Severn Group

Transfer Pricing Policy

JANUARY 2023

Accountability

SEVERN
Superior Valve Engineering

Introduction

This Transfer Pricing Policy (the "Policy") provides a mandatory framework for dealing with all intercompany transactions within the Severn Group ("Group") and between any direct or indirect subsidiary of the Company ("Group Companies").

This Policy addresses how intercompany transactions are handled within the business on a statutory basis. Management reporting will acknowledge the full sale price and associated costs for both division and region.

This Policy applies to any transaction between two Group Companies. The principal transactions currently in place that have been contemplated in the development of this Policy are as follows

- Valve Sales
    - Sales of manufactured goods
    - Pass-through sales
- Customer Referrals
- Spares and service sales
- Provision of manufactured components
- Provision of valve design, strategic and other support services
- Warranty support

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Policy Statement

The purpose of this Policy is to establish sound internal controls to ensure that sensible levels of profit are achieved on a statutory basis when handling intercompany transactions within the Group.

This Policy is informed by a "Transfer Pricing Design Report" prepared by KPMG between March and June 2020, which in turn followed the context of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations to determine transfer prices using the arm's length principle (in practice, arm's length pricing is determined in the report by reference to transactions between unrelated companies under comparable circumstances i.e. through detailed benchmarking studies).

Additional recharges may be made as required to ensure the achievement of minimum operating margins, which are defined by the arm's length range of results for comparable activities in the respective region.

This Policy does not include financing loans which are governed by separate agreements between the relevant companies.

Who must comply with this Policy?

All directors, officers, employees, consultants and contractors of the following Group Companies must comply with this Policy:

- Contour Technologies Limited
- Severn Glocon UK Valves Limited
- Severn Unival Limited
- Severn Glocon (Aberdeen) Limited
- L.B. Bentley Limited
- Mars Valve (UK) Limited
- MCE Group Limited
- Severn Glocon Valves Pvt Ltd
- Severn Glocon FZE (incorporating Abu Dhabi)
- Severn Glocon (Australia) Pty Ltd
- Severn LLP (Kazakhstan)

Representative offices are exempt from this Policy as the retained value of sale will be 0%

Who is responsible for the Policy?

Any deviation from this Policy must be approved in writing by Chief Financial Officer.

The board of directors of the Company (the "Board") may review and update this Policy from time to time to ensure it remains consistent with the Board's objectives and responsibilities.

Any questions or support requests should be addressed to the Group Finance Director & Treasurer. Any issues or concerns regarding this Policy should be addressed to the Chief Financial Officer.

The Approach

Responsibilities

The margins represented in the examples included within this Policy are illustrative only. The actual margin is variable dependent on the selling price to the customer versus our total costs. Minimum margin expectancies are defined within the Commercial Management Rules of the Road. For sale of manufactured goods, for the order-taking entity, this is expected to be in the region of what is targeted for traded products. The external sales team are responsible for liaising with the internal team to provide local intel and guidance on pricing expectations to ensure we achieve the best possible Group position.

If during the contracting or execution of the order the gross margin is depleted, this is the responsibility of the manufacturing entity that has prepared the pricing and controls the costs.

If a performance bond or invoice retention applies to the contract, the order-taking entity is responsible for this as they are contractually responsible for these obligations.

As this arrangement is on a cost-plus basis, the order-taking entity is responsible for commissions as they are adding margin to the cost provided by the manufacturing Group entity. Commissions are to be based on the total sales value (excluding non-commissionable items).

If liquidated damages apply to the contract, the responsibilities for the charges are as follows. Both entities must agree and accept the liquidated damages liability at the point of order placement.

Valve Sales	Sales of manufactured goods	Shared
	Pass-through sales	Manufacturing Entity
Customer Referrals		Manufacturing Entity
Spares and service sales		Manufacturing Entity
Provision of valve design, strategic and other support services		Not applicable
Provision of manufactured components		Arbitration approach in the event of a claim
Warranty support		Not applicable

The Approach

Process

The transaction type should be agreed at the quotation stage to ensure clarity upfront and throughout processing.

It is important to have transparency internally surrounding cost structures and pricing to ensure that the team liaising with the client is able to negotiate the sale price as required. For intercompany transactions that have retentions applied, the PO should be based on the final PO value that is received from the customer. Where local costs apply, such as transport, duty and special documentation (e.g. legalised certificate of origin), these can be excluded from the value to which the retention is applied.

No charge or credit should be issued for infrequent orders of a sale value less than £100.

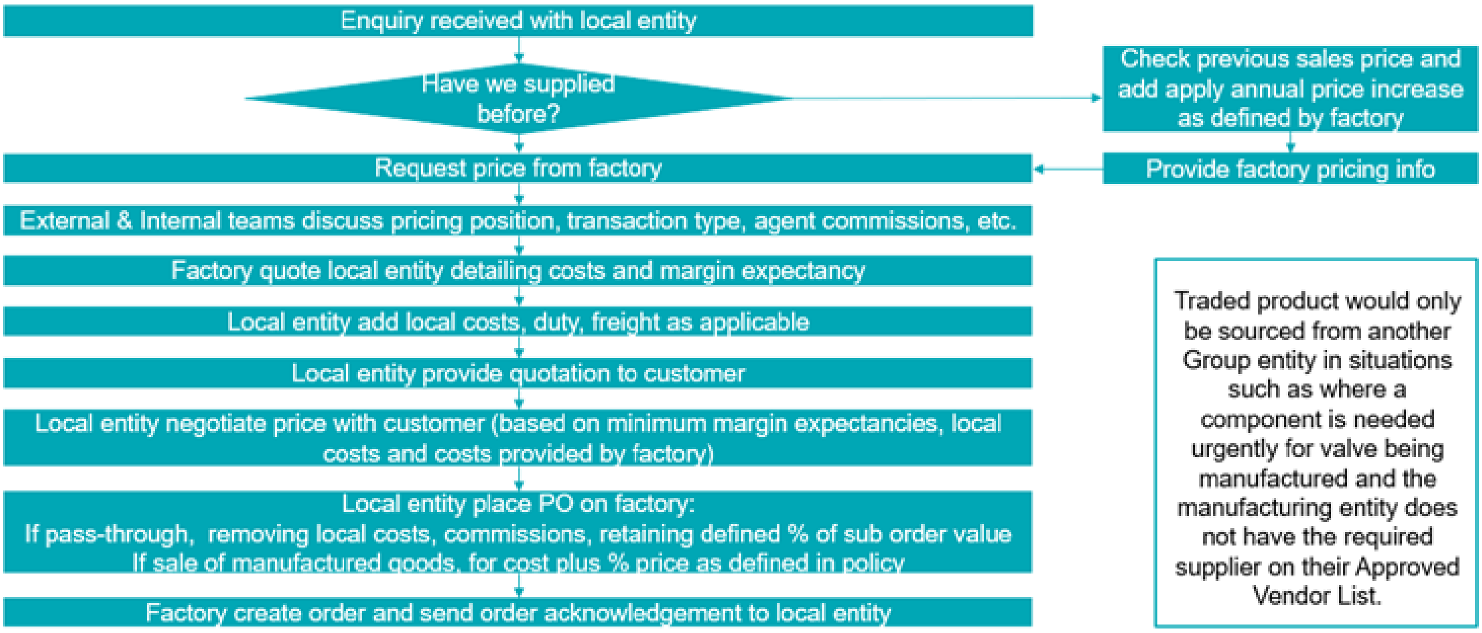
In addition to the parameters outlined within the Delegation of Authority, a financial check is required as part of the contract authorisation process for all intercompany orders over £250,000/$300,000/₹25,000,000 to ensure they are in accordance with this Policy.

Agency commissions are charged to the order-taking entity and are based on final PO values from the customer. Reference the Commercial Management Rules of the Road for commissionable/non-commissionable items. Agents are to send commission invoices directly to the responsible Group entity.

All intercompany invoices shall be paid on a back-to-back basis from receipt of payment by the customer. The aim for intercompany payments shall be 30 days, with 60 days accepted as the norm. The maximum term for payment of intercompany invoices shall be 120 days. Intercompany invoices can be settled on alternative terms with agreement in writing from the Financial Controller of both parties. If there is a requirement for payment of an invoice to be deferred longer than the maximum term of 120 days, approval is required from the Group Finance Director & Treasurer or Group Financial Controller. The order-taking Group entity is responsible for chasing the customer for payment.

The purchase order and invoice currency should be consistent with the customer's PO. In the case of 'Warranty Support' or 'Provision of Valve Design, Strategic or Other Support Services, in the absence of a customer purchase order, the currency shall be the preferred currency of the business unit providing the support.

The Approach



Application of the Policy

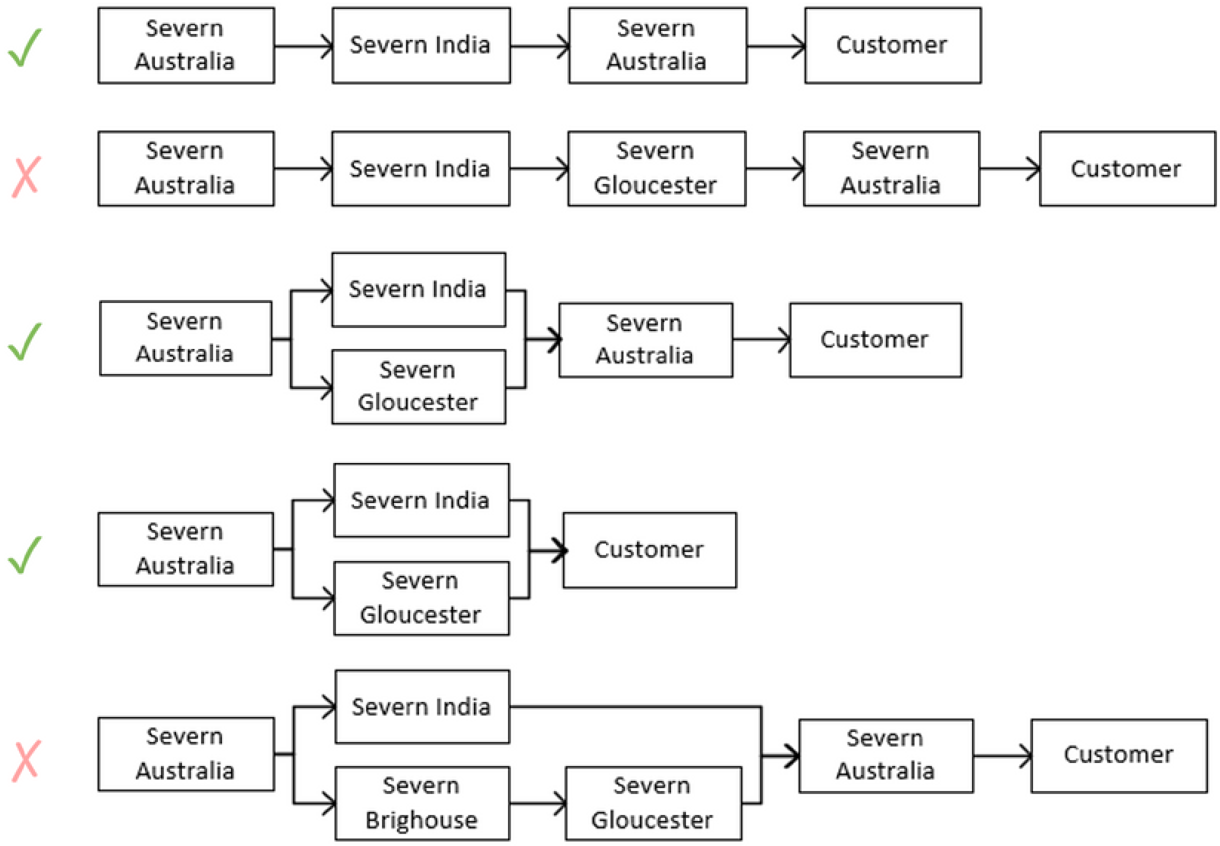
The below table provides guidance as to the transaction types which may occur in relation to the provision of goods or services.

				Supplier of Good or Services			
				Severn Glocon		Bentley	Regions
				UK Manufacturer	Indian Manufacturer	UK Manufacturer	
Order-taking Entity	Severn Glocon	UK Manufacturer	Valves	Cost plus 8% or 3% Retention	Cost plus 12% or 3% Retention	5% Referral	N/A
			Service	5% Retention	5% Retention	5% Referral	5% Retention
			Spares	15% Retention	15% Retention	5% Referral	N/A
		Indian Manufacturer	Valves	Cost plus 8% or 3% Retention	N/A	5% Referral	N/A
			Service	5% Retention	5% Retention	5% Referral	5% Retention
			Spares	15% Retention	N/A	5% Referral	N/A
	Bentley	UK Manufacturer	Valves	5% Referral	5% Referral	N/A	N/A
			Service	5% Referral	5% Referral	N/A	5% Referral
			Spares	5% Referral	5% Referral	N/A	N/A
	Regions		Valves	3% Retention or 5% Retention	3% Retention or 5% Retention	5% Referral	N/A
			Service	5% Retention	5% Retention	5% Referral	5% Retention
			Spares	15% Retention	15% Retention	5% Referral	N/A

The Approach

Only two Group entities should be involved in any one chain. For situations where involvement is required by more than two Group entities, approval must be sought from the Chief Financial Officer prior to bidding. The sale of manufactured components is considered a separate chain from the procurement of the product the component is used in.

Examples:



If spares are required for a valve that was historically supplied via a chain of two or more Group companies, the enquiry should be addressed to the manufacturing entity unless there is reason to engage another Group company (e.g. local content needed from a region where the manufacturing company is not based, customer approval of a specific site). Checks must be conducted with the order-taking entity to ensure no modification/upgrades have since been carried out.

The Approach

Valve Sales

Sale of Manufactured Goods

The sale of manufactured goods is where the order is made by the purchasing Group company which is recognised by the customer as the manufacturing company. This only applies to instances where one manufacturing company subcontracts manufacturing work to another manufacturing company within the Group; where project management activities and value-added direct labour contribution is provided by the order-taking entity.

Manufactured goods sold by one Group company to another must be priced on a cost-plus basis. The % markup to be used in the cost-plus calculation is:

- For Indian manufactured goods – cost plus 12%
- For UK manufactured goods – cost plus 8%

The cost used for this basis is the fully loaded cost incurred by the manufacturing company in respect of that order (including direct overheads). If a price list is used, the fully loaded cost price is to be calculated by removing the standard margin level applied to the price list.

Where manufacturing is shared between multiple Group entities, the relevant percentage mark-up shall be applied to the cost of sale for each facility. Margin shall be applied by the order-taking group entity following mark up of each of the Group entity costs of sale.

Example – multiple manufacturing facilities:

Cost of sale for manufacturing Group entity 1	£70,000	Fully loaded cost
Mark up % on cost of sale for manufacturing Group entity 1	8%	Example is based on UK manufacturing
Mark up value for manufacturing Group entity 1	£5,600	= (COS / 100) x mark up % = (70,000 / 100) x 8
Total sale value for manufacturing Group entity 1	£75,600	= COS + mark up value = 70,000 + 5,600
Cost of sale for manufacturing Group entity 2	£40,000	Fully loaded cost
Mark up % on cost of sale for manufacturing Group entity 2	12%	Example is based on India manufacturing
Mark up value for manufacturing Group entity 2	£4,800	= (COS / 100) x mark up % = (40,000 / 100) x 12
Total sale value for manufacturing Group entity 2	£44,800	= COS + mark up value = 40,000 + 4,800
Total sale values for both manufacturing Group entities	120,400	= Total sale value for manufacturing Group entity 1 + Total sale value for manufacturing Group entity 2 =75,600 + 44,800
Margin applied by order-taking Group entity	20%	Margin objective as defined by business unit targets [1]
Margin value for order-taking Group entity	£30,100	= Total sale value for both manufacturing Group entities / ((100 – margin) / 100) - Total sale value for both manufacturing Group entities = 120,400 / ((100 – 20) / 100) – 120,400
Total sale value for order-taking Group entity	£150,500	= Total sale value for both manufacturing Group entities / (100 – margin) / 100 = 120,400 / (100 – 20) / 100

The Approach

Pass-through Sales

Pass-through sales are where valves are acquired by one Group company on behalf of another. This is a purely administrative transaction type where all manufacturing and order management activities take place within the manufacturing entity. For example, a customer would like to place an order with Severn Glocon UK Valves Limited but does not have an account set up for them. Due to time constraints, as the customer already has an account set up with Severn Unival Limited, the order is placed with them and a sub-order placed by Severn Unival Limited for all activities to be carried out by Severn Glocon UK Valves Limited. Severn Unival Limited's involvement is limited to contract administration and invoicing upon completion.

This also includes instances where one Group company acquires components from a third party on behalf of another Group company, for example in situations where a component is needed urgently for a valve being manufactured and the manufacturing entity does not have the required supplier on their Approved Vendor List.

For all 'pass-through' valve sales, a fee of 3% of the related sales value.

Example:

Cost of sale	£60,000.00	Fully loaded cost
Margin %	30%	Margin objective as defined by business unit targets
Margin value	£25,714.29	= COS / ((100 – margin) / 100) - COS = 60,000 / ((100 – 30) / 100) - 60,000
Total sale value	£85,714.29	= COS / (100 – margin) / 100 = 60,000 / (100 – 30) / 100
% Retained by order-taking Group entity	3%	Pass-through fee
Value retained by order-taking Group entity	£2,571.43	= (sale value / 100) x Pass-through fee = (85,714.29 / 100) x 3
Value retained by manufacturing Group entity	£23,142.86	= margin value – Pass-through fee = 25,714,29 – 2,571.43

The Approach

Customer Referrals

Customer referrals is where the order is placed directly by a third-party customer, but the introduction is made by a separate part of the Group. For example:

- LB Bentley provide a customer referral to Severn Glocon
- The Regional teams provide a customer referral to LB Bentley

This transaction type applies only to separate parts of the Group where the sales team are not recharged as defined in the section 'Provision of Valve Design, Strategic and Other Support Services'.

- For all referrals, a referral fee of 5% of the related sales value.

Example:

Cost of sale	£60,000.00	Fully loaded cost
Margin %	30%	Margin objective as defined by business unit targets
Margin value	£25,714.29	= COS / ((100 – margin) / 100) - COS = 60,000 / ((100 – 30) / 100) - 60,000
Total sale value	£85,714.29	= COS / (100 – margin) / 100 = 60,000 / (100 – 30) / 100
% Payable to referring Group entity	5%	Referral fee
Value payable to referring Group entity	£4,285.71	= (sale value / 100) x referral fee = (85,714.29 / 100) x 5
Value retained by manufacturing Group entity	£21,428.57	= margin value – referral fee = 25,714,29 – 4,285.71

The Approach

Spares and Service Sales

Spares sales are when spare parts are acquired by one Group Company on behalf of another. Spares sales shall be placed with the original Group Company which manufactured the valve.

If the manufacturing entity who produced the valves originally is unable to meet the customer delivery requirements, this shall be treated as Provision of Manufactured Components, as the drawings will need to be provided by the entity who manufactured the valve originally.

If purchased parts are acquired by one Group Company on behalf of another, this is considered a pass-through sale.

Service sales is when paid service support is provided by one Group Company on behalf of another. This transaction type is used where the order is carried out by another Group Company in its entirety. If labour is to be used from two Group Companies, the order-taking entity is to carry out coordination activities and the supporting entity will charge for labour support as per the rates defined for transaction type 'Provision of Valve Design, Strategic and Other Support Services'.

- For all Spares sales, a fee of 15% of the related sales value.
- For all Service sales, a fee of 5% of the related sales value.

The above rate for service sales applies where the service work is referred to a different entity. In situations where an entity acts as a support function to aid in the completion of a customer service order which is led by another entity, rates are as defined within the next section 'Provision of Valve Design, Strategic and Other Support Services'.

Example (Spares Sales):

Cost of sale	£30,000.00	Fully loaded cost
Margin %	60%	Margin objective as defined by business unit targets [1]
Margin value	£45,000.00	= COS / ((100 – margin) / 100) - COS = 30,000 / ((100 – 60) / 100) - 30,000
Total sale value	£75,000.00	= COS / (100 – margin) / 100 = 30,000 / (100 – 60) / 100
% Retained by order-taking Group entity	15%	Spares sale fee
Value retained by order-taking Group entity	£11,250.00	= (sale value / 100) x Spares sale fee = (75,000 / 100) x 15
Value retained by manufacturing Group entity	£33,750.00	= margin value – Spares sale fee = 45,000 – 11,250

The Approach

Example Service Sales:

Service rate	£20,000.00	In accordance with the Commercial Management Rules of the Road
Total sale value	£20,000.00	In accordance with the Commercial Management Rules of the Road
% Retained by order-taking Group entity	5%	Service sale fee
Value retained by order-taking Group entity	£1,000.00	= Service rate / 100 x Service sale fee = (20,000 / 100) x 5

Provision of manufactured components

Provision of manufactured components is when the Group company which is manufacturing a valve, repair or upgrade order, places a sub-order with another Group manufacturing company to supply components only. The Group company which requires components to be manufactured provides a sub-order and manufacturing drawing to the Group company which is manufacturing the components.

Manufactured components must be supplied by one Group company to another on a cost-plus basis. The provision of such manufactured components is a high value-added service. The cost used for this basis is the fully loaded cost incurred by the manufacturing company in respect of that order (including direct overheads). If a price list is used, the fully loaded cost price is to be calculated by removing the standard margin level applied to the price list.

• For Provision of all manufactured components – cost plus 20%

Example Service Sales:

Cost of sale	£60,000.00	Fully loaded cost
Mark up % on cost of sale	20%	Mark up %
Mark up value	£12,000.00	= (COS / 100) x 20 = 60,000 / 100 x 20
Total sale value	£72,000.00	= COS + mark up value = 60,000 + 12,000.00

The Approach

Provision of Valve Design, Strategic and Other Support Services

The OECD recommend a 5% mark up on the proportion of fully loaded employment costs of the relevant employees for the recharge of senior management services that relate to Group activities (e.g. excluding time spent on shareholder matters or Group level activities such as strategy and corporate transactions). This principle is applied to all support services, including:

1. Other support services are provided within the Group. As an example, one facility may provide stores services to another facility based on the same site. This can also, for example, include IT costs, marketing support, CRM licenses. These are recurring, consistent support requirements which are identified and agreed during the budgeting period.
2. Service labour can be provided across the Group to aid in the completion of customer orders contracted with another Group entity.
3. There are shared resources within Divisions and across Division/Regions which are agreed during the budgeting period. These are categorised into 4 areas:
    - Group – Recharges relating to Group resources or costs that are split between all Group companies. This includes senior management, legal and financial services. The proportion of cost attributable to each entity in a period is allocated at the end of the period.
    - International Sales Team (External) – These recharges shall be recorded in site overheads and accrued on a monthly basis with actual recharges confirmed based on actual sales split in March and December.
    - Split – Resources or costs split between two or more specific sites. Percentages agreed during budgeting.
    - Charge – timesheets are prepared as required or hours agreed in advance of a specific project requirement.

Valve design and technical support services are charged at cost plus 15%. This applies where resources are employed by one entity in order to carry out work for other entities. For example, if Severn Glocon Valves Private Limited were to employ a design engineer to carry out design activities on behalf of Severn Glocon UK Valves Limited.

There are also ad hoc operational/project requirements which are to have hours agreed in advance and will be charged immediately following the completion of activities. The following hourly rates shall apply:

- Labour / Paint / Administration – £20 / $28
- Drawing Office / Fitting / Contracts – £25 / $35
- Managerial – £35 / $50
- Machining – £56 / $78

The Approach

A normal working day is considered to be 8 hours. Weekday overtime is charged at the above rates multiplied by 1.33. Weekend work (Friday/Saturday in the Middle East, Saturday/Sunday across the rest of the Group) is charged at 1.5 x and 2.0 x respectively. Travel costs, accommodation costs and subsistence are to be charged at cost.

Travel time, as relevant, is charged at the applicable rates defined above (e.g. if travel is required to take place on a weekend, the hourly weekend rates will apply).

Stand-by time is chargeable at the normal hourly rates defined above.

Warranty Support

Warranty support refers to instances when one Group company is requested to support another with a service or spares requirement for a warranty claim from a customer. Any warranty claims shall be coordinated by the original manufacturing entity and they shall be liable for any costs associated with the claim.

As a warranty claim from a customer reflects on overall Group performance, these transactions should not benefit any part of the Group. The intent for warranty support is not for the Group company providing the support to recover all associated costs, but not to make any profit in doing so. Warranty transactions should therefore be non-profitable. Intercompany pricing should therefore comprise of the following items, where relevant:

- Service engineer cost (incorporating weekends, overtime and report preparation); plus
- Subsistence (including, but not limited to, travel costs, accommodation, meals, fuel, etc.); plus
- Material/Component costs (fully loaded cost only); plus
- Equipment Hire at £75 / $100 per day
- 5% administration fee; plus
- Any applicable taxes or tax deductions.

Charges apply to all hours booked from check-in and return to mobilisation point. Exchange rates to local currencies will be made at the agreed monthly rates published by the Group.

In the event that the issue is later deemed to be not the fault of the Group, client charges will apply in accordance with the service rates defined within the Commercial Management Rules of the Road. Any profit from this transaction is retained by the Group company which supported the warranty claim. The Group company that initiates the warranty support request shall be responsible for collection of payments from the client and for payments to the Group company which supported the warranty claim.

Definitions

- Project Management – This is expected to consist of:
  - Specification review and interpretation of requirements into control documents
  - Internal expediting
  - Progress reporting, communications and client management
  - Document preparation and submittal to project requirements
  - Compilation of databook
  - Risk management and mitigation
  - Coordination of witness inspection requirements
- Fully loaded cost means the total cost of all materials and associated direct costs used to produce the applicable good, product or service, plus a proportion of the indirect costs that are reasonably attributable to the provision of such good, product or service. Fully loaded cost for this purpose will be calculated as:
  - Cost of materials (actual incurred cost); plus
  - Cost of direct labour (allocation based on time recording of total employment costs of the relevant employees - salary, employer's pension contribution, employer's social contributions, and also bonus and benefits) based on [hours/days] incurred on the order; plus
  - Cost of subcontract labour, if any; plus
  - Any other direct costs incurred on the order (e.g. freight and duty, tooling and patterns, plant hire); plus
  - An allocation of indirect costs (rent and utility costs) – a standard 15% uplift on the direct costs is to be applied. This is only to be applied where a Group company is bidding on a cost-up basis.

Example – Fully Loaded Cost:

Cost of materials	£40,000	Actual incurred cost
Cost of direct labour based on time recording	£10,873	Total employer cost allocated
Cost of subcontract labour	–	No subcontract labour in this example
Other direct costs	£4,683	Freight and duty, tooling etc
Total direct costs	£55,556	
Indirect overhead allocation	£8,333	15% uplift to cover rent and utility costs
Cost of sale for manufacturing Group entity	£63,889	Fully loaded cost

At Severn, our business success flows from expertise – from technical knowledge and experience that position us as a leader in our field. Not everything, however, can be engineered. The Values which underpin that success stem instinctively from the culture we seek to sustain. Everything we do is tested against our Values, and our people are encouraged to apply them every day: they are the stewards of our brand, our reputation, our heritage, our ambitions.

Customer

Integrity

Excellence

Accountability

SEVERN
Superior Valve Engineering