PENNON
GROUP PLC

SCRIP DIVIDEND ALTERNATIVE BOOKLET – TERMS AND CONDITIONS

SCRIP DIVIDEND MANDATE

If you wish to elect to receive new ordinary shares automatically in respect of the final cash dividend and all future dividends for which the scrip dividend alternative is offered ("relevant dividends") for all of your holding, you should sign the form of mandate. Alternatively, you can elect to do this online by logging on at ***www.capitashareportal.com*** and going to ***Manage your account > Change your dividend options > Scrip dividend.***

Your mandate will remain valid in respect of all relevant dividends unless and until revoked by you or, in certain circumstances, by the Company (see below). Details of each future scrip dividend offered by the Company will be given in the "Investor Information" section of the Company's website at ***www.pennon-group.co.uk*** under "Dividends".

For your protection, the Directors may (and absent mitigating circumstances intend to) declare your mandate void and pay a cash dividend instead, in respect of a relevant dividend, if the middle market quotation for the Company's ordinary shares by the final date for elections in respect of that relevant dividend falls by 15 per cent or more from the share price used to calculate your entitlement. The Directors may also declare your mandate void and pay a cash dividend instead, in respect of a relevant dividend, if the middle market quotation for the Company's ordinary shares by the final date for elections in respect of that relevant dividend rises by 15 per cent or more from the share price used to calculate your entitlement.

Mandates will be applied to your total shareholding at the record date for each relevant dividend. Any fractional entitlement will be accumulated for your benefit without interest until sufficient funds are available to subscribe for one new ordinary share in a subsequent scrip dividend, which will then be allotted to you automatically.

All new ordinary shares issued instead of a cash dividend will automatically increase the basic holding on which the next entitlement to a dividend will be calculated. If you hold less than the minimum number of ordinary shares required for exercise of the right to receive new ordinary shares, funds representing your fractional entitlement will be accumulated for your benefit. These funds will be added to the cash amount of any dividends in respect of which a subsequent scrip dividend alternative is offered and applied in calculating your entitlement in that offer. These funds will, however, be paid to you if you cancel your mandate or dispose of your entire shareholding.

Notice of revocation of your mandate may be given by you at any time and must be given in writing to the Company's Registrar. Such notice will take effect upon its receipt by the Company's Registrar in respect of all dividends payable on or after the date of receipt of such notice, other than in respect of a relevant dividend for which the latest time has passed for receipt of new forms of mandate. Your mandate will be deemed to be revoked if you sell or otherwise transfer your ordinary shares to another person but only with effect from the registration of the relevant transfer and will terminate immediately on receipt of notice of death. Funds representing fractional entitlements previously accumulated on your behalf will be paid to you at the next dividend payment date following registration of the transfer or, in the event of the transmission of shares following death, to the person so entitled.

The operation of mandates is subject both to there being an authority in place under the Company's Articles of Association and the Directors' subsequent decisions to offer the scrip dividend alternative. Mandates may also be modified or terminated at any time by the Company on giving not less than three months' notice in writing to shareholders. If authority is not granted by shareholders or if the Directors decide in their discretion not to offer the scrip dividend alternative in respect of any particular dividend, the full cash dividend will be paid to you in the usual way. In the case of any modification, current mandates will be deemed to remain valid under the modified arrangements unless and until the Company's Registrar receives a revocation in writing from the shareholder or the mandate is terminated by the Company. In any of the above scenarios, funds representing fractional entitlements accumulated on your behalf will be paid to you at the next dividend payment date.

CREST

If your shareholding is held in uncertificated form in CREST, you will not be able to complete a mandate. Instead, you will need to follow the CREST procedure. By doing so, such CREST shareholders confirm their election to participate in the scrip dividend alternative and their acceptance of these terms and conditions, as amended from time to time. **No other method of election will be permitted under the scrip dividend alternative and will be rejected.**

If you are a CREST sponsored member, you should consult your CREST sponsor, who will be able to take appropriate action on your behalf. All elections made via the CREST system should be submitted using the Dividend Election Input Message in accordance with the procedures as stated in the CREST Reference Manual. The Dividend Election Input Message submitted must contain the number of shares on which the election is being made. If the relevant field is left blank, or completed with zero, the election will be rejected. If you enter a number of shares greater than the holding in CREST on the relevant record date, the election will be applied to your total holding held as at the relevant record date for the dividend. Evergreen (mandate) elections will not be permitted. **If you wish to receive new shares instead of cash in respect of future dividends for which a scrip dividend alternative is offered, you must complete a Dividend Election Input Message on each occasion otherwise you will receive your dividend in cash.** To qualify for this final scrip dividend, elections via CREST should be received by CREST no later than 5.00pm on 15 August 2016 in respect of those shares on which you wish to make an election.

Once an election is made using the CREST Dividend Election Input Message it cannot be amended. If a CREST shareholder wishes to change their election, the election is required to be cancelled.

SHAREHOLDERS OUTSIDE THE UNITED KINGDOM

The option to elect to receive new ordinary shares instead of the final, and relevant, dividend is not being offered to, or for the account of, any North American Person. “North American Person” means any natural person resident in the United States or Canada, any corporation, partnership or other entity created or organised in or under the laws of the United States or Canada, or any political sub-division thereof, or with a registered address in either of those countries, or any estate or trust the income of which is subject to United States federal income taxation or Canadian income taxation (regardless of its source). “United States” means the United States of America (including each State of the United States of America and the District of Columbia). References to the United States and Canada include their territories, possessions and all areas subject to their jurisdiction. Accordingly, they will receive their dividends in cash in the usual way and are not being sent forms of mandate and any such forms of mandate received from a North American Person will not be accepted by the Company. Shareholders in other countries should note that no action is being taken by the Company to permit the exercise of any rights of election. Shareholders who are residents, citizens or nationals of any such other overseas countries may only elect to receive new shares if the scrip dividend alternative can lawfully be offered to and accepted by them under the laws of the relevant jurisdiction(s) and in both cases without any further obligation on the part of the Company. It is the responsibility of any person outside the United Kingdom wishing to receive new ordinary shares to ensure compliance with the laws of the relevant jurisdiction including the obtaining of any governmental or other consents and compliance with all other formalities.

BASIS OF ENTITLEMENT FOR THIS FINAL DIVIDEND

If you wish to receive new ordinary shares instead of the full cash dividend for the final dividend for the year ended 31 March 2016, you should sign and return your form of mandate to Capita Asset Services, Corporate Actions, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU, so that it reaches the Registrar no later than 5.00pm on 15 August 2016. **If the Registrar does not receive your form of mandate by that date, you will receive the full cash dividend** but your mandate will be valid for future dividends until cancelled or revoked.

Your entitlement to new ordinary shares in respect of this final dividend has been based on a price of 906.4p (the “share price”) which was the average of the middle market quotations for the Company’s ordinary shares for the day on which they were quoted “ex” dividend and the four subsequent dealing days as derived from the London Stock Exchange’s Daily Official List. The value of your entitlement has been subject to rounding to ensure that it is as nearly as possible equal to but not greater than the cash amount of the final cash dividend (disregarding any tax credit).

The formula used in calculating your maximum entitlement is as follows:

number of ordinary shares held at the record date x final cash dividend*

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share price

* plus cash residue from the last scrip dividend alternative (if any) for those shareholders who have a scrip dividend mandate in place.

Application will be made to the UK Listing Authority and the London Stock Exchange plc for admission of the new ordinary shares to, respectively, the Official List of the UK Listing Authority (the “Official List”) and to trading on the London Stock Exchange’s market for listed securities. The new ordinary shares will on issue rank pari passu in all respects with the existing ordinary shares and will rank for all future dividends. Certificates in respect of new ordinary shares will be posted to shareholders who hold their existing ordinary shares in certificated form, at the risk of the person entitled thereto, on 1 September 2016. Dealings in the new ordinary shares are expected to begin on 2 September 2016. In the unlikely event that the UK Listing Authority does not agree before 2 September 2016 to admit the new ordinary shares to the Official List, forms of mandate will be disregarded and the final dividend will be paid in cash in the usual way.

Shareholders who hold their existing ordinary shares in uncertificated form on 8 July 2016 and have made a valid scrip election will be allotted and issued their new ordinary shares as uncertificated shares on 2 September 2016 unless the Company is unable to do so under the provisions of the Uncertificated Securities Regulations 2001 (SI2001 No 01/3755) (as amended) or the facilities and requirements of CREST, in which case such shares will be issued as certificated shares and share certificates for such new ordinary shares will be posted to such shareholders at their own risk on 1 September 2016 together with the dividend cheques in respect of any remaining cash dividend entitlement.

Where new ordinary shares are issued as uncertificated shares, the Company will procure that Euroclear & Ireland Limited is instructed to credit the shareholder’s stock account in CREST with such shareholder’s entitlement to new ordinary shares. The stock account will be an account under the same participant ID and member account ID as the ordinary shares from which the new ordinary shares are derived.

The total cash cost of the final dividend would be £95,399,549 if no elections for the scrip dividend alternative were received. If all shareholders were to elect to receive new ordinary shares instead of cash in respect of their entire holdings, 10,525,104 new ordinary shares would be issued (ignoring any reduction in respect of fractions and assuming a share price used to calculate their entitlements of 906.4p, being the middle market price detailed above), representing an increase of 2.55% in the issued ordinary share capital of the Company (excluding shares held in treasury) as at 22 July 2016.

If for any reason your shares are registered in more than one holding and as a result you receive more than one form of mandate, unless you arrange with the Company’s Registrar to consolidate your holdings of ordinary shares before 15 August 2016 the holdings will be treated for all purposes as separate and you should complete the separate forms of mandate.

If you have sold any of your ordinary shares before 7 July 2016 (the day on which the shares went ‘‘ex” dividend), you may not be entitled to the dividend on those shares and you are advised to contact your stockbroker or other agent through whom the sale was effected without delay as there may be a claim for the cash amount of the dividend by the purchaser in accordance with the rules of the UK Listing Authority.

If you sell part of your shareholding prior to the relevant record date for any dividend and such sale is registered in the Company's Register of Members prior to the relevant record date, the scrip dividend alternative will apply only to your remaining ordinary shares.

A statement will be sent to all shareholders electing for the scrip dividend alternative stating the number of new ordinary shares allotted and the total cash equivalent of the new ordinary shares for tax purposes.

Timetable for the final dividend

7 July 2016	Ordinary shares quoted ex dividend
8 July 2016	Record date for final dividend
22 July 2016	Posting of scrip dividend alternative offer
15 August 2016	Final date for receipt of forms of mandate and CREST Dividend Election Input Messages
1 September 2016	Posting of dividend cheques and share certificates
2 September 2016	Final dividend payment date
2 September 2016	First day of dealing in the new ordinary shares.

No receipt or acknowledgement of forms of mandate will be issued. The Directors may suspend, change or terminate the scrip dividend alternative at any time. Duplicate copies of the form of mandate can be obtained from Capita Asset Services, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU, United Kingdom up to and including the last day for receipt of forms of mandate.

TAXATION

The taxation consequences for shareholders electing to receive new ordinary shares instead of a cash dividend is to change from 6 April 2016. The Finance Bill in which the changes are included has not yet been passed by Parliament therefore the changes are as understood at 22 July 2016. **This summary relates only to the position of shareholders resident in the United Kingdom for taxation purposes who hold their shares as an investment.** In particular, this summary does not address the position of certain classes of shareholders such as dealers in securities. The precise taxation consequences for a particular shareholder will depend on that shareholder's individual circumstances.

The interim dividend paid on 1 April 2016 is not affected by the changes, that were announced in the Summer Budget 2015 and are included in the draft Finance Bill 2016, to the taxation regime for dividends that are proposed to take effect from 6 April 2016.

This summary of the taxation treatment is not exhaustive. Please note levels and bases of taxation can change. If you are in any doubt as to your tax position or, if you are resident or otherwise subject to taxation in any jurisdiction outside the United Kingdom, you should consult your professional adviser before taking any action.

UK resident individuals

Income tax

Where individual shareholders elect to receive new shares in place of a cash dividend, they are treated as having received gross income of an amount equal to the "cash equivalent of the new shares". The cash equivalent of the new shares will be the amount of the cash dividend foregone unless the market value of the new shares on the first day of dealings on the London Stock Exchange ("the opening value") differs substantially (e.g. by 15 per cent or more either way according to current HM Revenue & Customs practice) from the cash dividend foregone in which case the dividend value will be treated as the cash equivalent of the new shares for taxation purposes.

For the purposes of calculating dividend income from 6 April 2016, individuals should include all income received on dividends from any company in the tax year and any cash equivalent of the new shares received in place of a cash dividend. The previous taxation regime, whereby a tax credit was attached to certain distributions, has been abolished. Instead, individuals have a £5,000 tax-free Dividend Allowance, or nil-rate band. The allowance exempts the first £5,000 of a taxpayer's dividend income from income tax.

Individuals who receive a dividend income in the tax year which exceeds the Dividend Allowance will be liable for income tax on the dividend income in excess of £5,000. For example, if an individual receives a dividend income of £6,000 in the tax year, £1,000 will be subject to income tax, subject to the utilisation of any other reliefs which may be avaiable.

In order to calculate the rate of tax due from an individual shareholder on the dividend income in the tax year which exceeds the Dividend Allowance, the following two rules should be applied:

i) the dividend income in the tax year which exceeds the Dividend Allowance is treated as the highest element of the shareholder’s income (for the purpose of identifying the applicable income tax band); and

ii) dividends within the allowance count as taxable income when determining how much of a taxpayer's basic rate band or higher rate band has been used, which may affect the rate of tax due on the dividend income in excess of the Dividend Allowance.

The next step is to identify the rate (or rates) at which dividend income in excess of the Dividend Allowance is to be taxed:

i) any dividend income in excess of the Dividend Allowance that falls above the individual shareholder’s personal allowance but below the basic rate limit will be subject to tax at the dividend basic rate of 7.5%;

ii) any dividend income in excess of the Dividend Allowance that falls within the higher rate tax band will be subject to tax at the dividend upper rate of 32.5%;

iii) any dividend income in excess of the Dividend Allowance that falls above the higher rate limit will be subject to tax at the dividend additional rate of 38.1%.

Capital gains tax
For capital gains tax purposes, if an election to receive new shares instead of a cash dividend is made, then the “cash equivalent of the new shares” (as described above) will be treated as being the base cost for the new shares. The new shares will be treated as a new asset and added to the existing pool of shares already held.

Trustees

Income tax
Where trustees of discretionary or accumulation trusts elect to receive new shares, they will be liable to income tax at the dividend trust rate (currently 7.5% on dividend income up to £1,000 and 38.1% on dividend income over £1,000). For the purposes of charging this income tax, the trustees will be treated as having received gross income which is the same as the cash equivalent of the new ordinary shares (as described above).

Trustees of an interest in possession trust (where the beneficiary with an interest in possession is entitled to the trust income) who have elected to receive new shares will be taxed at the dividend trust rate of 7.5%

If the new shares are held in a bare trust or in the name of a nominee, the trustee or nominee will be disregarded for the purposes of income tax and the tax position of the beneficiary entitled to the shares, will be that of the individual shareholder.

Capital gains tax

Where trustees of discretionary or accumulation trusts, where no beneficiary is entitled to the trust income, elect to receive the scrip dividend, the new shares will constitute a new holding of shares in the Company acquired for the cash equivalent in the manner described above.

Where trustees of an interest in possession trust (where the beneficiary with an interest in possession is entitled to the trust income) elect to receive the scrip dividend and treat the new shares as income, a beneficiary entitled to the trust income, if a UK tax resident individual, is treated for capital gains tax purposes as having acquired the new shares for the cash equivalent of the new shares, in the manner described above.

If the new shares are held in a bare trust or in the name of a nominee, the trustee or nominee will be disregarded and the beneficiary is treated as having acquired the new shares for the cash equivalent of the new shares.

Companies

A corporate shareholder resident in the United Kingdom for tax purposes is not generally liable to corporation tax on cash dividends from a company resident in the United Kingdom and will not be charged corporation tax on the new shares received instead of a cash dividend. For the purposes of corporation tax on chargeable gains, it will be assumed that no consideration has been given for the new shares. They will be added to the corporation shareholder's existing holding of shares in the Company and treated as though they had been acquired when the existing holding was acquired. On a disposal of the new shares, the base cost of the new shares will be calculated by reference to the base cost of the existing holding.

Pension funds

Where pension funds elect to receive the scrip dividend, no tax credit will attach to the new shares. Pension funds will not be able to claim repayment of the tax credit on the equivalent cash dividend.

Stamp duty and stamp duty reserve tax

No stamp duty or stamp duty reserve tax is payable in respect of the allotment and issue of the new ordinary shares.

22 July 2016