10 March 2025

Dear Alistair,

Thank you for the opportunity to appear before your select committee on 26 February.

I am grateful for the opportunity to have discussed a wide range of issues with the committee, including what we are doing to improve the health of rivers. I am, however, very conscious that I did not explain two issues sufficiently clearly: our corporate structure regarding Trimpley and the alignment of dividends and performance. I hope to set out the situation more clearly in this letter.

Corporate structure and Trimpley

In 2017 we established Severn Trent Trimpley with the goal of increasing our flexibility to manage the differences between regulatory earnings and earnings recognised under accounting standards, referred to as IFRS earnings. This flexibility is important because it allows us to invest in much needed infrastructure at the same time as smoothing out potential peaks and troughs in bill levels.

Over a five-year period, Trimpley is *not* designed to change customers' overall bills, the overall amount of dividends we distribute nor the overall value of Severn Trent Group. Neither does it reduce overall tax liabilities; it is tax neutral. The purpose of Trimpley is instead to help us address the widely-recognised mismatch between IFRS earnings (that look at revenue over a single year) and the regulatory model (that looks at things over a five-year period).

By way of example, under the regulatory model we generate additional earnings from delivering better service than the regulatory target. These earnings are called Outcome Delivery Incentives (ODI) and the reward revenue is recovered in future years. Under the Regulatory Accounting Guidelines, the earnings would be recognised in the actual year the performance occurred, whereas under the accounting standards the earnings would only be recognised when they flow through bills.

Having flexibility to manage ODI and similar income variations is important as it means we can defer ODI income, thereby smoothing potential peaks and troughs in bills, whilst maintaining a stable dividend policy, something we believe to be in both customers' and investors' interests.

Trimpley provides us with additional flexibility to manage these variations and this structure has always been openly set out in our accounts. Whilst the flexibility is important to us, in practice we have never needed to make use of it given the retained earnings we have held.

Looking to the future, the International Accounting Standards Board is developing a new accounting standard that we understand will deal with the timing differences and revenue fluctuations that Trimpley was designed to manage. We intend to adopt the new standard as early as possible, likely to be the year ending 31 March 2027, and have already started our migration planning to ensure that we have in place the systems and processes required to do this. This will render the Trimpley structure redundant.

Dividends and performance

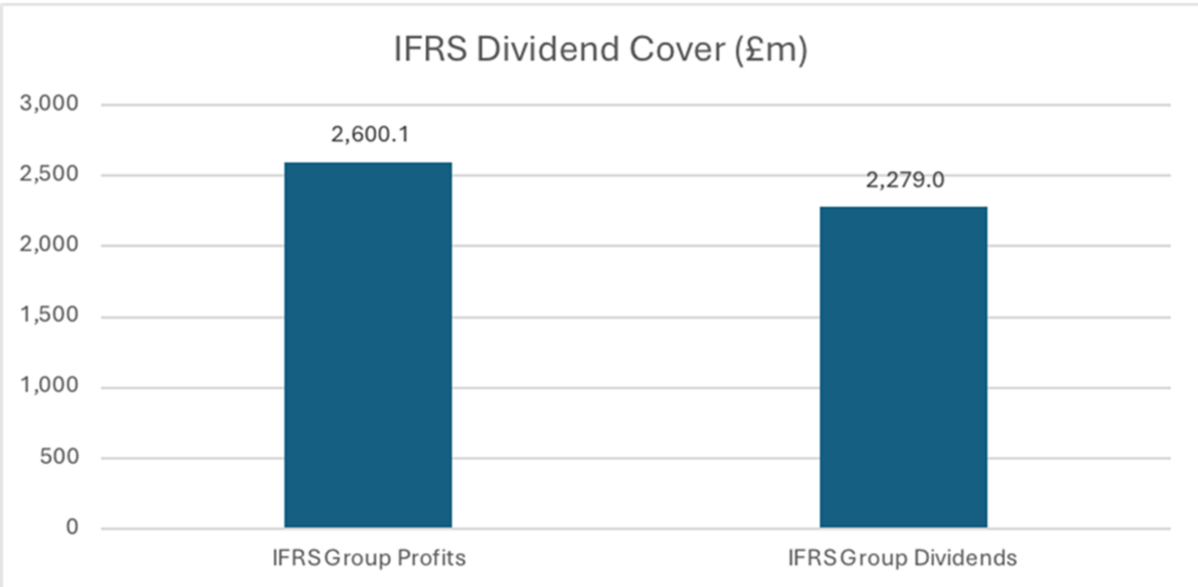
The committee also asked whether the returns we pay shareholders are appropriate. I'd like to make two points.

First, the average dividend Severn Trent group has paid over the last 10 years works out at just under £1 a share, which represents an average yield paid out by the group to external shareholders of almost exactly four percent. By maintaining a comparatively modest but predictable dividend, we have been able to raise £1.25 billion in new equity over the last three years to support the acceleration of our investment programme. In total, we are investing £15 billion in the Midlands over the next five years and paying a steady dividend is an essential enabler for this investment.

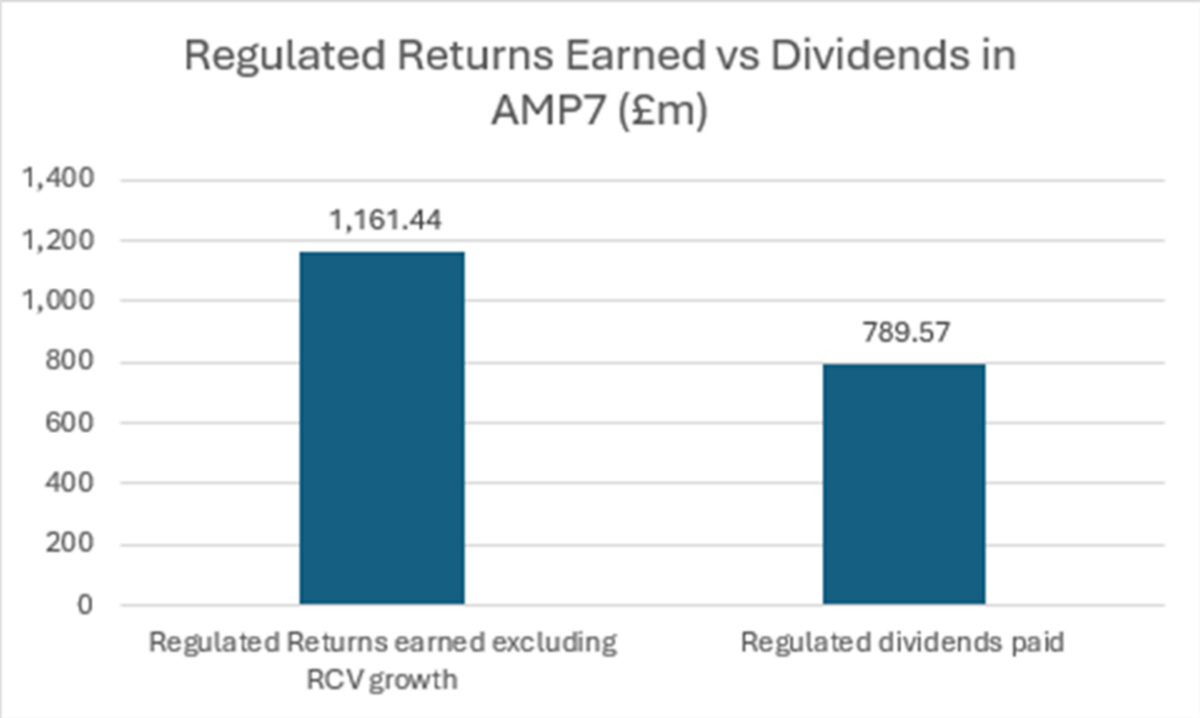
The second point is that the dividends we pay out are justified by our performance and earnings. As noted above, there are significant differences between earnings recognised under the Regulatory Accounting Guidelines and IFRS earnings, which is precisely why the latter is being changed. For example, in the current 5-year regulatory period we have £238 million of revenue that we have not yet billed and will instead recover in the next control period, that is 2025-2030 (see page 86 of our Annual Report and Accounts). The point is that when assessing the alignment of dividends for regulated business such as ours the assessment needs to be done on the basis of either:

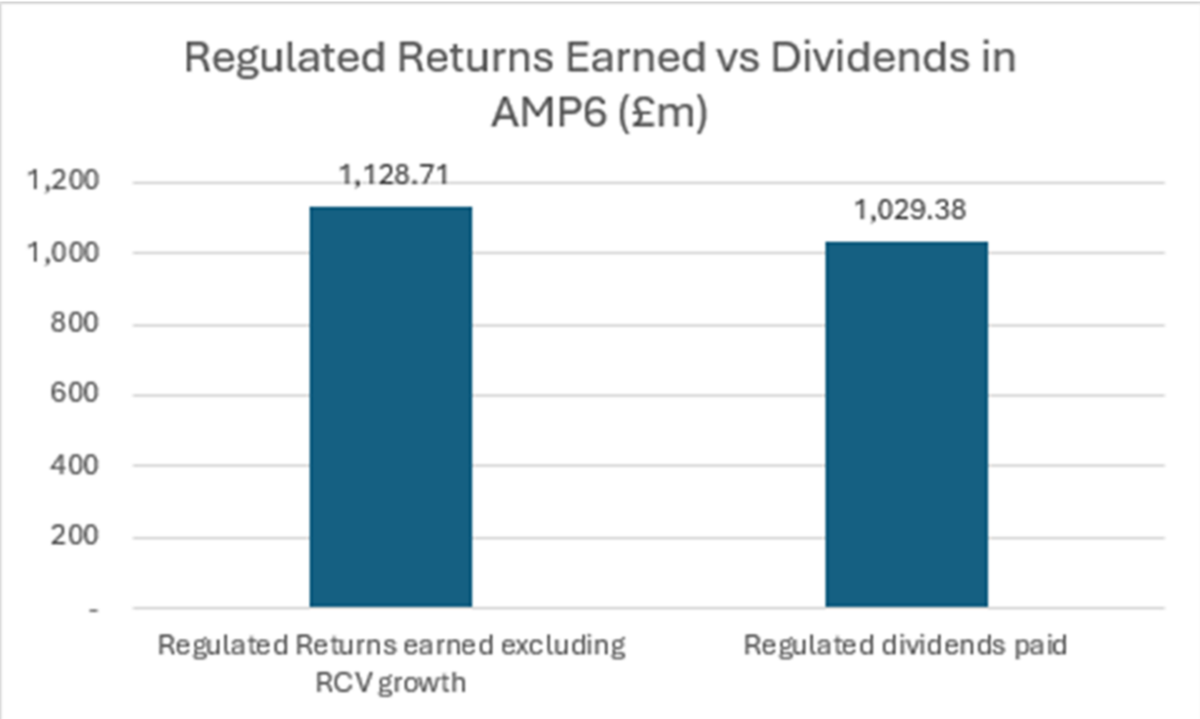
- a longer time period to capture these timing variations; and/or
- over a shorter period but utilising regulated returns as reported under Ofwat's Regulatory Accounting Guidelines (see Table 1F of water company Annual Performance Reports).

Across both measures our dividend is clearly justified by our performance. For example, if we consider our IFRS earnings over the last 10 years, our dividend cover has averaged 1.14, with £2.6bn of Group profits (Adjusted PAT per Severn Trent Plc Annual Report and Accounts) and £2.3bn of Group Dividends (Dividends Paid per Severn Trent Plc Annual Report and Accounts). This is illustrated below



If we consider regulated earnings versus dividends, as set out in Table 1F of the Severn Trent Water Annual Performance Report we can observe a similar outcome. As illustrated below across the first four years of the current AMP7 (2020-2024) and the whole of the last AMP6 (2015-2020*)* our regulated earnings have been £471m above the dividends paid.





As you can see from the above information, our dividend has been comfortably justified by our performance.

Turning to the bigger picture, I am very conscious that the water sector has much to do to regain the trust of customers. I am pleased with the progress Severn Trent has made over the last ten years – as our performance measures show – but I am the first to admit that there is much more for us to do. The good news is that we have a record £15 billion investment programme to do just this. Among other things, we will be reducing the harm our operations cause to the Midlands' rivers to less than two percent of the overall total, further increasing the reliability of our world class drinking water supplies to 99.999 percent (and average disruption of less than five minutes a year) and generally supporting the environmental and economic renewal of the Midlands.

Best wishes,

Liv

Liv Garfield (Pronouns: She/Her)

Chief Executive
Severn Trent