligible customer c. £20

No dilution of existing shareholdings or voting rights

Eligible customers who choose to participate in the share scheme will receive a share of company profits, in the form of dividends, as and when shareholders do

All customers will have additional rights through attending a new customer AGM, voting on the appointment of WaterShare+ panel members and attending quarterly public meetings.

Share scheme

Each eligible South West Water customer will receive an equal part of the total available pot of accrued benefits, the value of which will be confirmed at the close of the current regulatory period in July 2020. Customers will be given the choice of how they would like to receive their portion of the pot – a reduction in their bill, a cash rebate or (if they meet certain specific criteria) in the form of Pennon shares.

The number of shares that customers choosing to participate in the share scheme receive will depend on the share price at the time of the market purchase. Customers will receive the equivalent of their part of the available pot, rounded up, to the nearest whole share.

Eligibility

South West Water and Bournemouth Water household customers will be eligible to participate in the share scheme if they meet certain specific criteria. Businesses will not be eligible to participate in the share scheme. Customers with multiple properties or supplies will be eligible to receive one portion only, which can be taken in one of the three ways.

Financials

The cost of sharing the regulatory outperformance will result in a reduction in South West Water's revenue for 2020/21. The cost of acquiring shares for customers electing to participate in the share scheme will be settled through a dividend from South West Water to Pennon Group plc and the accounting transactions will also arise in 2020/21.

Administration and process

Customer Choice

South West Water will ask eligible customers how they would like to receive their portion of the available pot of accrued benefits – cash rebate, bill reduction or Pennon shares. Pennon will issue a prospectus in 2020 as well as a summary document. Customers will be recommended to seek their own qualified advice as to which of the available choices is appropriate for their circumstances.

Share Purchase

Pennon has taken advice in the design of a mechanism that allows existing ordinary shares to be purchased and held on behalf of customers who decide to participate in the share scheme. There will be no new issue of ordinary shares and no dilution to existing shareholdings.

A nominee company will be appointed to operate the share scheme and will hold a single new WaterShare+ Share with the right to receive the cash dividends to be used to purchase shares in the market for customers and set up and operate the scheme. It is envisaged that Link Market Services group, Pennon's current registrars, will act as the Nominee.

The Nominee will use the dividends to acquire ordinary shares for participating customers and hold such ordinary shares, with the participating customers being the underlying beneficial owners. Once registered in the share scheme customers will be clients of the Nominee and able to buy, sell or transfer Pennon shares according to the terms and conditions of the scheme.

Timescale

The return of the c. £20m - £25m accrued benefits from the 2015-2020 regulatory period in 2020 will be a one-off. The customer choices, including the purchase of required Pennon shares, will be processed in 2020 and when complete all available outperformance gains will have been returned to customers. The commitment to return unearned gains to customers and the principles of WaterShare+ will remain.

It is anticipated that the share scheme will run for a period of 5 years, aligned with the South West Water regulatory period. At the end of this period the scheme will terminate and participating customers holding shares in the scheme will be offered the choice of either transferring their shares from the trust into their own name on the Pennon share register, or selling their shares.

Customer Benefits

Like other shareholders, customers who hold Pennon shares will receive dividends on their shares. Dividends will be paid by the Company to the Nominee and then on to customers participating in the scheme.

Dividends will be paid in line with Pennon's standard financial calendar.

Customers participating in the share scheme will be able to instruct the Nominee to vote on resolutions proposed at shareholder general meetings. The Nominee will collate responses and submit them electronically based on one share-one vote. Customers will also be able to request a 'Letter of Representation' from the Nominee allowing them to attend the Pennon AGM and put questions to the Directors.

Administration and process continued

Impact on Existing Investors

The share scheme will not dilute existing shareholdings or the voting rights of existing shareholders.

Resolutions

To allow the mechanism for the share scheme to be put in place, the Board is requesting the authority to create the share rights to be attached to, and issue the new WaterShare+ Share to be held by the Nominee. This requires approval for a change in Pennon's Articles of Association; including to enable that share to receive WaterShare+ dividends.

Two resolutions are being proposed at the Pennon AGM in 2019.

Special resolution 18 inserts a new Article 5A into Pennon's Articles of Association and sets out the rights of the new WaterShare+ Share that will be issued to the Nominee. The share will carry the right to a one-off dividend (the "WaterShare+ Dividend"), up to a maximum of £25m, for the scheme setup and the purchase of Pennon shares on behalf of the customers opting for the share scheme.

In addition, the share will carry the right to an annual dividend of up to £1m to cover the costs of operating the scheme. We have indicated a maximum figure here in order to avoid an open ended dividend value, however, we anticipate the operating costs to be significantly lower than this value.

The WaterShare+ Share will carry no voting rights and Article 5A will remain in force until the WaterShare+ Share, once issued, is subsequently cancelled.

Ordinary resolution 19 grants the Directors the authority to issue the WaterShare+ Share to the Nominee. The authority expires at the Pennon AGM in 2021.

The authority for the Board to award the one-off WaterShare+ Dividend will be put to shareholders through an ordinary resolution at the Pennon AGM in 2020.

Frequently asked questions

What is WaterShare+?

WaterShare+ is an extension of the innovative mechanism introduced by Pennon's subsidiary South West Water ('SWW') as part of its 2015-20 business plan, as a means of sharing with customers the benefits that accrue when the company achieves or exceeds its regulatory performance commitments. To date, these benefits have been shared with customers in the form of reinvestment in services, bill reductions or a deferral of benefits for the future, with the decision being driven by the output of various customer engagement activities and overseen by an independent WaterShare panel.

In SWW's 2020-25 business plan, we have committed to offer customers the choice, alongside bill reductions and rebates, of taking a financial stake in the business via an equity share of the parent company, Pennon Group plc. Subject to confirmatory votes at the Pennon AGMs in 2019 and 2020, eligible household customers will have the option of receiving their rebate in the form of Pennon shares. This is a key feature of WaterShare+.

Why do the Directors believe this is in the best interests of the Company's shareholders?

WaterShare+ is an innovative way through which our customers can participate in our success, helping us in turn to deliver sustainable shareholder value.

The Board believes this is a positive step for Pennon as the interests of customers and shareholders will be more aligned. The purpose of our business model is to create value for all our stakeholders and we have seen the benefits WaterShare has brought to the business in terms of higher levels of customer engagement and enhanced trust through additional scrutiny and transparency of SWW's performance.

Are there any disadvantages from a shareholder perspective?

The Directors are of the view that there are no material risks to shareholders arising from the proposed WaterShare+ scheme. WaterShare+ is a key feature of SWW's 2020-25 business plan, which was awarded fast-track status by Ofwat and a customer approval rating of 88%.

Potential areas likely to be of specific concern to shareholders are dilution and cost of funding the share scheme, in respect of which:

- the shares to be allocated to customers participating in the WaterShare+ share scheme will be purchased in the market, meaning there will be no dilution of existing shareholdings or voting rights; and
- the share scheme, bill reductions and cash rebates will be funded by c. £20m - 25m of accrued benefits from the current WaterShare mechanism, generated through SWW's regulatory outperformance of the 2015-20 business plan. SWW has already committed to sharing these benefits with customers; and
- the annual cost of operating the scheme (which will depend on the number of participants) is capped at £1 million. The scheme's set-up costs will be covered by the one-off 'WaterShare+ Dividend', which will be used primarily for the purchase of ordinary shares for scheme participants. The WaterShare+ Dividend is capped at £25 million.

Frequently Asked Questions continued

What elements of outperformance will you be sharing?

We will continue to share with customers the rewards we receive for meeting or exceeding our regulatory performance commitments and the savings we achieve through efficiencies.

For 2015-2020, these included total expenditure savings and Outcome Delivery Incentive (ODI) benefits (which will be shared with customers through bill reductions and reinvestment via the 2020-25 business plan) and other items. From 2020, in addition to sharing the benefits of operational outperformance, WaterShare will include any outperformance on the cost of embedded debt.

What do you expect customers will think of share ownership?

We know from customer feedback that they want to see the benefits of success shared fairly between customers and investors, which is why we launched WaterShare in 2015.

To date, benefits have been shared with customers in the form of reinvestment in services and bill reductions. We also know from customer feedback that customers want this framework to evolve. They want a real stake in the business, comparable with investors.

Therefore, as part of our business plan to 2025 we will offer customers the choice of whether to take a cash rebate, a bill reduction or a stake in Pennon.

Who have you consulted about your plans?

We carried out our most extensive customer consultation to date, which gave us a very good understanding of what our customers want to see and where their priorities lie. Our 'New Deal' recognises that, as well as reliable and resilient services and fair and affordable bills, customers want to feel more empowered. Through the WaterShare+ share ownership scheme, we are seeking to enhance the relationship between company and customer.

The 'New Deal' was included in SWW's 2020-25 Business Plan which was fast-tracked by Ofwat in September 2018.

How many customers do you expect to take up the shares?

When the idea of share ownership was tested with customers the majority were in favour with around 79% expressing an interest in participating in a share scheme. We will continue to engage with our customers to assess uptake as part of our plans to introduce the scheme.

Can you explain the mechanics of the scheme?

Subject to the passing of Resolutions 18 and 19 at the 2019 AGM, and an additional confirmatory vote at the 2020 AGM, a single new share, the 'WaterShare+ Share', will be created. It is envisaged that the WaterShare+ Share will be issued to Link Market Services group (the 'Nominee'), which is also Pennon's registrar. Regulatory outperformance funds will be transferred to the Nominee (by way of dividend paid on the single WaterShare+ Share) for the purposes of acquiring and holding ordinary shares for participating customers.

Are new shares being issued?

It is proposed that a single new share, the 'WaterShare+ Share', will be issued to the Nominee to facilitate implementation of the WaterShare+ scheme. It will carry very limited rights beyond the right to receive certain dividends for the purpose of funding the acquisition of ordinary shares under the WaterShare+ scheme and the costs of setting up and operating such scheme. The rights and restrictions carried by the 'WaterShare+ Share' are set out in Resolution 18.

No new ordinary shares in Pennon will be issued as part of the WaterShare+ scheme. Existing ordinary shares will be bought in the market ensuring there will be no dilution for existing shareholders.

How will fractions of shares be managed?

We will round up to the nearest number of whole ordinary shares and we will top up funds as required to achieve this. The 'top-up' amount will be deducted from the future total value of the regulatory outperformance pot.

Frequently Asked Questions continued

How will the shares be held by customers?

It is envisaged that the shares will be held in trust by the Nominee. The participating customers will be the beneficial owners of the shares.

How will the dividends on customers' shares be paid?

Dividends on the ordinary shares held for customers will be paid to the Nominee holding the shares for distribution to participating customers.

Will customers be able to reinvest dividends?

There will be no reinvestment alternative offered on the ordinary shares held on behalf of participating customers.

Will all customers be eligible to receive shares?

The option of taking Pennon shares will only be offered to eligible household customers. Eligible household customers in arrears will still have the choice of receiving the benefit in the form of Pennon shares.

Eligible customers will need to consider their own circumstances and, if they wish to do so, take their own qualified advice when deciding whether to take their portion of regulatory outperformance benefits in the form of a cash rebate, bill reduction or Pennon shares.

Can participating customers sell their shares?

Participating customers will be able to sell their ordinary shares in Pennon with no minimum holding period. It is likely there will be a timetable to allow for regular dealing.

The Nominee will allow customers to buy and sell additional Pennon shares and hold them within their nominee account. Share dealing charges for buying and selling additional Pennon shares will apply and will be paid by the customer (as a client of the Nominee).

Do you expect to offer shares to new customers following the initial distribution?

The return of the regulatory outperformance gains to customers from the 2015-20 period will be a one-off exercise. The cash rebate, bill reduction and share purchase will all take place in 2020. Once processed the current WaterShare+ pot will reduce to zero and will not be available to share again. SWW will be seeking to grow the regulatory outperformance pot again during the 2020-25 period and options for sharing such benefits will be assessed towards the end of the period.

What benefits will be available to customers under WaterShare+?

We anticipate c. £20m - £25m of outperformance benefits in respect of the 2015-20 regulatory period (for c. 1 million customers).

Will customers get shares, a bill reduction or a cash rebate every year?

No. Returning the regulatory outperformance pot to customers will be a one-off process in 2020. Similar schemes may run in the future but will require separate approval from shareholders.

What rights will be enjoyed by customers under WaterShare+?

All customers will be able to:

- vote on the appointment and removal of members of the WaterShare+ Panel at a Customer AGM; and
- attend public quarterly meetings.

Customers participating in the share scheme will also:

- receive a share of the company profits, in the form of dividends, as and when shareholders do;
- receive the Company's annual reports and accounts; and
- be able to vote on resolutions at the Pennon AGM (via the Nominee).

Frequently Asked Questions continued

Will the Nominee be able to vote at Pennon AGMs?

The WaterShare+ Share held by the Nominee simply facilitates the implementation of the WaterShare+ scheme and will not carry any voting rights. The Nominee will submit the voting preferences of the underlying customer shareholders in respect of the ordinary shares held by the Nominee on behalf of such customer shareholders.

What will happen when the share scheme comes to an end?

At the point the Board decides to close the WaterShare+ share scheme, the WaterShare+ Share will be cancelled and participants will be offered the choice of selling their shares, or having the legal title to their shares transferred directly into their names on Pennon's share register. It is envisaged that the scheme will run for five years, in line with SWW's regulatory period.

Why does the shareholders' authority to issue and allot the WaterShare+ Share to the Nominee need to last for two years?

The way in which we are required to structure the share scheme means we need to follow a certain order of events and timeline. Approval sought from shareholders at the 2019 AGM will need to last for two years to allow customer engagement and, following the AGM in 2020 (at which shareholder approval will be sought for the payment of the WaterShare+ Dividend), the application process for participating in the share scheme.

Why does the shareholders' authority to issue and allot the WaterShare+ Share to the Nominee need to last for two years?

The WaterShare+ Share will be held in a bare trust by the Nominee and this requires acceptance by each participating customer as part of the application process for the share scheme. We anticipate that the application process will take place after the 2020 AGM, as it will be conditional on shareholders' approval for the payment of the regulatory outperformance dividend to the Nominee as holder of the WaterShare+ Share.

Will the WaterShare+ Share receive a dividend every year?

The dividend that will enable the Nominee to acquire the Pennon ordinary shares for participating customers will be a one-off and is expected to be paid in 2020 subject to shareholder approval at the 2020 AGM. The WaterShare+ Share will however also be entitled to an annual dividend to cover the share scheme operating costs decided by the Board and payable from the calendar year following the year in which the WaterShare+ Share is issued until such time as the WaterShare+ Share is cancelled and the scheme comes to an end.

What will happen in 2020?

Subject to the approval of the two WaterShare+ resolutions being passed at the 2019 AGM, in 2020 Pennon will finalise preparations for the launch of the scheme including the development of a prospectus relating to the Company and raising awareness with customers.

At the 2020 AGM, shareholders will be asked to vote on an ordinary resolution to give the Board the authority to award the one-off dividend which will be used to purchase Pennon ordinary shares in the market on behalf of participating customers. A revised estimate of the dividend amount will be provided at the 2020 AGM based on the latest forecast of the number of customers that will choose to participate in the scheme, within the £25m maximum set in Resolution 18 to be put to the 2019 AGM.

Following the 2020 AGM, SWW will offer eligible customers a choice as to how they would like to receive their portion of the WaterShare+ pot – a cash rebate, a bill reduction or participation in the share scheme. When the registration period has closed and calculations have been completed, the WaterShare+ Share will be issued and the one-off dividend for the WaterShare+ Share will be paid allowing the ordinary shares to be purchased on behalf of participating customers. SWW will process the cash rebate and bill reduction options in its billing system.

Proposed timetable

2019	July	The two resolutions required to amend Pennon's Articles of Association to create the rights attaching to the WaterShare+ Share and grant the Directors authority to issue such share to the Nominee will be proposed to shareholders at the AGM in 2019.
	After July	Subject to shareholders' approval of the WaterShare+ resolutions at the AGM in 2019, the documents, processes and stakeholder engagement required to implement WaterShare+ will be progressed. It is expected that customer engagement will continue into 2020.
	December	Ofwat announce the final determination of the 2020-25 Business Plan.
2020	July	<p>Total value of the available WaterShare+ regulatory outperformance pot will be finalised.</p> <p>Shareholders will be asked at the AGM to authorise the Board to declare the one-off dividend on the WaterShare+ Share to be used to purchase existing ordinary shares for customers choosing to participate in the share scheme. The maximum dividend amount will be £25 million as set out in Special Resolution 18 to be proposed at the 2019 AGM. We expect to be able to notify shareholders of the latest estimated dividend amount based on additional analysis of expected customer participation in the share scheme.</p>
	August to November	Pennon will issue a prospectus and invite eligible customers to register their individual preferences for how they would like to receive their portion of the available WaterShare+ pot – cash rebate, bill reduction or Pennon shares. Following the close of the registration period, South West Water will process the cash rebates and bill reductions for customers selecting these options and calculations will be completed to determine the amount of dividend required to satisfy customers' applications for shares. The WaterShare+ Share will be issued and allotted to the Nominee and the Board will declare the dividend to be paid to the Nominee. The dividend will be used by the Nominee to acquire shares and allocate them to customers that have elected to receive shares.

The proposed timetable is subject to shareholder approval of resolutions 18 and 19 at the Pennon AGM in 2019 and of the dividend authorisation resolution at the AGM in 2020.

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