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**Portsmouth Water Limited**  
Annual Report & Accounts 2017



## Portsmouth Water At A Glance

159

We are proud to have served the local community since 1857.

98

On average our domestic customers pay £98 per year for their water supply.

We are an independent company unique in the industry as we are majority owned by a Trust on behalf of our employees

722,000

Over 722,000 people use our clean drinking water every day.

316,000

We provide clean drinking water to 316,000 homes and businesses in our area.

170

We serve the cities and towns of Portsmouth, Chichester, Fareham, Gosport, Havant and Bognor Regis. On average, each day we supply approximately 170 million litres of water.

3,300

Our area of supply has a network of over 3,300 kilometres of underground mains.

## Highlights

- > At £98 our average household bill continues to be the lowest in England and Wales
- > Over 2,800 households joined our newly established Social Tariff
- > RoSPA Presidents Award winner for the third successive year
- > Top water company in the Institute of Customer Service survey
- > Successfully implemented £3m ERP system
- > Completed two out of three required environmental schemes
- > An industry leader in customer service

### Turnover

£40.3m

|      |       |
|------|-------|
| 2017 | 40.3m |
| 2016 | 39.8m |
| 2015 | 38.8m |

### Cash generated from operations

£10.6m

|      |       |
|------|-------|
| 2017 | 10.6m |
| 2016 | 13.7m |
| 2015 | 11.9m |

### Capital expenditure

£9.4m

|      |      |
|------|------|
| 2017 | 9.4m |
| 2016 | 9.3m |
| 2015 | 5.8m |

### Operating profit\*

£5.6m

|      |      |
|------|------|
| 2017 | 5.6m |
| 2016 | 7.6m |
| 2015 | 6.7m |

*\*After loss on disposal of fixed assets*

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## Registered Office

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Havant  
Hampshire  
PO9 1LG

# Chairman's Statement

**Mike Kirk**  
Chairman  
25 May 2017

We were pleased to be ranked in the top three for customer satisfaction in the Independent SIM survey

I have great pleasure in presenting the Annual Report and Accounts for what has been a busy and eventful year. We have continued to deliver excellent customer service, the lowest household bill in the country and a strong financial performance. We introduced a new tariff for those customers who find it difficult to pay their bills and other measures for those in vulnerable circumstances. The market for non-household customers opened on the 1st April 2017 and, as highlighted in last year's report, we completed the sale of our non-household retail business on the same date having exited the market. A significant element of our capital programme was completed, further enhancing the resilience of our infrastructure.

## Our Customers

We were pleased to be ranked in the top three for customer satisfaction in the independent Service Incentive Mechanism (SIM) survey conducted for Ofwat. The survey contributes 75% of the overall SIM score, with the remainder relating to quantitative measures, measuring written complaints and unwanted telephone calls. In 2015/16 we were ranked first in the overall SIM and although the overall rankings for 2016/17 are not available until later in the year we would expect to, once again, be close to the top. We are members of the Institute of Customer Service who conducted a satisfaction survey of our customers for the first time this year. The results were very positive with our score being the highest of any Water Company who are members of the Institute. The number of complaints that we receive per 10,000 customers rose to 12.7, this compares to the industry average for 2015/16 of 33.7, and our 2015/16 score of 8.7, which was the lowest in the industry. The increase was associated with the successful implementation of a major new IT system, which had a small impact on operations.

In July we introduced a social tariff for those customers who have low household incomes and have genuine difficulty paying bills. In the

year 2,800 customers signed up to this tariff which was ahead of our target. This is part of a range of services to help those in society that need additional support.

In the second year of the current regulatory period, we achieved all but two of our Outcome Delivery Incentives (ODI'S). Leakage for the year at 30.36Ml/day was slightly higher than the target of 29.95Ml/day, although the average for the two years is on target. Atypically dry ground conditions through late summer and autumn and cold snaps in January impacted leakage and bursts. Water quality contacts for taste and appearance whilst over our target, remain at a level which is one of the lowest in the industry. This is indicative of the high standards that we set ourselves. Water Quality is fundamental to our business and 99.99% of samples taken from customer taps met the standards set by the Drinking Water Inspectorate. The overall number of burst pipes and average interruption to supply experienced by our customers was better than the targets set.

We continue to work with local developers to understand both of their expectations and their experience of working with us. In our annual developer survey 85% indicated they were satisfied with our performance.

During the year we recruited a Customer Advisory Panel (CAP). This group of 20 customers is a representative cross section of our household customer base. The CAP has been established to help us gain greater insights into our customers' needs and priorities in order to support our key business decisions.

## Our Infrastructure

Over many years we have invested in the resilience of our infrastructure and have a robust network of pipes and treatment works. We are able to move water across our region and we are capable of providing water from more than one source to almost all of our customers. In the year we completed construction of an ultra violet (UV) treatment plant at our Eastergate and Westergate water treatment works, at a total cost of almost £5m. The improvements were made to address the risk of cryptosporidium, which, although low can, if left untreated, cause sickness. We are also close to completion of a £5m scheme to introduce UV treatment at our largest works at Farlington, and at the same time install a facility to recycle waste water from the works. Reusing this waste water will increase the amount of water available for supply making us more resilient to droughts.

During the year we invested £4.2m replacing 21km of pipes to improve the long term reliability of our network. Over the five years of this regulatory period we expect to replace 110km of pipe representing 3.3% of the network. We have also conducted a study of the resilience of all our resources to pollution and flooding. Although the study showed we have strong resilience, we have identified the requirement for some further investment, which we will bring forward in the next regulatory period.

### **Our Business**

On 1st April 2017 the non-household water market opened to competition. This allows business customers to choose who will provide their retail services. As I reported last year, the board decided to exit the retail market for business customers and agreed to sell these activities to Castle Water and this was completed for market opening.

There is of course no change to the infrastructure, that delivers drinking water to all customers, and Portsmouth Water continues to supply clean water to businesses in our area and is responsible for emergencies. Despite having decided to exit the retail market, there was still a tremendous amount of work needed to be ready for the market opening as a wholesaler. This was successfully achieved thanks to the dedication of our staff.

In October 2016 we implemented a new £2.8m company-wide IT system, which will handle almost all of our business activities except for customer billing. The new system will enable us to improve services to customers and to provide us with the information we need to maintain our assets effectively and our planning capability. The implementation was a large undertaking and a major change for our staff, but I am pleased to report that there was no major impact on customers, although we did have some minor delays to works, which resulted in a small increase in our normal level of complaints. This system was the final element of our strategy to move away from mainframe technology, which was becoming very expensive to maintain.

Although we do not have to submit our Business Plan until September 2018, we have begun our preparations for the Periodic Review which will be concluded in 2019. Our customer engagement programme is underway and we expect to consult on our draft Water Resource Management Plan later this year.

### **Our People**

We were delighted for the third consecutive year to receive the President's Award from the Royal Society for the Prevention of Accidents (RoSPA). This recognises 13 consecutive years of winning 10 Gold Awards and three President's Awards. Healthy and Safety is our number one priority and we are immensely proud of this achievement.

This has been a busy year for our staff, implementing a major IT system change, preparing successfully for the new Retail market, whilst at the same time achieving high levels of customer's service. On behalf of the Board I would like to thank our staff for the hard work and dedication that has made this possible.

### **Our Environment**

Over recent years we have seen increasing levels of nitrates in some of our water sources resulting from fertiliser use and other agricultural activities. We are seeking to reduce nitrate levels by working direct with farmers. In 2016/17 our work has established the potential sources and pathways of nitrate pollution to our boreholes. We will now focus on actions to address the areas of higher risk.

Associated with this, the Catchment Management Team has been a partner involved in developing an Anglo-French European Union Interreg project bid to trial 'payments for ecosystems services' across our area of supply. This involves looking at innovative ways of supporting farmers and landowners to alter their practices to deliver cleaner groundwater in our catchments.

There were no restrictions to customer supplies last year. Although the winter has been very dry, our groundwater levels have recovered and we do not expect any restrictions this summer.

As a result of our relatively strong water resource position we have been providing a bulk supply to Southern Water on our eastern boundary since 2004. We have reached agreement with Southern Water to continue this bulk supply for a further 10 years and also to provide a new supply from our River Itchen works, in the west of our region. The new supply, expected to commence later in 2017, comes as a result of our work as part of Water Resources in the South East, a collaborative programme involving the six water companies in the South East of England.

### **Financial Results**

The financial results for the period show a return to more typical levels of profitability with

an operating profit of £5.6m (2016: £7.6m). The 2016 results benefitted from lower infrastructure renewals expenses and these have now returned to a more typical annual expense of £4.2m (2016: £1.8m). Other net movements were as follows:

- A £0.5m increase in turnover
- Net reductions in depreciation and amortisation of £0.6m
- Higher staff costs (including pension) of £0.7m
- £0.5m non recurring outsourcing costs for non-household retail activity

The increase in turnover reflects the allowed regulatory price increase together with 2,100 new properties and higher measured consumptions, offset by lower chargeable work of £0.4m.

Gross capital investment in the year remained stable at £9.4m. In addition the Company renewed 21.4km of mains at a cost of £4.2m which is charged to the income statement under FRS102. Two new UV treatment plants were largely completed and commissioned and a further UV plant is substantially underway resulting in total spend on these schemes of £5.1m in the year.

Cash generated from operations of £10.6m fell by £3.1m on 2016 driven by higher infrastructure renewals activity of £2m, adverse working capital movements of £0.9m on non-household trade debtors and other smaller movements in operating expenses and working capital.

The net cash increase in the year of £2.4m was further effected by receipts from the revolving credit facility of £4.0m and a £2.9m payment in advance for the disposal of non-household retail activities (which includes the fair value of future meter reading activities for five years).

Gearing at the year end of 68.6% (2016 - 70.2%) improved primarily as a result of growth in Regulatory Capital Value (RCV). The cash interest cover ratio of 1.44 times remains above the target of 1.4. Return on Regulatory Equity (RORE) of 7.5% has fallen primarily due to lower operating profit as discussed above.

## Strategic Report

# Our Mission

**“To supply high quality drinking water whilst providing excellent levels of service for our customers at the lowest price in the country”**

Portsmouth Water supplies drinking water to a population of 722,000 over an area of 868km<sup>2</sup>.

To achieve our Mission we have developed a number of Outcomes, as part of the Regulatory Business Plan process (see page 7). These summarise our business goals and aspirations over the coming years. We did this by consulting our customers and our stakeholders.

These Outcomes form the backbone of our strategy and are reflected in our Business Plan for the 5 year period from 2015/16 to 2019/20.

The way that these business Outcomes align to our strategy, detailed objectives, KPIs and business risks is set out in more detail on pages 8 and 9.

### Our Outcomes:

**Safe secure and reliable drinking water**

**A high quality service**

**Less water lost through leakage**

**Supporting the community**

**A health and safety culture**

**An improved environment supporting biodiversity**

Underpinning the outcomes is an overarching business need for;  
*A business which is financeable, provides a stable return to shareholders and has ongoing financial resilience.*

Delivering excellence  
for our customers  
our people and our  
environment

## Strategic Report

# What We Do

**We use a combination of natural resources, technology and a motivated and committed workforce to supply high quality drinking water whilst providing excellent levels of service for our customers at the lowest price in the country.**

Our principal business activity is the supply of drinking water to both domestic (household) and commercial (non-household) customers. From April 2017, we no longer bill or handle non-emergency contacts from non-household customers as these retail services were opened to competition and we decided not to be a retailer to this group of consumers. The supply of water is a closely regulated industry. We talk about our regulators more on page 27. Portsmouth Water operates as a water supplier under an Instrument of Appointment granted by the Secretary of State for the Environment under the Water Industry Act 1991.

We collect water from the environment, make it safe to drink and distribute it to our customers. Our process is broken down into four main areas and we have explained this further below.

Portsmouth Water provides water to 298,000 homes and 18,000 businesses in an area of 868km<sup>2</sup> extending from Fareham in the East of Hampshire to Littlehampton in West Sussex. Our area of supply covers the major conurbations of Portsmouth, Fareham; Gosport, Bognor Regis, Havant and Chichester. A map showing the area of distribution is set out on page 1.

The Company's water is drawn from the chalk of the South Downs and is abstracted from wells, boreholes springs and the River Itchen. We treat this in 21 treatment works. Further information about our water resources is set out in page 18 under "Our Environment".

### Water resources

#### *Wholesale Service*

We take water from, natural springs, boreholes and rivers. We take care to make sure that we have enough water for you to use but don't damage our environment. We invest in supporting the local environment.

### Water treatment

#### *Wholesale Service*

We filter and treat it so that the water is safe to drink. We do lots of checking to make sure that our water meets all of the drinking water standards. We invest in new equipment and technology to do this efficiently and effectively.

### Treated water distribution and supply

#### *Wholesale Service*

We move the water through our underground network of pipes to your tap. We carry on checking the quality until it gets to you. We take care to repair leaks and deal with bursts quickly so that you always have water.

### Customer services

#### *Retail Service*

From April 2017 we only provide retail services to our household customers. Retail activities include sending out bills, taking payments, reading meters (if you have one) and dealing with any other questions or problems that household customers have. We do our best to make sure that we get things right and say sorry, and put them right, if we don't.

### The Regulatory Price Review

With the exception of non-household retail services, the water industry in England and Wales is, currently, a monopoly business. Accordingly the prices that we may charge our customers for water (and related services) are set and regulated by Ofwat, the industry's Economic Regulatory Body. The primary way that Ofwat financially regulates water companies is through a five yearly review commonly known as the "Price Review" ("PR"). Through this process companies set out in their "Business Plan" what they expect to spend on the services that we supply to our customers. This includes elements such as the cost of customer service, investment in capital schemes (fixed assets) and meeting all of the other legal and social obligations. As a result of this process Ofwat sets price limits for each company and this, in turn, determines the bills that customers pay.

The current regulatory period commenced on 1 April 2015 and runs for five years until 31 March 2020. As part of the Price Review, companies set a number of Outcomes which they promised to achieve over the five year PR period. Many of these outcomes have financial rewards and penalties attached to them. These are part of a regulatory mechanism called the Outcomes Delivery Incentive Mechanism ("ODIs").

The Company's Outcomes are set out on page 8. A summary of how they relate to our business strategy can be found on pages 8 to 9 and those with related financial rewards and penalties attached are noted in our table covering KPI's on pages 10 to 11.



## Strategic Report

# Our Strategy

The Outcomes that we have form the backbone of our strategy. As a business we align our day to day activities closely to these and monitor them using a set of key performance indicators (KPIs). Many of these KPIs also form the basis of rewards and penalties which are part of the quinquennial price review process with Ofwat (the ODIs). We monitor and manage our significant business risks against our ability to achieve the Outcomes. We have summarised how these elements align below;

### Outcomes

### How we are delivering

#### Our customers

**Safe secure and reliable drinking water**

**High quality service**

**Support the Community**

- A comprehensive testing programme in accordance with Drinking Water Inspectorate requirements
- A dedicated catchment management officer and activities to protect the quality of our water sources
- Investment in schemes to improve water quality and reliability such as new UV treatment plants
- Review of our water resources to determine whether we have sufficient resources for the next 25 years
- Careful monitoring of our mains network, a programme of mains renewals and management of bursts and leakage
- A focus on excellent customer service including a culture of excellence
- Treating all non-household retailers identically in accordance with our Compliance Code so that no commercial customers are disadvantaged because of the retailer they choose.
- Telephone calls are handled locally and in person
- Supporting vulnerable customers through a number of schemes
- Working closely with local schools and actively supporting local education activities

#### Our people

**A Health and Safety Culture**

- Driving a culture of health and safety in everything we do
- Ensure the safest possible environment for employees, visitors and the general public
- Risk assessments for employees and public safety on every job we undertake
- Invest in our people by supporting ongoing professional development, education and training

#### Our environment

**Less water lost through leakage**

**An improved environment supporting biodiversity**

- Investment in an ongoing programme of leak detection and repair
- Complete our agreed Biodiversity Action Plan by 2020
- Promotion of water efficiency through free advice, water saving devices and community events
- Appointment of a "catchment management officer"
- An active programme to promote meters to our customers
- Deliver environmental improvements required under the National Environment Programme

#### Our business

**A business which is financeable, provides a stable return to Shareholders and has financial resilience**

- An effective corporate governance structure
- Operation of effective finance processes and internal controls
- Close monitoring of budget and out-turn performance against KPIs and key ratios (for covenants and rating agencies)
- A stable dividend policy

## Key Performance Indicators (pages 10 to 11)

- Water quality standards
- Water quality contacts
- Bursts
- Interruptions to supply
- Service Incentive Mechanism
- Guaranteed Service Standards

- RoSPA accreditation
- Health and Safety "reportable accidents"
- Health and Safety "total accidents"
- Employee absence
- Headcount

- Leakage
- Per capita consumption
- Temporary usage bans
- Biodiversity Action Plan

- Operating profit
- Cash Interest Cover
- Gearing (Net Debt: RCV)
- Regulatory Rewards and Penalties (ODIs)

## Risks (pages 28 to 29)

- Operational
- Water Quality
- Business Continuity
- IT

- Human Resources
- Health and Safety

- Environmental

- Financial
- Regulatory
- Legal and Governance
- Competition
- IT

## Strategic Report

## How We Measure Success

As a business we focus on a range of operational and financial key performance indicators ('KPIs') to help us assess and monitor our performance. We believe that the KPIs, summarised below, provide a balanced view of how we are performing against both our business Outcomes and our overall long term business vision. These KPIs align closely to our Outcomes and cover the key areas of our business operations and activities. They also cover the range of interests of our different stakeholders. A number of the KPIs are also linked directly to financial rewards and penalties built into the Ofwat regulatory framework through the Outcome Delivery Incentive Mechanism (ODIs):

| KPI   | Definition  |
|---|---|
| <b>Our customers</b>  |   |
| <b>Water quality standards (Mean Zonal Compliance) *</b><br>(Calendar year) | This is the average of the compliance rates for the 39 standards tested. This is reported to the Drinking Water Inspectorate. This is known as Mean Zonal Compliance.   |
| <b>Water quality contacts *</b><br>(Calendar year)                          | A measure of customer contact for taste, odour, discolouration and illness calculated as the number of contacts per 1,000 population.   |
| <b>Bursts *</b>   | The number of burst mains calculated in accordance with Ofwat guidance. Defined in number of incidents per annum.   |
| <b>Interruptions to supply *</b>  | Average time of supply interruption per property (includes both planned and unplanned interruptions).   |
| <b>Service Incentive Mechanism (SIM) *</b>                                  | An independent Ofwat survey covering all companies. A domestic customer experience performance measure with two elements: Qualitative score derived from the customer experience survey and quantitative score based on the number of 'unwanted' calls received, combined with the number of complaints received and the Company's effectiveness at resolving these complaints. |
| <b>Guaranteed Service Standards</b>   | A scheme for our customers which puts in writing the minimum standards we aim to meet. If we fail to meet the standards we pay compensation.  |
| <b>Our people</b>   |   |
| <b>RoSPA accreditation *</b>  | The Company will apply for its Health and Safety accreditation annually.  |
| <b>Health &amp; Safety Reportable accidents</b>                             | An absence of more than 7 days as a result of an injury at work and reportable to the HSE.  |
| <b>Health &amp; Safety Total accidents</b>                                  | All accidents including reportable accidents but excluding vehicle accidents.   |
| <b>Employee absence</b>   | The number of days absent from work per person.   |
| <b>Headcount</b>  | The number of staff employed by the Company.  |
| <b>Our environment</b>  |   |
| <b>Leakage *</b>  | The total level of leakage, including customer supply pipe leakage, as measured on an average mega litre per day (M/c) basis.   |
| <b>Per Capita Consumption *</b>   | The weighted average water consumption per customer served calculated from the number of measured and unmeasured households.  |
| <b>Temporary Usage Bans *</b>   | Introduction of water restrictions in accordance with the Company's approved drought plan.  |
| <b>Our business</b>   |   |
| <b>Operating Profit</b>   | Financial measure in accordance with UK accounting standards being turnover less operating costs.   |
| <b>Cash interest cover</b>  | The ratio represents the number of times that adjusted cash flow covers interest payment. A detailed calculation is included in Appendix I.   |
| <b>Gearing (Net debt: RCV)</b>  | The ratio of Net Debt (loans and debentures less cash) to RCV. A detailed calculation is included in Appendix I.  |
| <b>Return on Regulatory Equity (RoRE)</b>                                   | The % return (and adjusted profit based measure on the equity component of RCV). The equity input is derived by applying the inverse of the gearing ratio to RCV. A detailed calculation is included in Appendix I.   |

\* these measures are also part of the Ofwat Outcome Delivery Incentive Mechanism

|  | 2016/17 Target   | Our performance |                |                              |                | 2016/17 target met? |
|--|--|-----------------|----------------|------------------------------|----------------|---------------------|
|  | Financial year   | 2016/17         | 2015/16        | 2014/15                      | 2013/14        | pages 12 - 13       |
|  | > 99.98%<br>(Calendar year)                              | 99.99%          | 99.94%         | 99.97%                       | 99.97%         | ✓                   |
|  | < 0.425 contacts per 1,000 population<br>(Calendar year) | 0.665           | 0.570          | 0.841                        | 0.430          | X                   |
|  | < 342 bursts per annum                                   | 298             | 219            | 294                          | 226            | ✓                   |
|  | < 5 minutes  | 4 mins 9 secs   | 3 mins 30 secs | 8 mins 44 secs               | 5 mins 16 secs | ✓                   |
|  | Upper quartile<br>> 80 (Total Score is out of 100)       | 87.7            | 89.6           | 82.0                         | 82.8           | ✓                   |
|  | < 120 payments   | 221             | 109            | 139                          | 56             | X                   |
|  | Calendar year  | 2016            | 2015           | 2014                         | 2013           | pages 14 - 15       |
|  | RoSPA awarded  | Awarded         | Awarded        | Awarded                      | Awarded        | ✓                   |
|  | 0 accidents  | 1               | 0              | 2                            | 1              | X                   |
|  | < 12 accidents   | 5               | 9              | 6                            | 7              | ✓                   |
|  | < 2.5 days   | 2.5             | 2.43           | New measure - no comparative |                | ✓                   |
|  | 266 staff  | 255             | 252            | 243                          | 237            | ✓                   |
|  | Financial year   | 2016/17         | 2015/16        | 2014/15                      | 2013/14        | pages 16 - 20       |
|  | < 29.95 Ml/d   | 30.4Ml/d        | 28.2Ml/d       | 28.9Ml/d                     | 29.5Ml/d       | X                   |
|  | < 146.0 l/h/d  | 145.1 l/h/d     | 143.3 l/h/d    | 145.5 l/h/d                  | 148.3 l/h/d    | ✓                   |
|  | 0 bans   | 0               | 0              | 0                            | 0              | ✓                   |
|  | Financial year   | 2016/17         | 2015/16        | 2014/15                      | 2013/14        | pages 22 - 23       |
|  | Better than budget                                       | £5.6m           | £7.6m          | £6.7m                        | £5.9m          | ✓                   |
|  | > 1.40   | 1.44            | 1.96           | 1.80                         | 1.58           | ✓                   |
|  | < 80%  | 68.6%           | 70.2%          | 72.4%                        | 81.4%          | ✓                   |
|  | > 6.0%   | 7.5%            | 10.8%          | 5.1%                         | 5.8%           | ✓                   |

## Strategic Report

# Our Customers

Our new 'Helping Hand' tariff was launched to support financially vulnerable customers

### Customer Service levels

Having become a member of the Institute of Customer Service, we were this year able for the first time to undertake one of their surveys to give us a comparison of how customers rate our service, compared to companies outside of the water industry. Our score was 79.9, which compares positively to the overall utility sector of 73.3.

Within the water industry, customer service levels are measured and compared using the Service Incentive Mechanism (SIM). The score includes both quantitative and qualitative measures. The quantitative measure looks at the number of unwanted telephone contacts and written customer complaint levels and the qualitative measure is based on customer surveys, where customers rate the service they have had when contacting us. Ofwat uses the SIM score as a metric with rewards and penalties attached.

Our score for 2016/17 was 87.7, compared to 89.5 the previous year. The number of complaints increased to 12.7 per 10,000 customers which is expected to be amongst the lowest in the industry. When a complaint has passed through our two stage complaints procedure the customer, if still unhappy, can ask the Consumer Council for Water (CCW) to review their complaint. CCW will review a complaint if it believes that we have failed to fully respond to the customer's complaint. This year CCW investigated no complaints against Portsmouth Water.

The SIM survey score was 4.48 out of a maximum of 5, resulting in us being 3rd in the industry. Whilst we are disappointed not to be first for a third consecutive year, we have achieved our aim of being within the industry top quartile.

### Affordability and vulnerability

Portsmouth Water's charges, for household customers, are the lowest in England and Wales. Our average household bill is £98 (2016 - £98).

Whilst bills are low, in national terms, they are not always affordable by all customers. Following customer research, confirming a willingness to pay extra on bills to support those that are financially vulnerable, we introduced a social 'Helping Hand' tariff in July 2016. This tariff caps annual bills at our minimum charge, currently £75.28, for those customers whose household income, excluding certain benefits, is below the Government's low income threshold, of £16,105.

Vulnerability goes beyond affordability and many of us will at times, or from time to time, suffer from vulnerability as a result of difficult personal circumstances. In order to improve our identification of this customer group, and the service we provide them, we have appointed a dedicated Customer Support Advisor. This advisor is helping to build relationships with organisations that support customers, undertakes home visits and provides training to staff on the identification of signs of vulnerability.

**KPI performance**

Set out on pages 10 and 11 are the key performance indicators that we use to manage the business. Disappointingly we have failed to meet four of these measures.

**Leakage**

Whilst leakage was below target early in the year and on target at the start of September, at the start of autumn it began to increase. This increase was, in part, due to the dry late summer and autumn weather impacting ground conditions. The Company increased leak detection resources which reduced leakage. However, a cold snap in late November and again in January combined with low rainfall, led to a number of bursts and more leakage.

Despite continued additional resource in the final quarter, leakage continued to rise. This level of leakage has not been seen in recent years. However, this trend has been seen by other water companies in the South East. The Company continues to meet its long term (5 year) target.

**Guaranteed Standards Scheme**

We made 221 payments to customers under this scheme. Payments compensate customers where we have not delivered our expected level of service. This exceeded target as a result of a significant interruption to supplies following a burst main in Portsmouth in July 2016.

**Reportable Accidents**

During the year the Company had one reportable accident where a member of staff was off work for 9 days (including two weekends).

**Water Quality Contacts**

This is a measure of the number of times that customers contact us with queries connected to water taste, odour, discolouration or illness. This is calculated as the number of contacts per 1,000 population served and is reported annually (for the calendar year) to the Drinking Water Inspectorate. We set ourselves a challenging level of less than 0.425/1,000 population. Unfortunately, we reported 468 water quality contacts of this nature which equates to 0.665/1,000 population. Despite this value being above our KPI value this remains significantly below the industry average of 1.64/1,000 population (2015 data). We currently have a number of initiatives in place to further reduce the number of water quality contacts. The current trend shows that levels are falling on average and we will continue to focus on improving this performance.

## Westergate sustainable drainage solution

Flooding has historically been a significant problem at Westergate water treatment works (WTW). This posed a challenge for how to deal with surface water run-off from the new UV plant building and increased area of hardstanding being constructed in 2016. The site is underlain by clay which prevented the use of a soakaway.

The Company Environment & Biodiversity Specialist suggested constructing a new pond and worked with the Project Engineer and Contractor to develop a sustainable drainage solution. The pond has been designed to cope with a 1 in 100 year storm, but the design also makes provision for the central area of the pond to hold water all year round, providing an important new habitat for wildlife.

This has been made possible because water from the sample taps and water quality analyser lines in the building have also been directed to drain to the new pond, topping up the pond even in a dry summer. This water contains a low level of chlorine which must be removed. All water from the building is directed through a shallow channel into which yellow flag iris have been planted. These plants slow down the flow of water into the pond and will ensure that the chlorine is naturally removed. Some of the yellow flag iris and all of the other native pond species planted have been sourced from some of our other sites in Hampshire.

## Strategic Report

# Our People

### Developing our people

Our people are critical to the success of our business. We are committed to the development of our employees and believe that they should all have opportunities to reach their full potential. As a result, many employees have undertaken degrees, HNC's, and NVQ's along with relevant professional qualifications. Nearly 40% of all staff have received supported further education at some point during their employment. We are committed to maintaining an approach of "lifelong learning".

### Apprenticeships

We offer Modern Apprenticeships in the field of Mechanical & Electrical, Maintenance and Customer Services for employees under 25. Our Apprenticeships follow an agreed training programme of both on and off-the-job training alongside approved further education to an HNC or NVQ standard. The training programme is conducted by both the Company and the accredited training organisation. Programmes are normally between two and four years long. Many staff who have obtained their apprenticeship with the Company have progressed further, both academically and in their career within the Company.

### Further Education

A key part of staff development is the Company's involvement with the Institute of Water. The Institute of Water is a professional body promoting knowledge within the water industry, organising meetings, seminars, technical visits and conferences. The Company encourages its staff to belong to the Institute of Water and gain the benefit for both their personal and professional development by attending these events.

Nearly 40% of all staff have received supported further education during their career here

© WaterAid / Tim Ireland

## WaterAid Innovators – Runners Up

This global challenge set by WaterAid saw teams from across the UK, America and Australia choose either a water, sanitation or hygiene-focused problem to overcome using innovative thinking, and fresh creative skills. The aim is to develop professional and core business skills, competing to solve real problems from the communities where WaterAid operates. In addition, all teams were tasked with raising a minimum of £3,000 each.

A team from Portsmouth Water took up the challenge and were tasked with crafting solutions for people in Cambodia. The team of six called themselves 'The Kingfishers.'

The Kingfishers not only took on the challenge to provide some of the poorest Cambodian communities with access to clean water, sanitation and hygiene, but managed to finish 'runner up' in the team category. They were presented with the award by Deborah Meaden of Dragons Den fame at an awards ceremony in London.

To raise the target £3,000 for WaterAid, the Kingfishers carried out a summer of fundraising, involving sponsored mountain walks, football sweepstakes building up to a community festival at Staunton Country Park. The final Kingfishers event was a Cambodian Lunch for all Portsmouth Water employees, giving them an opportunity to taste food from a different culture, and immerse themselves in the world of Cambodia. They surpassed their target £3,000, raising an amazing £6,000 for the campaign!

Emma Camm, the Chair of the Kingfishers said after receiving the award "As a small water company, and a small team, the Kingfishers are immensely proud of the success of the campaign, showing that by working together as a company and a community, anything is achievable. The fact we have finished runner up is the icing on the cake. Even if we if we won nothing we knew that by raising £6,000 we have made a real difference to people's lives."

### Health and Safety

Health and Safety has been the top priority within the Company for a number of years and this has helped us achieve a trend of falling accident numbers, making the Company a safer place to work.

We continually review our working practices, challenge ourselves and our colleagues to ensure we put safety first.

We are proud of our safety record but continually challenge ourselves to do better. During the year we initiated a 'Hearts and Minds' campaign to drive ownership of H&S within our departments and teams. This saw individual managers and their teams report to both our Executive team and the Board on their H&S initiatives and progress.

### Number of Accidents in 2016

We measure the number of accidents for a calendar year. 2016 saw our first reportable accident for nearly 2 years. A reportable accident means someone has been injured enough to be off work for over 7 days.

There were 5 accidents during the year which was our lowest on record. The graphs below show how far we have progressed in making the Company a safer place to work.

## Gender Diversity

The Company is committed to the principle of gender equality in all aspects of employment including recruitment, promotion and remuneration. The numbers of female and male employees (headcount) at the end of the financial year are shown in the table below;

|                        | 2017<br>Female | 2017<br>Male | 2016<br>Female | 2016<br>Male |
|------------------------|----------------|--------------|----------------|--------------|
| <b>Directors</b>       | <b>2</b>       | <b>4</b>     | <b>2</b>       | <b>4</b>     |
| <b>Senior Managers</b> | <b>2</b>       | <b>11</b>    | <b>2</b>       | <b>11</b>    |
| <b>Other Employees</b> | <b>85</b>      | <b>158</b>   | <b>80</b>      | <b>159</b>   |
| <b>Total</b>           | <b>89</b>      | <b>173</b>   | <b>84</b>      | <b>174</b>   |

### Driver Safety Week

To raise the awareness of driver safety we held a driver safety week with employees taking part in activities such as a quiz booklet, a roadworks 'set up', an interactive quiz and a speed board set up to monitor the speed registered by staff as they drove into the Head Office.

The main event was a drama performance of "Ever After". This hard hitting and relevant performance showed the breadth of the impact that a road traffic accident can have. The play was written specifically for us and the script was designed to be relevant to all those who worked for us; from the road workers to those who drive a vehicle on a social basis.

### RoSPA 2017 Presidents Award

2017 saw us awarded the RoSPA President's Award for the third successive year. The President's Award, is part of the RoSPA prestigious awards scheme and is given to organisations that have demonstrated excellence in the area of H&S consistently for 10 years or more.

The President's Award acknowledges our achievements in the previous 13 years, winning ten Gold Awards, three President's Awards including an Industry Sector Award. This is a tremendous achievement and a true testimony of the efforts that everyone in the Company has put in making us a safer place to work.

Our strong health and safety record continues to be recognised by RoSPA



## Strategic Report

**Our Environment****An improved environment supporting biodiversity.****Biodiversity & Conservation**

The Company has made a commitment, as part of our Outcomes, to support conservation and biodiversity. As part of the commitment to our environment we employ an Environment & Biodiversity Specialist to;

- Raise awareness within the business of environmental issues and constraints, especially when we plan new schemes to ensure any impacts are avoided, minimised or mitigated.
- Provide advice to the engineering teams on all aspects of environmental legislation and biodiversity.
- Work with our operational teams to ensure that we manage the habitats on our own land holdings in a way that protects and where possible enhances their biodiversity potential.
- Ensure that we have up to date ecological survey information for all our sites so we can protect habitats and species likely to be present.
- Identify and manage projects to protect and enhance biodiversity.
- Liaise with external stakeholders on related issues to meet shared objectives such as providing 'stepping stones for nature'.

The Company are pleased to be able to report that land at two of our treatment work sites (Farlington and Itchen), identified by our surveys as having a high conservation value, have been selected for designation as Sites of Importance for Nature Conservation (SINC) by Hampshire County Council.

Following the Ofwat price determination we have increased our budget in this area in order to undertake a more proactive programme of biodiversity enhancement projects. In summer 2015 we appointed a specialist consultant to complete an ecological survey of 52 of our sites. A key objective of the surveys was to identify potential biodiversity enhancement projects. In 2016 the recommendations were collated and prioritised for action into a 4 year programme. The biodiversity action plan programme was then agreed with Natural England and the Customer Challenge Group. The following prioritised conservation tasks have been completed in 2016/17.

- Employed specialist consultants to complete invertebrate surveys at 4 high conservation value sites, a water vole survey at Fishbourne WTW and a bat survey at Madehurst Reservoir.
- Employed a botanist to carry out a detailed vegetation survey and map priority habitat at 3 sites.
- Ongoing work to restore chalk grassland at Farlington WTW, Nore Hill and Fort Southwick.
- Converted a small building at Northbrook WTW into a bat roost.
- Cleared trees and scrub from around the old pond at Westergate WTW to allow more light in to the pond.
- Thinned the woodland and removed non-native species at Whitways Lodge Reservoir.
- Removed invasive willow from the old and new lagoon at Itchen WTW to diversify and enhance these wetland habitats.
- Thinning of woodland to remove invasive blackthorn and other species, let in more light and plant with native species trees to diversify the woodland.
- Removed trees and scrub at Madehurst Reservoir to restore grassland habitat and create a sheltered clearing within the woodland for the benefit of insects and bats.
- Removed Buddleia to restore a woodland clearing at Lovedean Reservoir.

In addition the following projects were also completed in 2016/17;

- Created a large new pond at Westergate WTW providing a sustainable solution for surface water drainage.
- Appointed a specialist consultant to complete bat surveys, obtain a Natural England License, then complete a destructive search for bats prior to demolition of the Westergate WTW old building, which was known to contain a small bat roost.
- Erection of a barn owl nest and roost box at the Itchen WTW.
- Reptile relocation/introduction project at Nore Hill Reservoir.
- Woodland management at Highwood Reservoir.
- Hedgerow enhancement at George Reservoir.
- Construction and erection of 2 tawny owl, 3 little owl and 2 kestrel boxes at a number of sites with suitable habitat.
- Erection of 18 bat boxes and 48 bird boxes for smaller birds.
- Six volunteer staff working parties undertook a range of projects.

## **Itchen Water Treatment Works – Biodiversity Projects**

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Action to thin a woodland and remove invasive blackthorn scrub has let in more light for plants to thrive and provided opportunities to plant berry and nut trees which will help diversify the habitat and provide food for animals, birds and insects.

# Strategic Report Our Environment

The Company is committed to ensuring a sustainable water supply for its customers now and into the future

### Water Resources

The Company is committed to ensuring a sustainable water supply for its customers now and into the future. We work closely with our key stakeholders such as the Environment Agency to ensure that the water we abstract remains within our licence terms and does not damage the environment. During the year we worked with local land owners to help improve the environment including the scheme at the River Hamble described on the next page. The Board continues to focus on the risk that growth in populations and climate change could impact on water resources. This risk is discussed further on page 28.

In 2014 the Company published its Water Resources Management Plan (WRMP). The WRMP focuses on the factors that will impact future demand for water including climate change and population growth. It identifies whether the Company will have sufficient water resources over the next 25 years to meet this demand. In its plan the Company is projecting a water resource surplus in the period to 2040. Consequently, the Company has been approached by two neighbouring water companies to provide bulk supplies of water to meet their needs and these have been included in the Plan.

The Water Resources in the South East (WRSE) group, led by the Environment Agency and comprising seven water companies, has been investigating the potential for regional solutions to meeting the water needs of South East England. This may

require further schemes, such as the Havant Thicket reservoir, to be commissioned in the Portsmouth Water area in order to provide a long term sustainable water supply to other communities in the South East.

On average, each day the Company supplies approximately 170 million litres of water. The chart below shows the major sources used by the Company during the year.

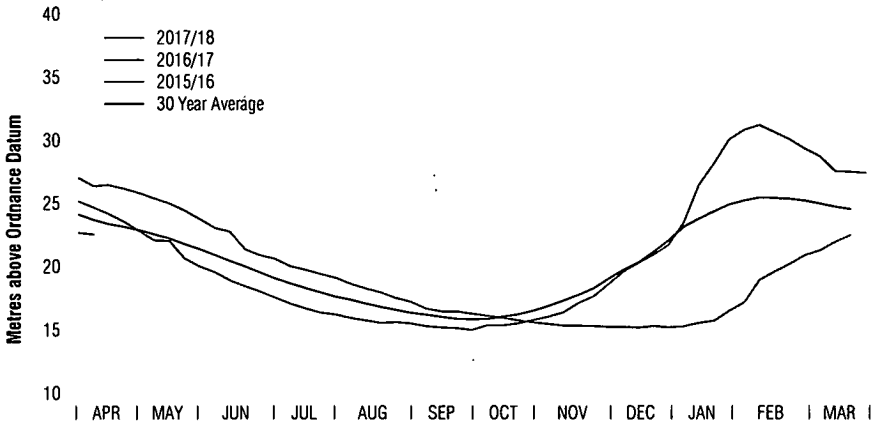
### Water Resources - Outlook for 2017

88% (2016 - 91%) of water supplied to customers is from groundwater springs and boreholes abstracted from the underground chalk of the South Downs. Groundwater levels are, therefore, critical to maintaining supplies to customers. The Company has for many years monitored the groundwater levels at Idsworth Well, Rowlands Castle. The Company has not had to impose restrictions on our customers since 1976 and, as a result of the current groundwater level, it is unlikely to do so this year.

Groundwater levels in the spring and summer of 2016 were above the long term average as outlined on the graph below. The autumn and winter were unusually dry with only 47% of the long term average for the six months. Levels have recovered significantly now due to average rainfall in January and February. Groundwater levels approached the first drought trigger in January but Portsmouth Water did not need to instigate any drought management actions. It is unlikely that any restrictions will be needed during the summer.

Abstraction Sources 2016/17 (2015/16)

Trends in Groundwater Levels



## River Hamble Restoration Scheme

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As part of the National Environmental Programme Portsmouth Water were asked to improve the River Hamble for fish and invertebrates. This has been done by implementing improvements at two farms which has reduced the level of silt in the water.

At Ford Farm a large arable field drained via an access track, into the River Hamble. With heavy rainfall sediment from the field washed into the river and created poor water quality. Portsmouth Water, in association with the Rivers Trust, has provided a 'Silt Trap' and modifications to the access track to divert flows at critical times.

At Tangier Farm the existing cattle crossings caused sediment to enter the river and the structures were an impediment to fish migration at times of low water flows.

Portsmouth Water and the Rivers Trust replaced three crossings with hard surfaced structures with graded banks and approach ramps.

Portsmouth Water plan to do further work on the River Hamble in 2017/18. This will include the removal of barriers to fish migration and potentially a length of bankside fencing. The fencing is designed to reduce 'Cattle Poaching' where animals break down the river bank and sediment enters the water.

All of these measures are designed to make the upper section of the River Hamble more resilient to low water flows. Improved water quality and improved fish migration will help to enhance the ecology of the river.

Both photos The Rivers Trust

Improvements in water quality and the removal of barriers will improve the river for fish such as the Brown Trout.

## Strategic Report

**Our Environment**

During the year we have spent almost £15m on maintaining our assets

**Resilience**

We know that customers rely upon a constant supply of clean, safe drinking water. Society needs confidence that these services will be provided today and every day into the future without harming our natural environment. These responsibilities are at the core of our business and we have developed a highly resilient network of assets to ensure that we can deliver these commitments now and for future generations.

Resilience is the ability to recover quickly from problems, disruptions and unexpected events. It also means that we can adapt to future changes such as population growth or migration, long term weather changes or other environmental pressures.

Portsmouth Water has a long history of building a resilient network including multiple water sources and a highly interconnected network; we continue to invest in projects and activities that will further enhance our resilience as we face increasing external stresses such as population growth in the South East and the effects of global warming.

Our long term strategy of constructing and maintaining a resilient asset base ensures that no customer, under normal water demands, is at risk of a loss of supply resulting from a single failure of a water treatment works.

In our focus on resilience we follow the principles of;

- protecting customers from the risk of asset failures;

- promoting long-term planning and investment, and the use of a range of measures to manage water resources in sustainable ways;
- making available bulk supplies of water to neighbouring areas where we have surplus capacity; and
- increasing efficiency in water use to minimise pressure on water resources.

During the year we have spent almost £15m on maintaining our assets to ensure existing levels of resilience are sustained. A root and branch strategic review of our operational resilience is now drawing to a close and has identified where risks may develop, customer views and support will be sought to inform decisions about reducing these risks and proposals included in our business plan for 2020.

It is apparent that the UK's national infrastructure's ability to manage threats from extreme weather may not be as strong as it needs to be. Historically these typically have been rare events but more recently the winter flooding in 2013/14 across the UK indicates climatic changes may mean extreme events become more common. During the year we reviewed our resilience against extreme flooding and developed emergency plans to manage such events. We will consider improving flood resilience against more extreme events in our next business plan.

As a company which has not historically suffered from severe water shortages we do not have high numbers of metered properties. However, as the level of water shortage, for other companies across the South East, continues to be a significant political and environmental issue we are challenging ourselves to find ways to further reduce levels of consumption. This would allow us to share more of our resources with other companies in the area. This is likely to be a continuing theme as we move in to the next regulatory period at the start of 2020.

To improve the understanding of areas where the water sector carries risk, Defra has established a Cyber Scoping Assessment and appointed the Defence Science Technology Laboratory to assess the industry's preparedness. Overall they judged our security measures as 'developing' and did not consider a more detailed assessment necessary. A number of relatively minor improvements have been put in place and others will be complete by the summer of 2017. We continue to have a high degree of focus on cyber security.



## Strategic Report

# Our Business

The year ended 31 March 2017 was the second year of the current Ofwat regulatory review period. Ofwat's determination for 2015-2020 set our allowed income from customers when we committed to keeping customer bills flat in "real" terms. Work is already underway within the company to ascertain our business plan for 2020-2025 known as PR19.

### Ownership structure

The ownership structure of the business is unique within the industry, with the majority of the shares being owned by an Employee Benefit Trust on behalf of the employees. The Board believes that this structure ensures that we are able to take a long-term view on the business without being pressurised to provide unsustainable dividend growth. We feel that this structure also helps to align the interests of employees and customers in the long-term – with the vast majority of our employees also being customers. Further information on the group structure is set out in page 35.

### Financing structure

Since 2001 the Company has largely been a debt financed entity. An index linked fixed interest loan with a base value of £66.5m was drawn in 2002, with inflation risks on the cost of the loan being effectively hedged against regulated revenues which are also linked to the Retail Prices Index (RPI). Interest is charged at a fixed rate of 3.635% on the indexed amount of the loan. The indexed carrying value of the loan at 31 March 2017 was £99.6m (2016 - £97.7m).

### Gearing and liquidity

Net debt to regulatory capital value is a key covenant defined by the Company's index

linked loan documents. Gearing at 68.6% (2016 - 70.2%) improved as a result of the increase in Regulatory Capital Value (RCV) driven by higher indexation and the significant capital programme. This remained comfortably within the 86% ceiling imposed by the bond covenants.

As a consequence of cash flow requirements (discussed further on page 23) the Company utilised £4m of the £10m revolving credit facility at the year end (2016 - £nil). The £4m committed overdraft facility was unused at the year end (2016 - unused). Both facilities are currently provided by Lloyds Bank. The overdraft is renewable annually and the revolving credit facility in May 2022. These facilities, are used to manage day to day working capital and the expected working capital peaks driven, primarily, by the profile of spend in connection with significant capital programmes.

The Company has concluded that it has adequate funding to meet both ongoing working capital requirements and the needs of the planned capital investment programme over the 3 remaining years of the current regulatory period.

### Interest cover

The interest cover ratio, defined by the covenants associated with Company's index linked loan, of 1.44 times (2016 - 1.96 times) remains above the 1.4 times covenant required.

### Return on regulatory equity (RoRE)

This is the primary ratio used by our equity shareholders. The reduction from 10.8%

to 7.5% reflects the lower operating profit discussed below.

### New UK GAAP

This is the second annual accounts since the Company adopted FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (typically referred to as "new UK GAAP". During the year the tax position relating to deferred infrastructure contributions, received by the Company since 1990, was recalculated as part of finalising the 2015/16 corporation tax computation. This change in tax treatment followed the change in accounting treatment under new UK GAAP and resulted in a significant credit to 2015/16 corporation tax charges and deferred tax movements. This is set out further in note 9. There are no further changes to the accounts related to the FRS102 transition.

### Review of trading performance

#### Operating Profit

Operating profit at £5.6m (2016 - £7.6m) returned to a more consistent level following the one off favourable impact in 2015/16 of lower infrastructure renewals (2015/16 impact £1.9m reduction). In addition increased turnover in the year of £0.5m was offset by other operating costs discussed further below.

#### Revenue

The increase in turnover reflects the allowed regulatory price increase together with 2,100 new properties and higher measured consumptions, offset by lower chargeable work of £0.4m.

#### Operating costs

Total operating costs increased by £3m which resulted from a number of movements.

As noted above during 2015/16 infrastructure renewals were atypically low following change-over of our main contractor during the year. In 2016/17 infrastructure renewals activity returned to normal levels resulting in an increase of £2.4m on 2015/16.

Depreciation during the year has fallen by £0.9m this is primarily as a result of the £0.7m accelerated depreciation included within 2015/16. Offsetting this is an increase of amortisation on intangible fixed assets of £0.3m following commissioning of our ERP system.

Staff costs, charged to the income statement, have increased by £0.7m. This reflects increased headcount from 251 to 255 driven by operational requirements, particularly the impact of preparation for non-household retail competition and the staff involved in the

implementation of the new ERP system (which went live in October 2016). Together with the annual salary increase of 2%, continued increases in pension costs of £0.3m and lower capitalised costs of £0.1m this caused the incremental cost.

In addition there were incremental costs of £0.5m (2016 £nil) under the operating agreement to outsource non-household retail activities to Castle Water for the year. This was a one off cost and will not recur in 2017/18.

### Interest & other finance income

Interest payable shows an overall increase of £0.9m which is primarily due to £0.8m higher indexation on the £66.5m index linked loan driven by RPI levels. Other finance income reflects movements in the net pension scheme position and is set out further in note 25.

### Taxation

The tax credit in the period of £0.4m includes a current tax credit of £0.6m and deferred tax charge of £0.2m. The reduction in current tax charge was driven by a £0.8m prior year credit in connection with the treatment of previous infrastructure contributions on FRS 102 conversion. In addition losses elsewhere in the group were used to relieve trading profits in the year. Deferred tax charges increased as a result of a number of net movements including the reduction in corporation tax rate and prior year adjustments (as noted above).

### Dividends

The dividends paid during the year totalled £1.2m (2016 - £1.2m). Dividends are paid up to the parent company with part of the payment being used to service interest payments on an inter-company loan of £0.8m (2016 - £0.7m) with the balance being paid as a dividend to the Group's shareholders. The Company's dividend policy aims to show sustainable growth in real terms and is based on a 1.65% growth rate. The final dividend proposed for the year is £0.5m.

### Capital investments

Gross capital investment in the year was £9.3m (2016 - £9.3m).

### Mains activity

|  | 2016/17<br>£m | 2015/16<br>£m |
|--|---------------|---------------|
| Renewals charged in the income statement | 4.2           | 1.8           |
| New mains capitalised                    | 1.4           | 1.7           |
| Total mains investment                   | 5.6           | 3.5           |

During the year the Company renewed 21.4km of mains (2016 - 11.6km) at a cost of £4.2m charged to the income statement.

The increase represents a return to typical run rates of activity in 2016/17. A further 13.9km (2016 - 7.6km) of new mains were capitalised at a cost of £1.4m.

### Major capital schemes

The Company continued the programme of capital schemes that were agreed in the Business Plan. The two new UV treatment plants commenced in 2015/16 were largely completed in the year with additional capital spend of £1.7m. In addition, we are close to completing a further UV treatment plant at our Farlington works with a spend of £3.4m during the year.

### Capital contributions

The Company receives capital contributions, primarily in connection with new mains for housing developments, which amounted to £1.2m (2016 - £1.2m). These contributions are deferred and amortised to the Income Statement.

### Cash and Cash Flow

Cash generated from operations of £10.6m fell by £3.1m on the prior year. This was driven by the return to normal levels of infrastructure renewals with a cash flow impact of £2m together with other smaller movements in operating expenses. In addition there were a number of working capital movements, the most significant of which related to a £0.9m increase in non-household trade debtors following the outsourcing of this activity during 2016/17. The overall £2.4m increase in cash at the year-end was driven by a draw down on our revolving credit facility of £4.0m, together with a £2.9m payment received in advance in connection with our disposal of the non-household retail operation (this includes the fair value of future meter reading services for five years - note 30). These were offset by higher expenditure on fixed and intangible assets totalling £3.3m.

### Pensions

The Company operates both a defined contribution and a defined benefit pension scheme, the latter of which has been closed to new members since 2011. The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest actuarial valuation as at 31 March 2017 was carried out in accordance with FRS 102 and shows a net pension asset (after deferred tax) of £11.4m (2016 - £14.6m). The overall decrease in the surplus on actuarial valuation has largely been driven by the fall in AA corporate bond rates.

### Post Balance Sheet Events

As previously disclosed the Company made a decision to dispose of its non-household

retail operations with effect from 1 April 2017 (the date of Retail Market Opening) to Castle Water Limited. During the year the Company received a payment in advance of £2.9m (including the fair value of future meter reading activities for five years) in consideration for this transaction. This is discussed further in note 30.

### Financial Viability

The Company's financial position is set out in the financial statement on pages 53 to 71, including cash flows, liquidity position, borrowing facilities and loan maturities. The Strategic Report, on pages 6 to 31, also covers aspects such as the overall financial performance and financial risks. Finally the Viability Statement on pages 30 and 31 sets out the factors considered and the conclusions reached by the Board in assessing both the going concern of the business over the period of 12 months from the balance sheet date and the prospects over a longer period of 5 years.

The Company's current bankers are Lloyds who provide a £4m overdraft facility and a £10m revolving credit facility details of which are set out above.

The Company's financial projections, taking into account expected trading expectations, indicate that the Company is forecast to operate comfortably within the levels of our current facilities. The Directors have concluded that there is a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. Accordingly they continue to prepare the accounts on a Going Concern basis. Further detailed information in relation to the assessment process undertaken by the Board is set out in the Viability Statement on pages 30 and 31.



## Strategic Report

# The Issues That Affect Us

There are many external issues that impact our business. These shape our business decisions, risk profile and strategy. Set out below are the four key issues likely to impact the business over the next 5-10 years.

**Regulation**

The water industry is highly regulated (see page 27 for further information). The Regulatory environment continues to become more complex and challenging and this increases both the compliance burden and costs of addressing new regulatory requirements. Ofwat is our economic regulator and determines the prices we set for our water bills. We have completed the second year of the 5 year price review period.

The Environment Agency ('EA') controls the amount of water that we are allowed to take from the Environment. We work closely with the EA in developing our water resources management plan; currently our plan indicates that we have sufficient water capacity to support a resilient supply network.

The Drinking Water Inspectorate sets the standard for the quality of water that we supply to our customers and sets the standards required. Of late we have seen continuing tightening of the drinking water standard for lead. The majority of lead pipework within the network is in customers' properties and therefore difficult to influence. This continues to result in increasing challenges for the business.

**Competition**

The retail market for commercial (non-household) customers opened on 1st April 2017 as anticipated. This new market allows commercial customers to choose their water retailer, who deals with all billing and non-emergency queries. We still physically supply the water, which is billed for by the retailer. We have chosen not to be a retailer in this market segment and have sold our retail activities to Castle Water, a specialist water retailer.

It was the 2014 Water Act which formally set out plans for this new market, and we have been working since then to prepare for this change. Whilst we are only in the market as a wholesaler, considerable efforts have been required to prepare and provide eligible customer data to the newly established market operator and have set up a specialist team to ensure that we understand and comply with market and competition rules.

The Board has overseen this transition to a competitive market, set strategy and reviewed the assurance activities to a degree that has allowed them to confirm our readiness to Government at various stages of the programme.

**Resilience of Supply**

The South East of England faces the dual challenges, in both the near and long term, of continued population growth and limited water resources. Most of the South East, with the exception of the area supplied by the Company, is designated as an area of 'serious water stress'. Predictions also suggest that this part of the UK may be dis-proportionately impacted in the future by climate change.

As a result of these pressures, the Company continues a focus on balancing supply and demand for water, in order that generations in the future will continue to benefit from a secure supply of clean water at affordable prices.

At present Portsmouth Water is in a positive position of having sufficient water supplies. In the future, this could be utilised for the benefit of the wider South East area, by investment in the building of Havant Thicket reservoir. This significant 10 year programme would require a highly collaborative approach between water companies and regulators in order to fund and develop. In the meantime, we continue to invest in schemes to maintain and enhance the resilience of our supply network and to promote water efficiency amongst our customer base.

**Affordability and Vulnerability**

Despite general improvements in economic conditions, the UK continues to see a rise in levels of household debt for lower income families. Across the industry, trends show both increasing levels of overdue and bad debt and greater numbers of applications for reduced tariffs. In addition, both Government and Ofwat have clearly signalled the need for a more proactive and targeted approach to both identify and support those household customers in greatest need of support.

Previously the approach taken by water companies, including Portsmouth Water, was to work with charities such as The Citizens Advice Bureau, StepChange, Christians Against Poverty, National Debtline and The Money Advice Service and to offer reduced tariffs and other forms of support. For the main part these have relied on the customer to apply for such schemes. However, in addition, we have now launched a new Helping Hand tariff to support financially vulnerable customers and appointed a Customer Support Advisor in order to take a more proactive approach to customers with vulnerability.

## Strategic Report

# The Issues That Affect Us

## Our Stakeholders

**Our Customers and our community**

Customers are at the centre of our business. Our mission statement describes what our customers expect of us and we are continually reviewing the service we provide and how we can improve it. We supply water to over 298,000 households and 18,000 businesses. This number increases each year as we work with housing developers to ensure they can build and serve significant housing plans for the area.

We are an integral part of the local community; proud of our close ties with the community we serve, having supplied drinking water for almost 160 years.

- Most of our employees are from the local area.
- We have a partnership with a local Country Park, contributing to an education centre which introduces children to the importance of fresh water, how it is delivered and why we must use it wisely. To date, over 10,000 children have visited the centre.
- We have been actively involved in schools and have attended and sponsored local science fairs for many years.
- The Company participates in PUSH, The Partnership for Urban South Hampshire, which seeks to encourage local development in a sustainable manner.

**Customer Challenge Group**

In 2012 we established our Customer Challenge Group ('CCG'), which includes a range of stakeholders and customers. This is a forum initially established to ensure the Company built a business plan based upon high levels of customer engagement and provided a challenge to the Business Plan submitted to Ofwat. We undertook significant customer research where customers told us their expectations of us as a business and this was the foundation of our Business Plan. It is a key part of the Company's governance in respect of our performance against the Business Plan over the 5 year regulatory cycle.

The Group is chaired by an independent member of the public whose responsibility is to represent the customers and stakeholders to hold us to account on our performance.

**Our employees**

One of our primary objectives is that our employees return to their families at the end of the day without injury and customers are safe when we are working near their homes or when they are near our sites. The Board

of Directors see Health and Safety as a key priority of the business and they ensure:

- The safest possible environment for our employees, visitors and general public.
- Continual review of all our operational practices from a health and safety perspective

We must make sure we provide an attractive remuneration package for our staff. We are located within the South East of England with a relatively dynamic labour market and low unemployment. We offer an attractive package including life assurance cover and entry to a pension scheme.

Finally we invest in our people, offering all of our staff development opportunities to reach their potential. This includes degrees, NVQs, professional qualifications and relevant courses.

**Our investors**

Like all businesses we need to generate sufficient profits to provide a fair return to shareholders and meet the interest cost of our borrowings.

The major shareholder in the Company is an Employee Benefit Trust (EBT) which acts on behalf of our employees who receive discretionary bonus payments as a result of this shareholding. The EBT has told us that they want to see us maintain the current level of return provided to them and they expect a reasonable small real annual increase in the level of dividends.

Our main source of finance is an index linked loan which has conditions which require a certain specified level of financial performance. The conditions also stipulate that the Company has to take all reasonable steps to maintain an Investment Grade credit rating. This rating demonstrates to lenders that we can meet our interest payments and allows us to secure borrowing at reasonable interest rates.

**Our suppliers**

Suppliers and the overall supply chain are key to enabling the business to successfully function operationally, financially and environmentally. This supply chain is diverse in nature ranging from the pipe and fittings that supply the water to our Customers, to the pumps and the electricity that powers them and to the chemicals that are used to treat the water. In addition there is a significant range of supplied items and services that enable both

the supply of water and the overall functioning of the wider business.

We have always strived to deal with our suppliers on a professional partnership based approach; helping to ensure that we receive quality products and services and that our suppliers feel valued and are paid a fair price. During the year this principle has been cemented with the new mains laying contract which operates on a fully collaborative working basis. This includes common shared goals & behaviours and co-location.

Company collaborative working has been extended to other water companies and has enabled "benchmarking" of some internal operations and an increasing number of joint contracts with suppliers.

**The CCG Chairman's Note**

The CCG provides independent challenge and assurance on the quality of the Company's customer engagement and the degree to which customer views shape business planning and activities. It also has a monitoring role to review the performance against the Outcomes (Outcome Delivery Incentives) agreed for the current regulatory period.

Whilst the Company is currently meeting the majority of its target ODIs it was disappointing to see that two measures were not met; water quality contacts (which was also not achieved in the prior period) and leakage. The company has implemented plans to improve performance and achieve targets in both of these areas. The plans include a detailed programme of works, investment in additional resources and equipment and process improvement. The CCG will continue to monitor the progress of these plans as the company strives to achieve its ODI targets.

During the year the Company established an overall plan for the development of its business submission (PR19) for the next 5 year regulatory period. The plan includes a detailed customer engagement component and the company has completed the important step of recruiting a Customer Advisory Panel (CAP) to advise on specific business issues. As the customer engagement plan is further developed and implemented, we will work closely with the Company to provide oversight and challenge on the quality of the engagement and the extent to which it is reflected in the Business Plan.

**Lakh Jemmett**  
CCG Chair

## Our Regulators

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Defra is the UK government department responsible for safeguarding the natural environment. They set policy for the water industry. These policies, such as the development of competition for non-household customers, management of flood risk and water abstraction reform, are then implemented by individual regulators.

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The Water Services Regulation Authority, or Ofwat, is the body responsible for economic regulation of the water and sewerage industry in England and Wales. They are responsible for protecting the interests of customers in a monopoly market. Ofwat is primarily responsible for setting limits on the prices charged for water and sewerage services, taking into account proposed capital investment schemes and expected operational efficiency gains.

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The Drinking Water Inspectorate regulates the public water supply companies in England & Wales. It provides independent reassurance that drinking water quality is safe for customers, meeting the legal standards. The DWI's remit is assessing the quality of drinking water England and Wales, taking enforcement action if standards are not being met, and appropriate action when water is unfit for human consumption. It is also responsible for reporting on drinking water quality to the European Union.

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The Environment Agency is a non-departmental public body with responsibilities relating to the protection and improvement of the environment in England. The Agency's responsibilities include water quality and water resources. They set the volume of water that we may extract from the environment. They also have responsibilities for flooding, conservation, rivers and harbours.

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Natural England is the government's adviser for the natural environment in England. This non-departmental public body is responsible for ensuring that England's natural environment, is protected and improved. Natural England monitor the way we maintain and operate our sites to ensure we enhance the local environment. We have been complemented for the improvement in the management of our sites by Natural England and in particular the Site of Scientific Special Interest on the River Itchen.

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The Consumer Council for Water (CCWater) is the independent voice for all water consumers in England and Wales. It was established to provide consumers with strong representation, including that customers are at the heart of decisions made by water companies. It provides free advice to consumers and keep them informed on the issues that affect their water and sewerage services. CCWater monitor the quality of the service we provide to our customers.

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Market Operator Services Ltd (MOSL) is a private company that works on behalf of, and is funded solely by its water company members. Companies are required to be members of MOSL to participate in the non-household market. Prior to the opening of the new market on 1 April 2017, MOSL was responsible for developing and delivering the core IT systems and supporting water companies' preparations. In March 2017 MOSL was appointed the 'enduring' market operator. In this long-term role, MOSL is responsible for the effective and efficient operation of the non-household water retail market and plays a central role in its evolution through its continued work with the Code Panel.

## Strategic Report

## Principal Risks and Uncertainties

Effective risk management is critical to the achievement of our strategic aims and customer outcomes. As a company risk management is embedded in our day to day activities and use a range of formal and informal processes to keep risk at the heart of what we do.

| Risk category                   | Description   | Potential impacts   | Nature                                   | Likelihood | Impact |
|---------------------------------|---|---|--|------------|--------|
| <b>Our customers</b>            |   |   |  |            |        |
| <b>Operational</b>              | The significant loss of treatment works or failure of critical parts of the mains network   | Failure to supply customers over an extended period.  | Operational<br>Reputational<br>Financial | ●          | ●      |
| <b>Water quality</b>            | Failure against drinking water quality standards.   | Water not fit to drink.   | Operational<br>Reputational<br>Financial | ●          | ●      |
| <b>Business continuity</b>      | Scenarios for loss of major business elements such as key operational sites, power, telecoms, IT, personnel.  | Adverse impact on ability to carry on normal business activities. Potential impact on ability to supply services to customers and ultimately potential impact on business viability.  | Operational<br>Reputational<br>Financial | ●          | ●      |
| <b>Our people</b>               |   |   |  |            |        |
| <b>Human resources</b>          | Loss or shortage of critical skills, company knowledge or operational capacity. Possible over reliance on key individuals.  | Adverse impact on ongoing operational activities. Poor business decision making due to lack of knowledge or experience.   | Operational<br>Reputational              | ●          | ●      |
| <b>Health &amp; Safety</b>      | Failure to maintain appropriate health and safety standards.  | Serious injury or death of employee or contractor. Prosecution by HSE.  | Reputational<br>Financial                | ●          | ●      |
| <b>Our environment</b>          |   |   |  |            |        |
| <b>Environmental</b>            | Reduction in water abstraction licences due to EA reform and sustainability issues. Climate change and population growth increases demand. Damage to the environment. | Inability to provide a sustainable supply of water to the population. Impact on habitats and biodiversity.  | Operational<br>Reputational<br>Financial | ●          | ●      |
| <b>Our business</b>             |   |   |  |            |        |
| <b>Financial</b>                | Liquidity, solvency, capital risk and credit risk.  | Insufficient funds or facilities to finance capital programme, service debt or for day to day operating cash flow requirements. Breach of financial covenants and/or breach of licence conditions for financial viability. Inability to pay dividends. Inability to recover revenue due to increasing bad debt driven by socio-economic conditions. | Financial                                | ●          | ●      |
|                                 | Exposure to increasing costs or other financial loss reduce the financial viability of the Company.   | Significant costs, such as power or interest expense, limited control and result in trading losses. Unexpected events, such as significant claims against the Company result in significant costs.  | Financial                                | ●          | ●      |
| <b>Regulatory</b>               | Regulators' actions have an adverse impact on the business. DWI and EA related regulatory impacts are considered under Water Quality and Environmental risks.         | Failure to meet customer service standards or Outcomes agreed with Ofwat may result in penalties. Unexpected changes in the Ofwat regulatory approach. Increasing Regulatory Requirements.  | Reputational<br>Financial                | ●          | ●      |
| <b>Legal &amp; governance</b>   | Failure to meet our legal obligations particularly licence conditions and data protection. Lack of appropriate Governance.  | Prosecution or fines as a result of company failure. Significant adverse publicity and loss of reputation.  | Reputational<br>Financial                | ●          | ●      |
| <b>Competition 'Open Water'</b> | Failure to comply with Market Regulations or Competition Law.   | Adverse impact on ongoing operational activities. Breach of Competition Law by showing undue preference to one retailer or disclosing confidential information.   | Operational<br>Reputational              | ●          | ●      |
| <b>IT</b>                       | Significant successful cyber-attack on the Company  | Loss of critical computer systems result in failure to operate the business as usual. Cyber attacks in general are steadily increasing.   | Operational<br>Reputational<br>Financial | ●          | ●      |

**Likelihood of occurrence**

● Low ● Medium ● High

**Impact of occurrence**

● Negligible ● Moderate ● Serious ● Catastrophic

The table on pages 8 to 9 sets out how the principal risks and uncertainties identified relate to the Company's business objectives and reporting KPIs. We have summarised in the following table an overview of our risk management priorities. This summarises the type of risk, explains the likely impact and summarises the mitigations (plans, controls and actions) in place. It also provides an indication of the likelihood and potential impact of each risk occurring, together with the Board's assessment of the trend (increasing, decreasing or stable). In each category the level of required mitigation and control is determined by the Company's risk tolerance. On an annual basis the Board reviews its tolerance for risk and sets appropriate levels.

Further information on the Board's approach to risk is set out in the Corporate Governance Report on page 39.

| Trend | Mitigation/Control  |
|-------|---|
|       | <ul style="list-style-type: none"> <li>- The supply network has been developed to connect different supply areas, such that in most situations water can be transferred to compensate for a failure at a treatment works or in the network.</li> <li>- A fully documented Emergency Plan which is initiated in the event of a major incident.</li> <li>- Employment of modelling, telemetry and monitoring to assess the resilience of the network.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- A Drinking Water Safety Plan which identifies the potential risks throughout the supply process.</li> <li>- A rigorous sampling regime in accordance with statutory legislation together with 24 hour monitoring and response</li> <li>- We maintain two days storage of treated water in service reservoirs to provide sufficient time for any water quality issues at treatment works to be addressed.</li> <li>- Membrane filtration at five of the treatment works considered most at risk from cryptosporidium. Ultra violet treatment plants built at two other high risk sites with installation currently ongoing at a third.</li> </ul>   |
|       | <ul style="list-style-type: none"> <li>- Defined and documented Emergency Plan in place which utilises Drinking Water Safety Plan (DWSP) risk assessments.</li> <li>- Business continuity planning processes. See also IT risk mitigations.</li> <li>- Appropriate insurance cover.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- Investment in a programme of employee development and cross training and collaborative working with other water companies.</li> <li>- Regular succession planning reviews at the Board level and Non-Executive Directors with appropriate, relevant skills mix.</li> <li>- Control procedures and policies in place to ensure that all relevant legislation is complied with.</li> <li>- Appropriate use of contractors and consultants to support the business needs.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- Culture of health and safety awareness and "zero tolerance" policy lead from the Board down including a Health and Safety Committee.</li> <li>- Risk assessment, training and inspections embedded in the business. All incidents reviewed for lessons learned.</li> </ul>   |
|       | <ul style="list-style-type: none"> <li>- Detailed modelling and studies in order to assess and understand the future balance of supply and demand.</li> <li>- Monitoring and modelling in order to identify the impact of abstraction at certain sites; identification and implementation of mitigating solutions.</li> <li>- Biodiversity surveying and specific schemes to support and enhance biodiversity.</li> <li>- Completed all investigations and no obligations under new National Environment Programme to support sustainability.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- An appropriate capital structure with a mixture of cash, debt and equity together with appropriate credit facilities.</li> <li>- Effective processes of budgeting for costs and cash flows. This includes close monitoring of headroom against financial covenants and stress testing.</li> <li>- Mitigation of significant costs or claims (see below):</li> <li>- Utilisation of all appropriate means of debt collection, including the use of a dedicated debt recovery section and collection agencies.</li> <li>- A Social Tariff (Helping Hand) implemented in July 2016 to support our financially vulnerable customers.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- An effective system of internal controls together with a process of budgeting and forecasting to manage the underlying cost base.</li> <li>- Energy represents around 9% of operating costs. An energy broker was used in order to manage exposure to power costs and price fluctuations.</li> <li>- Both interest payments and revenue are currently linked to RPI and therefore provide a natural hedge.</li> <li>- The contract for mains renewals activities was recently re-negotiated to manage this significant cost and service.</li> <li>- Comprehensive insurance cover for a range of risks, including damage to property, public and employee liability, fraud and terrorism.</li> </ul> |
|       | <ul style="list-style-type: none"> <li>- The 5 year price review is conducted in an open and transparent manner and the Company actively participates in the process.</li> <li>- Performance against regulatory targets is reviewed on a monthly basis by the Board or the Executive Directors.</li> <li>- Close engagement with Ofwat through consultation processes, workshops and industry groupings.</li> </ul>   |
|       | <ul style="list-style-type: none"> <li>- Corporate Governance code and authorisation framework which is reviewed annually. Monitoring of legal and governance areas.</li> <li>- Appropriate levels of insurance cover such as Public Liability insurance.</li> <li>- Close monitoring of performance against licence conditions through KPIs. A clear data protection policy.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- A transparent Governance process around the Company's strategy and governance for "Open Water". This includes Board sponsorship, an Open Water Steering group and clear managerial responsibility. Strategic decision to exit the non-household retail market was taken to reduce compliance burden and costs.</li> <li>- Additional operational processes and resources deployed.</li> <li>- The Board approved the Company's Compliance Code and all employees have had training on compliance with Competition Law.</li> </ul>  |
|       | <ul style="list-style-type: none"> <li>- Third party end to end threat monitoring and alert services are used to promptly identify and respond to cyber threats.</li> <li>- Standard operating procedures such as regular back-ups held off site. Duplicate IT infrastructure held in a secure off site location.</li> <li>- A clear disaster recovery programme in place to enable us to continue working should the systems fail.</li> <li>- Regularly Audited by Defence Science and Technology Laboratories and other statutory bodies.</li> </ul>  |

## Strategic Report

**Viability Statement**

The Board has assessed the prospects of the Company over a period greater than one year.

**Background information**

The Company's business model and strategy are central to an understanding of its prospects, further explanation can be found on page 7. As a regulated, capital intensive, utility provider the nature of the Company's activities are long-term and, although subject to some regulatory changes, the business is generally stable. The Company's current overall strategy, budget and cash flow projections are intrinsically linked to the Ofwat 5 year regulatory review cycle. Consequently, the 5 year regulatory Business Plan (which runs from 1 April 2015 to 31 March 2020) and the related Ofwat Final Determination are the primary drivers for the Company's future prospects. The Final Determination sets out the allowed revenue, operating expenditure, capital expenditure and agreed business Outcomes for the 5 year period. More information in respect of the regulatory regime is set out in pages 25 to 27.

The Board continues to take a measured approach to the Company's strategy. The business' focus is largely on delivering the agreed regulatory Outcomes within the costs set out in the Ofwat Final Determination. Decisions relating to major capital schemes, water quality, resilience of supply and changes to the business strategy are made with a low tolerance for risk. In particular, the Board has considered the changes in the risk profile of the Company resulting from the introduction of retail competition in the non-household

market from 1 April 2017 and exited retail non-household activities at that date (note 30).

**The assessment process of the Company prospects**

The Company's prospects are assessed, primarily, through its budget process and performance against regulatory Outcomes. These are both closely linked to the 5 year financial position set out in the Ofwat Final Determination for the period 2015/16 to 2019/20 which drives the key budget assumptions.

The budget prepared included;

- Detailed budget analysis by department for the forthcoming (2017/18) financial period.
- Five year budget projections to 2019/20 comprising 2 year actuals, 1 year detailed budget and 2 years projections. These are compared against the Final Determination.
- Cash flow projections to 2019/20 (2 year detailed monthly and 3 year annual).
- Projection of key financial ratios including those required for banking covenants and to maintain an investment grade credit rating.

It also has regard to committed funding and liquidity positions and future funding requirements.

In addition the Company has produced financial modelling of the business performance for a further 15 year period. This is based, primarily, on the Final Determination modified by key assumptions such as expected Weighted Average Cost of Capital (WACC), efficiency levels and longer term assumptions such as RPI and CPI levels.

This assessment process involves an annual review of the budget (including financial projections through to the end of the current regulatory period) and related objectives, led by the Managing Director and Finance Director, through the Management Board. All Company departmental heads are involved in this review. A key part of this review is a comparison of the projected total operating and capital expenditure ("Totex") against that set out in the Ofwat Final Determination for the 5 year period. The Board participates fully in the annual process by means of the budget review and approval process, setting annual business objectives and the Board strategy day. The annual budget process was completed and approved by the Board during February 2017.

The key business assumptions in the budget related to;

- Increase in RPI (which drives tariffs and costs)
- Levels of capital and renewals spend and related efficiency and cost savings
- Salary increases
- Interest rates and loan indexation rates
- Levels of targeted cost savings

The further assumptions in the additional 15 year projections from 2020 relate to;

- Expected WACC, based on current Ofwat methodology, of 2.98%
- Increase in RPI and CPI (CPI will be used to drive tariffs in future periods)
- Levels of efficiency projected
- Levels of capital and renewals spend together with assessment of the need for any significant new capital schemes.

Alongside this, the Company also updates the analysis of significant risks that could prevent the budget and Outcomes from being delivered. The Board performs regular reviews of the principal risks and uncertainties and a formal annual review and a robust assessment was completed and approved in April 2017. Details of the principal risks and uncertainties are set out on pages 28 to 29 and details of the Board risk assessment process are set out on page 39. The purpose of the principal risks table is, primarily, to summarise those matters that could prevent the group from delivering on its strategy. A number of other aspects of the principal risks – because of their nature or potential impact – could also threaten the Company's ability to continue in business in its current form if they were to occur. This was considered as part of the assessment of the Company's viability, as explained further below.

### The period of assessment

The Board conducted the assessment for a period of 5 years to 31 March 2022. The Board considers that this period of 5 years to be most appropriate as it is consistent with the length of period generally considered for regulatory purposes. The Board also feels that this is an appropriate length of time to permit a reasonable assessment of likely business performance and to make reasonable estimates of key assumptions. As set out above the Ofwat Final Determination and Outcomes are significant drivers of the business strategy and performance. This is a key driver to the end of the current regulatory period of 2020 and beyond this the Board believes that appropriate assumptions have been used based on a combination of current methodology and those changes already signalled by Ofwat. Whilst the Board considers 5 years to be an appropriate horizon

to consider the continuing viability of the Company, they do consider the viability over a longer term beyond this period as indicated above.

### Assessment of viability

The Assessment of Viability therefore uses a period of 3 years of budgeted information to the end of the current regulatory period and the first two years of financial performance modelled for the next Regulatory period commencing 1 April 2020.

Although the budget and financial model reflect the Directors' best estimate of the future prospects of the business, they have also stress tested the potential impact on the Company of a number of scenarios. This has been performed by quantifying their financial impact and overlaying this on the financial forecasts. The potential impact has been considered in relation to operating profit, cash flow, liquidity and the key financial ratios needed for banking covenants and the retention of an investment grade credit rating.

These scenarios, which are based on aspects of principal risks and uncertainties set out in pages 28 to 29, represent 'severe but plausible' circumstances that the Company could experience.

The scenarios tested included combinations of the following:

- The loss of a combination of two critical strategic assets resulting in an in year unexpected cost increase of £8m.
- An in year unexpected capital outlay of £10m together with a £12m pension deficit arising.
- An upper limit capital expenditure test.
- Loss of a critical IT system for one month in combination with two different scenarios; i) loss of a significant treatment works; and ii) an in year unexpected capital outlay of £10m together with a £12m pension deficit arising.

In addition the Directors also tested a number of broad sensitivities including increase in interest rates, increase in costs and adverse movements in Retail Price Index/Consumer Price Index.

In each case the availability and effectiveness of mitigating actions that could reasonably be taken to reduce the impact was taken into account. The primary mitigating actions relate to the use of available credit facilities, levels of insurance cover, the ability to defer capital and renewals spend and the discretion not to pay dividends.

It has also been assumed that one year 'shocks' which may have an adverse but short lived (1 year) impact on financial ratios, could be managed by careful discussion with key stakeholders such as bond holders and the rating agencies.

The results of this stress testing showed that, due to the stability of the business, the Company would be able to withstand the impact of these scenarios occurring over the period of the financial forecasts by making adjustments to its operating plans within the normal course of business. This included both the restriction and elimination of dividend payments.

### Viability statement

Based on their assessment of prospects and viability above, the Directors confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the five year period ending 31 March 2022.

### Going concern

The directors also considered it appropriate to prepare the financial statements on the going concern basis, as explained in the Basis of preparation paragraph in note 1 to the financial statements.

### Directors' Responsibility Statement

We confirm that to the best of our knowledge:

- the accounts, prepared in accordance with the applicable set of accounting standards give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the report and accounts, taken as a whole, provides the information necessary to assess the Company's performance, business model and strategy and is fair, balanced and understandable; and
- the Strategic Report includes a fair review of the development and performance of the business, together with a description of the principal risks and uncertainties.

For and on behalf of the Board



**N. Smith**  
Managing Director

25 May 2017

# Corporate Responsibility Statement

## Affordability

In recent years the country has seen increasing levels of household debt. Accordingly the Company pays close attention to how we support customers who may be struggling to pay their water bill. We have a number of options available to support these domestic customers.

We introduced our 'Helping Hand' Social Tariff in July 2016. This tariff caps customers bills at our minimum charge, currently £75.28, for those customers whose household income, excluding certain benefits, is less than the Government's low income threshold of £16,105.

Our Arrears Assist Scheme started in May 2014. Through this scheme we encourage customers back into making regular payments by matching the payments we receive £ for £. We currently have over 100 customers on this scheme with over 200 having completed it. We have found the Arrears Assist Scheme has been successful in encouraging customers to engage with us about payment of their water accounts. It also enables us to better understand our customers' financial situation and the hardships they are facing.

Customers can also apply to be placed on the WaterSure Tariff. This tariff is for metered customers who are in receipt of certain benefits and have a medical condition that requires an individual to use more water or has 3 children under the age of 19 resident in the property. These customers have their measured bills capped at our average bill value.

We also operate a scheme called WaterDirect. Customers who receive certain benefits from the Department of Work and Pensions, and are in arrears on their bills, can request that water bill payments are deducted straight from their benefits.

Finally we have an in-house Customer Support Officer whose role is to engage with hard to reach customers, and the organisations that support them.

## Compensation & Customer Charter

We operate a compensation scheme as part of our Customer Charter. This includes the

service standards as set out in law, under the Guaranteed Standards Service (GSS) scheme. If we fail to meet any of the standards outlined in the GSS guidelines, customers are entitled to a compensation payment. The GSS standards cover the following areas;

- Making and keeping of appointments with customers
- Responding to account queries
- Responding to complaints
- Dealing with interruptions to the water supply (planned and unplanned)
- Levels of water pressure

Our Company Customer Charter is enhanced beyond the GSS standards. In addition to the GSS standards we will pay compensation if the water meter is not read at least once within a 12 month period. We also increase the compensation payment amounts beyond what is required in the GSS standards.

## Energy Use and Carbon Emissions

In common with all water companies energy is a significant operating cost of the business accounting for 6% of operating expenses. The majority of our energy consumption and the associated greenhouse emissions relate to water pumping and treatment activities. Our gross greenhouse emissions for the year was 11,079 tCO<sub>2</sub>e (2015/16 - 11,606 tCO<sub>2</sub>e (restated)).

The table below shows our energy consumption, greenhouse gas emissions and the volume of water we deliver to our customers.

We continue to work proactively to develop sustainable solutions that minimise the impact on the environment and reduce our carbon footprint.

In our Business Plan, over the 5 year period from 2015/16 to 2019/20 we committed "to increase the percentage of energy obtained from renewable resources and, wherever practicable, to reduce electrical consumption delivering a more sustainable water supply service".

We address carbon emissions in a number of different ways;

- Operate solar arrays at 5 of our water treatment works.
- Purchase 100% of our energy for our treatment and pumping sites from 'Green' energy sources (biomass).
- In June 2015 we completed our Energy Savings Opportunities Scheme (ESOS) in compliance with new legislation.

We will continue to investigate the feasibility of sustainable wind and solar energy projects and other renewable technologies where cost effective. We continue to work towards further reductions in our power consumption including;

- Enhancing telemetry controls monitoring power consumption.
- Targeting investment to optimise pump operation, reduce our base level power requirement and through life monitoring of pump efficiency.

We have also participated in National Grid's Demand Side Balancing Reserve (DSBR) where we switch off our pumps during times of peak demand, to assist the Grid in balancing supply and demand in the UK.

## Water Efficiency

Since 2010, when we started our Water Efficiency programme, we have distributed over 200,000 free water saving devices to our customers.

The Company continues to promote the benefits of saving water to our customers. We are constantly looking for new ways to encourage water saving. We promote ways to reduce water consumption through our website, free devices, community and school events and this year a team was set up to promote the benefits, financial and environmental, of a customer switching to a water meter.

## Working in the Community

We have a long standing tradition of community involvement. Part of this work involves educating our community about the value of clean and safe drinking water and how this is delivered by us. Since 2004 we have had a successful working partnership with Staunton Country Park, which we recently

|   | Units                      | 2016/17    | 2015/16<br>Restated | 2014/15    |
|---|----------------------------|------------|---------------------|------------|
| Electricity used  | MWh                        | 22,551     | 21,689              | 21,438     |
| Gross greenhouse gas emissions  | tCO <sub>2</sub> e         | 11,079     | 11,606              | 12,286     |
| Water delivered - Distribution input  | MI                         | 62,065     | 60,880              | 61,597     |
| <b>Gross Greenhouse gas emissions per million litres of water delivered</b> | <b>KgCO<sub>2</sub>/ML</b> | <b>179</b> | <b>191</b>          | <b>199</b> |



extended for a further 3 years, and for the past 20 years we have been sponsoring and contributing to the annual Education Business Partnership STEM Fair (Science, Technology, Engineering and Maths). This event gives hundreds of local school children the opportunity to see where their water comes from and discover the processes that are involved to achieve this.

#### **Supporting Disability in the Workplace**

The Company has adopted a policy which complies with the Disability Discrimination Act 1995. Every consideration is given to applications for employment from disabled persons, where the job requirements may be adequately covered by a person with a disability. Employees who become disabled during employment are given continued employment where possible and opportunities for training and career development are provided for all disabled employees.

#### **Catchment Management**

The Company has a Catchment Management Programme in place with the aim of improving the quality of the rivers, springs and aquifers from which we abstract by influencing the way the surrounding land across our catchment areas is managed. This involves working in partnership with land owners, farmers and other organisations (for example, the Environment Agency and Natural England) to reduce diffuse pollution. Improving the water quality 'at source' in the natural environment is a more sustainable approach than energy/chemical-intensive water treatment, representing 'end of pipe solutions' at our treatments works, just before water enters the supply system.

For the 2015-2020 Business Plan period, there are two principal aims to our Catchment Management Strategy. The first is to build an evidence base to better understand where and how pollutants originate and the best ways to address them.

The second is to continue our 'on the ground interventions' through the Downs & Harbours Clean Water Partnership ([www.cleanwaterpartnership.co.uk](http://www.cleanwaterpartnership.co.uk)), established in 2008 with the Environment Agency and Natural England. The principal aim of the Partnership is to protect and improve the water quality of groundwater, surface and coastal waters in West Sussex and East Hampshire.

The past year has seen the Company complete its evidence gathering; the focus for 2017-18 is now the application of this work. This will involve retargeting the work of the

Downs & Harbours Clean Water Partnership to more effectively address pollution risk, and the development of new, innovative interventions to further drive sustainable land management across our catchments. This will help us deliver water quality improvements 'today' and shape our longer term Catchment Management Strategy through our next regulatory period for 2020-2025.

#### **WaterAid**

The Company continues to support and promote the charity WaterAid to customers and staff. Over the last 30 years donations from our customers, together with fundraising efforts of our employees have raised nearly £500,000 for WaterAid. It is estimated the average cost is only £15 per person for supplying a safe water supply to a village, combined with sanitation and hygiene education for life. In March 2017 Portsmouth's landmark Spinnaker Tower turned blue to recognise World Water Day.

on the environment, to ensure that the impact is minimised.

As part of our wider commitment to improving the environment, we aim to conserve and enhance biodiversity on the 44 operational sites we own. Sites are located in a variety of habitats including chalk down-land, river catchments and coastal margins. Habitat management plans have been agreed for all operational sites.

We own one Site of Special Scientific Interest (SSSI) at the Itchen water treatment works, which we manage in conjunction with Itchen Valley Country Park. Through a Natural England High Level Stewardship agreement we allow cattle grazing of the meadow to maintain the wet grassland habitat.

Key biodiversity enhancing projects completed in 2016/17 have included;

- Chalk grassland restoration at three sites.
- A river restoration project on the River Hamble.
- Converted a small building at Northbrook into a bat roost.
- Removed Buddleia from woodland at Lovedean.
- Removed trees and scrub at Madehurst.

Further information in relation to our commitment to biodiversity and the environment is set out on pages 16 to 21 "Our Environment".

#### **Nature Conservation & Biodiversity**

The Company is committed to ensuring compliance with all environmental legislation and obligations, carefully assessing the impact of its activities, especially construction projects on the environment, to ensure that the impact of such schemes is minimised.

#### **Biodiversity**

The Company has a statutory duty to consider conservation and biodiversity as part of our business activity. We operate in an environmentally sensitive area and we are committed to ensuring compliance with all environmental legislation and obligations, carefully assessing the impact of our activities

# Governance

**Mike Kirk**  
Chairman  
25 May 2017

## Chairman's Introduction

We are committed to high standards of corporate governance and take the lead from those set out in the UK Corporate Governance Code and guidance issued by Ofwat. That guidance highlighted Ofwat's principles by which they believe Water Companies should deal with Board Leadership, transparency and governance. In 2014 the Company adopted its own Governance Code which can be found on the Portsmouth Water website.

I am pleased to confirm that we consider that the Company complies with the Ofwat principles in all areas with the exception of Board Composition. Our approach to this area is explained below.

## Board Composition

The Ofwat principles suggest that independent Non-Executives should constitute the largest fraction of Directors. We currently consist of three independent Non-Executive Directors (including myself as Chairman) and three Executive Directors. I have the casting vote and therefore believe we still comply with the spirit of the proposal. In addition, discussion and approval of dividends is solely carried out by the Non-Executive Directors as the Executives are Directors of the Ultimate Parent and are prevented, by the Instrument of Appointment, from voting. The Non-Executives carefully considered this issue and believe the structure is appropriate. To increase our number would be an unnecessary expense and we believe it is important to have an Engineering and Finance Executive on the Board. Ofwat have confirmed that they are satisfied with this position.

## Auditor Change

In accordance with The Code provisions, the Board completed a tender for External Audit Services in 2016. As a result of that tender I can confirm that at the AGM a resolution will propose KPMG as new auditors of the Company.

I would like to take this opportunity to thank Saffery Champness for their commitment and support to both the Company and the Board over the past eleven years.

## Links

A copy of the FRC 2014 UK Corporate Governance Code can be found at: [www.frc.org.uk/our-work/publications/corporate-governance/UK-corporate-governance-code-2014.pdf](http://www.frc.org.uk/our-work/publications/corporate-governance/UK-corporate-governance-code-2014.pdf)

A copy of the Portsmouth Water Governance Code can be found at: [www.portsmouthwater.co.uk/wp-content/uploads/2015/02/D67ZBEE-1EAZ-42F6-BE30-3D086D7COZCZ.pdf](http://www.portsmouthwater.co.uk/wp-content/uploads/2015/02/D67ZBEE-1EAZ-42F6-BE30-3D086D7COZCZ.pdf)

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## Governance

**Ownership Structure**

The following chart shows the ownership of the Company and the Group Structure. Unless indicated, all companies are wholly owned by the parent company shown and all companies are domiciled in the UK for tax purposes.

**Explanation**

Portsmouth Water Limited is the primary trading company in the group and is included within the regulatory ring-fence as established by the Instrument of Appointment. The immediate parent of Portsmouth Water is Portsmouth Water Holdings, a company established in 2002 to protect the interest of Bond holders by exercising control over distributions.

We consider South Downs Capital Limited to be Portsmouth Water's ultimate holding company and ultimate controlling entity. Although the South Downs Employee Benefit Trust, through South Downs Trustee Limited, holds the majority of the equity shares and hence the majority of the voting rights, they are not considered to be in a position to exercise a 'dominant influence' over South Downs Capital Limited and nor can they appoint or remove the majority of the Board. Accordingly consolidated Group Financial Statements are prepared at the level of South Downs Capital Limited. During the year the Directors of both South Downs Trustees Limited and the Company, having taken legal counsels' advice, decided that the Trust qualified as an Employee Ownership Trust. The change allows the Company to make discretionary payments direct to eligible employees.

The corporate vehicle for South Downs Employee Benefit Trust is South Downs Trustee Limited. SD Parent Limited is a dormant company purely set up to hold and protect the shares of South Downs Trustee Limited. As such the financial results reported in the consolidated Group Financial Statements of South Downs Capital Limited would be no different if consolidated Group Financial Statements were prepared at the level of SD Parent Limited.

**Financing**

Portsmouth Water Limited is financed primarily by way of an RPI indexed linked loan secured upon the assets of the Company. This thirty year £66.5m index-linked loan was issued in June 2002 and is repayable on 30 September 2032. The loan interest is calculated by adjusting the value of the loan by RPI and then charging interest on this amount at 3.635%. The current value of the loan is £99.6m (2016 - £97.7m).

## Governance

# Board of Directors

## Executive Directors

**Neville Smith (60)**  
Managing Director

**Appointed to the board**  
February 1998

**Qualifications**  
B.A., F.C.M.A., C.G.M.A.

**Committee membership**  
Member of Nomination Committee

**Experience**  
Neville was appointed to the Board of Portsmouth Water as Finance and Regulation Director in 1998. He became Managing Director in 2011 and is also a Director of the ultimate holding company, South Downs Capital Limited and is a Trustee of the Brockhampton Pension Scheme.

Neville is a Fellow of the Chartered Institute of Management Accountants and previously had 15 years' experience in the electronics manufacturing sector in finance positions at GEC, Smiths Industries Aerospace and Roxspur plc.

**Helen Mary Grace Orton (47)**  
Finance and Regulation Director

**Appointed to the board**  
October 2015

**Qualifications**  
B.Sc., F.C.A.

**Experience**  
A Chartered Accountant and previously a Director with PricewaterhouseCoopers LLP. Helen has a broad range of commercial experience working with a wide range of listed and large companies. She has particular experience working with businesses in the Water Industry and other regulated industries including the development of Regulatory Financial Statements.

Helen joined the Company and was appointed to the Board in October 2015.

**Roderic Colquhoun Porteous (60)**  
Engineering Director

**Appointed to the board**  
May 2012

**Qualifications**  
B.Sc., C.Eng., M.I.C.E.

**Experience**  
Rod has a broad Water Engineering background with extensive operational, engineering design, asset maintenance, capital planning and customer service experience, gained previously with S E Water (SAUR Water Services) and other water companies and consultants including overseas appointments.

He joined Portsmouth Water in 1999 holding Senior Manager positions across a range of functions and appointed to the Board in May 2012.

## Non-Executive Directors

**Michael Peter Kirk (57)**  
Independent Non-Executive  
Chairman

**Appointed to the board**  
November 2012

**Qualifications**  
FT Non Executive Director Diploma, MBA,  
M.Sc., B.Sc (Hons), AMIWater

**Committee membership**  
Chairman of the Nomination Committee,  
Member of Audit Committee, Member of  
Remuneration Committee

**Experience**  
Mike is a Chemical and Nuclear  
Engineer, with extensive experience  
of long-life infrastructure design and  
project economics. He then moved into  
investment banking and had extensive  
experience advising water, power and  
gas utilities through several periodic  
reviews. Mike is Chair Designate of VIVID  
- Hampshire's largest housing association  
with 30,000 homes. He is also Chairman  
of a large UK community volunteering  
charity, TCV, and Executive Chairman of  
a listed speciality oil & gas technology  
business.

**Heather Virginia Benjamin (59)**  
Senior Independent Non-Executive  
Director

**Appointed to the board**  
November 2012

**Qualifications**  
B.A., C.M.I.P.D., F.I.A.C.C.M., F.C.I.P.S.,  
F.I.O.D.

**Committee membership**  
Chair of the Audit Committee, Member  
of Nomination Committee, Member of  
Remuneration Committee

**Experience**  
Heather held the executive role of Chief  
Procurement Officer at Centrica and has  
significant experience in managing supply  
chains, including outsourced partnerships.  
She is also an Independent Director at  
Cheque and Credit Clearing Company  
which is a key programme for digitising the  
cheque, and is also the Chair of Trustees for  
Walsingham Support, a learning disability  
organisation.

**Martin Paul Johnson (44)**  
Independent Non-Executive Director

**Appointed to the board**  
July 2014

**Qualifications**  
M.Sc, C.Eng., F.I.MechE., B.Eng. (Hons),  
PRINCE2

**Committee membership**  
Chair of the Remuneration Committee,  
Member of Audit Committee, Member of  
Nomination Committee

**Experience**  
Martin Johnson is a Mechanical Engineer,  
a Fellow of the Institute of Mechanical  
Engineers and a Lean Six Sigma Master  
Black Belt, with experience in regulation,  
large capital programmes and customer  
strategy from BAA and BMI Healthcare.  
Martin brings board experience from his  
current role as Chief Executive of Adelle  
Foods Group and previously as Chief  
Commercial Officer at BMI Healthcare.  
Martin started his career as an Engineer in  
the automotive sector with Ford and BMW.

## Governance

**Board of Directors**

|  | <b>Board</b> | <b>Audit Committee</b> | <b>Nomination Committee</b> | <b>Remuneration Committee</b> |
|--|--------------|------------------------|-----------------------------|-------------------------------|
| <b>Number of meetings in the year</b>      | <b>11</b>    | <b>3</b>               | <b>0</b>                    | <b>3</b>                      |
| <b>Chairman</b>                            |              |                        |                             |                               |
| Mike Kirk                                  | 11/11        | 3/3                    | -                           | 3/3                           |
| <b>Independent non-executive directors</b> |              |                        |                             |                               |
| Heather Benjamin                           | 11/11        | 3/3                    | -                           | 3/3                           |
| Martin Johnson                             | 11/11        | 3/3                    | -                           | 3/3                           |
| <b>Executive directors</b>                 |              |                        |                             |                               |
| Neville Smith                              | 11/11        | -                      | -                           | -                             |
| Rod Porteous                               | 11/11        | -                      | -                           | -                             |
| Helen Orton                                | 11/11        | -                      | -                           | -                             |

**How the Board Operates**

The Board has a schedule of matters reserved for its decision and delegate more detailed consideration of certain matters to Board Committee.

Information is circulated to the Board in a timely fashion to ensure that all Directors are fully briefed on all issues arising at Board Meetings. They are free to seek any further information considered necessary. Under the guidance of the Chairman, all matters before the Board are discussed openly and presentations and advice are received frequently from senior managers.

All Directors have access to the services of the Company Secretary and may take independent professional advice at the Company's expense in the furtherance of their duties.

**Board Effectiveness**

The Board consists of three Non-Executive and three Executive Directors. There are no representatives of the Group Majority Shareholder on the Board. We consider that the composition of our Board is appropriate for balancing the needs of customers, the environment and our shareholding, as no single Director or group of Directors can dominate the Board's decision making.

It is considered that the Board and its Committees have the appropriate balance of skills, experience, independence and knowledge to enable them to discharge their duties and responsibilities effectively.

**Performance Evaluation**

During the year, a formal performance evaluation of the Board, its committees and its Directors was undertaken. Each Director was required to complete a questionnaire, the responses to which were reviewed by the Board as a whole. The Non-Executive Directors also met without the Executives to consider the performance of the Board and its committees, and without the Chairman to appraise his performance. The Executive Directors are subject to a formal appraisal of performance which is reviewed by the Chairman. The Chairman also meets with each Non-Executive Director to review individual performance. The evaluation concluded that the Board and its committees operated effectively, and that each Director demonstrated commitment to the role and performed effectively.

**Chairman and Managing Director**

The roles of Chairman and Managing Director are separate with a clear division of responsibilities between them.

The Chairman is responsible for leading the Board and ensuring its effectiveness. He facilitates the contribution of the Non-Executive Directors and the relationship between them and the Executive Directors.

**Shareholder Engagement**

Portsmouth Water is a subsidiary of South Downs Capital Limited, which is 73% owned by South Downs Trustees Limited on behalf of the South Downs Employee Benefit Trust. Although the Independent Directors of South Downs Trustee Limited are not entitled to sit on the Portsmouth Water Board, the Directors of Portsmouth Water do treat South Downs Trustee Limited's Directors as majority shareholders. They are sent Board Agendas and are entitled to attend, as observers, any meeting they wish. The Portsmouth Water Chairman meets with those Shareholder Directors on an annual basis and they have access to both the Senior Independent Non-Executive Director and the Company Secretary. Finally, all shareholders are invited to an annual presentation each year which follows the AGM.

### **Risk Management and Internal Control**

The Board is responsible for the Company's system of internal control and risk management and considers this to be fundamental to the achievement of the Company's strategic objectives. These systems and procedures are designed to identify, manage and, where practicable, reduce and mitigate the effects of the risk of failure to achieve business objectives. They are not designed to eliminate such risk recognising that any system can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board is of the view that there is an ongoing process for identifying, evaluating and managing the Company's significant risks, that it has been in place for the year ended 31 March 2017 and up to the date of approval of the Annual Report and Accounts, that it is regularly reviewed by the Directors. The Board have also set the Risk Appetite for the business and it is reviewed annually.

The key procedures, which have been established with a view to providing effective internal control, are as follows:

#### *Organisation*

The Company's activities are operated through a Board of Directors with clearly defined reporting lines and delegation of authority. The Directors meet regularly to consider a schedule of matters required to be brought to them for decision making. A standing sub-committee of the Board meets weekly for the purpose of ensuring that full and effective control is maintained over appropriate financial, regulatory and operational issues.

#### *Budgetary Control*

Each year the Directors approve an annual plan produced from a comprehensive budgeting system. Actual results are reported against the approved plan on a monthly basis to provide a timely and regular monitoring of performance.

#### *Investment Appraisal*

The Company has a clearly defined framework for assessing capital expenditure needs and options, while post project appraisal looks at relevant improvement in the internal control procedures. Board approval is required for any project exceeding a quantified expenditure level and those authorisation levels were reviewed during the past year.

#### *Business, Operational and Compliance Risks*

The Company assesses the risks facing its business on an ongoing basis and has identified them under ten main headings – operational, water quality, financial, environmental, regulatory, information technology, health and safety of employees, human resources, legal (including whistle-blowing and fraud) and business continuity. They are subject to regular reporting to the Directors. The Board reviews the controls established to mitigate these risks and its insurance requirement on an annual basis. The Directors also receive reports from independent regulatory bodies, which comment on the performance of the core water business. Any issues raised in these reports are identified and dealt with in an appropriate manner.

During the past year the Board invited Senior Managers to join them for a session on risk identification with the express intention of identifying new or emerging business risks.

At the Board meeting on 23 March 2017, the Directors carried out their annual assessment, including consideration of events since the year end. They also reviewed the Company's Risk Management Policy and processes. They agreed that this annual assessment, coupled with the Board's ongoing analysis of risks provided an effective Risk Management Strategy.

### **Board Committees**

A range of key matters delegated to the Board's Committees are set out on pages 40 to 47 of this Corporate Governance Report.

The Terms of Reference of each of the Board's Committees are available upon request from the Company Secretary at the Company's Registered Office.

## Governance

**Audit Committee**

**Heather Benjamin**  
Chair of Audit Committee  
25 May 2017

**Audit Committee Members**

Heather Benjamin (Chair)

Mike Kirk

Martin Johnson

During the year the Committee conducted a formal tender for the External Audit Services of both the Company and the Group. An initial six practices were reduced to a short list of three, including the incumbent, who attended the interviews.

Following the process the Committee recommended that KPMG are proposed as the new Auditors for the Company at the 2017 AGM.

**Role of Committee**

The purpose of the Committee is to ensure the preservation of good financial practices throughout the Company, to ensure that controls are in place to ensure the integrity of those practices and to monitor them, to review the interim and annual financial statements and to provide, by way of timely meetings, a line of communication between the Board and the external auditors. During these meetings with the external auditors the Audit Committee have asked to be made aware of significant issues, discovered by the Auditors on the financial statements. No issues have been identified which would have had a material impact on the financial statements.

The Committee has formal Terms of Reference, which deal with its authorities and duties. It has primary responsibility for making a recommendation on the appointment, reappointment and removal of external auditors. It also reviews annually arrangements by which staff of the Company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

**Activities during the Year**

In addition to fulfilling its ongoing duties, the Committee has an extensive agenda of items addressing issues relating to the day-to-day activities of the business with which it deals in conjunction with senior management, the Reporter and Auditor and the Company finance team. There were three scheduled meetings of the Committee during the year. Items on the agenda included:

- Reviewing the Year End and Interim Results, going concern statement and accompanying press releases
- Agreeing the Financial Estimates and Assumptions made in the Year End Results
- Reviewing the Audit and Assurance work carried out by the Company's Reporter
- Considering the Independence and Performance of the Company Reporter
- Tender for the ongoing External Audit Services
- Assessing the calculations of the 2017 Customer Tariffs

**External Audit and Non-Audit Services**

The Committee reviews the independence and objectivity of the external auditors. This includes reviewing the nature and extent of non-audit services supplied by the external auditors to the Company, seeking to balance objectivity and value for money. The non-audit services provided during the year were for advice given on taxation matters and for advice on dealing with statutory reporting. These services would be those expected to be provided by the Company's external auditor, with the requisite independence safeguards in place.

The review of the Auditors includes consideration of the audit process, the effectiveness and performance of the audit team, and the output, quality and cost effectiveness of the audit. The last review of the Auditor's independence and objectivity was carried out in 2013. The current Auditors have been in tenure for eleven years.

The Committee does not consider that an internal audit function is required for the Company due to the size and nature of the business. This recommendation is reviewed annually.

**Committee Performance and Effectiveness**

An annual review of the Committee's performance was undertaken as part of the external Board Evaluation process. No material shortcomings in the operation of the Committee were highlighted.

**Annual Report and Accounts**

The Audit Committee considers the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.



Governance

# Nomination Committee

**Mike Kirk**  
Chair of Nomination Committee  
25 May 2017

**Nomination Committee Members**  
Mike Kirk (Chair)  
Heather Benjamin  
Martin Johnson  
Neville Smith

- Role of Committee**  
The Committee’s primary function is to advise the Board in relation to the appointment of Executive and Non-Executive Directors. This includes the following:
- Taking responsibility for identifying and nominating for the approval of the Board candidates to fill Board vacancies as and when they arise
  - Before any appointment is made, evaluating the balance of skills, knowledge, experience and diversity on the Board and, in the light of this evaluation, preparing a description of the role and capabilities required for a particular appointment

The Committee comprises of all three Independent Non-Executive Directors and the Managing Director.

**Activities during the Year**  
Although the Committee did not formally meet during the year they remain abreast of the changing legislation around employment rules and appointment to both the Board and Company in general. The Committee, through a six monthly Board Paper, continue to review and consider the Company’s Succession Plan.

| Board composition    |               |                  |                  |
|----------------------|---------------|------------------|------------------|
| Executive<br>50%     | Male<br>67%   | Age 40-49<br>33% | Age 50-59<br>33% |
| Non-Executive<br>50% | Female<br>33% | Age 60-70<br>33% |                  |

## Governance

# Remuneration Committee

### Martin Johnson

Chair of Remuneration Committee  
25 May 2017

### Remuneration Committee Members

Martin Johnson (Chair)

Mike Kirk

Heather Benjamin

### Role of Committee

The primary objective of the Committee is to set a policy to ensure that competitive reward packages are offered that will attract, retain and motivate talented senior executives to run the business effectively and to promote the success of the Company.

Within these arrangements, a proportion of reward is based on performance against demanding targets. These targets are set by the Committee based on key strategic priorities benefiting customers, investors and other stakeholders and consistent with a Board approved level of risk.

### Activities during the Year

During the year the Committee dealt with the following matters:

- Annual executive salary review and achievement of performance targets
- Determining performance targets in respect of 2016/17 annual incentive bonus plan

### Remuneration Report

#### *Remuneration Policy*

The objective is to attract, retain and motivate high calibre Senior Executives through pay arrangements which are competitive and fair and reasonable for the responsibilities involved. In addition to individual performance, reference is made to pay levels in companies of similar size and within the same industry.

The remuneration packages of the Executive Directors, as reported in the accounts, includes a performance related element. The performance related element is based upon the achievement of agreed financial, customer service and personal targets for the whole of the previous year.

#### *Service Contracts*

All Executive Directors appointed to the Board are employed on service contracts of no fixed term with a notice period of one year, both by the Company and the Director. Each Executive Director is entitled to pension provision and certain contractual benefits, details of which are summarised below. Each Executive Director also participates in bonus or incentive arrangements at the sole discretion of the Remuneration Committee which are also described later in this Report. All Executive Directors are subject to retirement by re-election at the AGM.

None of the Executive Directors serves as a Non-Executive Director for another Company.

The Chairman and other Non-Executive Directors have service contracts but these can be terminated without compensation. All Non-Executive Directors are subject to re-election at the AGM.

**Future Remuneration Policy Table**

| <b>Element, purpose and link to strategy</b>  | <b>Operation, performance measures, deferral</b>  | <b>Maximum opportunity</b>  | <b>Performance metric</b>   |
|---|---|---|---|
| <b>Base Salary (Fixed Pay)</b><br>To pay a fair salary, commensurate with the individual's role, responsibilities and experience, and having regard to the market rates for similar roles in the water/utility sector and other comparable companies. | Reviewed annually, taking account of market salary levels, Company performance, individual performance, changes in responsibility and levels of increase for the broader employee population.<br><br>The remuneration committee considers the impact of any base salary increase on the total remuneration package.   | There is no prescribed maximum salary or maximum rate of increase. The remuneration committee is guided by the general increase for the broader employee population but on occasions may need to recognise, for example, development in role, change in responsibility, specific retention issues, market practice or changes in regulatory requirements.<br><br>Details of the outcome of the most recent salary review are provided in the annual report on remuneration. | None  |
| <b>Benefits (Fixed Pay)</b><br>To provide cost-effective taxable benefits and to support the wellbeing of employees.  | The Company currently provides a range of taxable benefits such as medical insurance; life insurance and paid holiday.<br><br>Specific benefits provision may be subject to minor change from time to time, within this policy.   | Taxable benefits are not subject to a specific cap, but represent only a small element of total remuneration. The costs associated with benefits provision are closely monitored and controlled.  | None  |
| <b>Pension (Fixed Pay)</b><br>To provide market competitive pension arrangements, to assist with recruitment and retention.   | Employer contributions are made to appropriate pension schemes.   | 10% of salary into a defined contributions scheme.<br><br>Under the defined benefits scheme a maximum future accrual of 1/80th of career averaged earnings for each year of service.  | None  |
| <b>Annual bonus (Variable Pay)</b><br>To reward performance by linking to achievement of key performance objectives aligned to the strategy of the Company.   | Bonus awards to Executive Directors are made each year and are approved by the remuneration committee. Executive bonus awards take account of the Company's key financial and service performance indicators for the relevant financial year.<br><br>Details of the performance indicators for the most recent financial year and performance against them are provided in the annual report on remuneration. | The maximum bonus potential for each Director is 20% of base salary.  | The incentive scheme is split between three distinct areas as follows:<br>5% customer service measures<br>5% personal objective<br>10% key performance objectives |
| <b>Long-term incentive bonus (Variable Pay)</b><br>To incentivise Executive Directors to deliver sustained long-term performance  | Long term bonus awards to Executive Director calculated on an annual basis but paid out at the end of the five year performance period, subject to the achievement of performance conditions.   | 10% of salary per year paid at the end of year five.  | Awards at the end of the five year performance period, based on achievement of eight specified performance conditions.  |
| <b>Employment contracts, and loss of office</b><br>To facilitate recruitment and retention, and support pay for performance, by providing fair but not excessive contract features.   | Notice periods from the Company are limited to 12 months.   | N/A   | N/A   |
| <b>New Executive Director appointments</b><br>To facilitate recruitment of necessary talent.  | Remuneration for new appointments will be set in accordance with the policy detailed in this table.   | N/A   | N/A   |

## Governance

**Remuneration Committee****Statement of Consideration of Employment Conditions Elsewhere in the Company**

The remuneration approach for the Executive Directors is broadly consistent with that for employees across the Company as a whole. However, the exception is that general employees do not receive an annual performance related bonus. However all employees, apart from the Managing Director, do receive discretionary payments under the qualifying Employee Ownership Trust arrangements as set out on page 35.

**Annual Report on Remuneration****Directors Remuneration as a Single Figure (Audited Information)**

Remuneration is analysed by Director below:

|                       | Salary/Fees<br>£000 | Benefits<br>£000 | Bonus<br>Scheme<br>£000 | Discretionary<br>Payment<br>£000 | Pension<br>£000 | <b>Total<br/>2017<br/>£000</b> | Total<br>2016<br>£000 |
|-----------------------|---------------------|------------------|-------------------------|----------------------------------|-----------------|--------------------------------|-----------------------|
| <b>Executive:</b>     |                     |                  |                         |                                  |                 |                                |                       |
| H. M. G. Orton        | 105                 | 11               | 7                       | 9                                | 11              | <b>143</b>                     | 68                    |
| R. C. Porteous        | 107                 | 9                | 15                      | 15                               | 32              | <b>178</b>                     | 208                   |
| N. Smith              | 148                 | 13               | -                       | -                                | 36              | <b>197</b>                     | 162                   |
| <b>Non-Executive:</b> |                     |                  |                         |                                  |                 |                                |                       |
| H. V. Benjamin        | 25                  | -                | -                       | -                                | -               | <b>25</b>                      | 24                    |
| M. Johnson            | 25                  | -                | -                       | -                                | -               | <b>25</b>                      | 24                    |
| M. P. Kirk            | 38                  | -                | -                       | -                                | -               | <b>38</b>                      | 37                    |
|                       | <b>448</b>          | <b>33</b>        | <b>22</b>               | <b>24</b>                        | <b>79</b>       | <b>606</b>                     | <b>523</b>            |

**Share options**

The Company does not operate an Executive Share Option Scheme.

**Directors' interests (Audited information)**

The Directors' beneficial holdings of shares in South Downs Capital Limited, the ultimate parent undertaking, are detailed below and, in total, represent 8% of the issued share capital of this holding Company. They have no direct interests in the shares of Portsmouth Water Limited.

|          | 'C' Ordinary Shares |
|----------|---------------------|
| N. Smith | 450                 |

There have been no changes to this shareholding between the 31 March 2017 and the date of this report.

**Directors' emoluments waived during the year**

There were no Directors' emoluments waived during the year.

**Taxable benefits**

Benefits comprise company cars and medical insurance.

The table below provides a breakdown of taxable benefits provided to directors in the period.

|                   | <b>2017<br/>£000</b> | 2016<br>£000 |
|-------------------|----------------------|--------------|
| Car benefit       | <b>25</b>            | 30           |
| Medical insurance | <b>8</b>             | 9            |
| <b>Total</b>      | <b>33</b>            | <b>39</b>    |

**Variable pay/performance measured pay for Executive Directors****Short term annual bonus scheme**

The remuneration package of the Executive Directors, as reported in the accounts, includes a performance related element. The performance related element is based upon the achievement of agreed financial, customer service and personal targets and is paid in the form of a payment at the end of the year.

The Executive Directors can earn up to 20% of basic salary for the annual performance related element. The assessment of this element is based upon:

- 25% based on Customer Service performance including meeting the outcomes agreed at the Final Determination 2014 and being a top performer in the Service Incentive Mechanism. Also includes water quality achievement, interruption to supply, leakage, complaints and abandoned calls.
- 25% Personal Objectives individually set by the Remuneration Committee.
- 50% Financial and Business Objectives such as cost efficiency, reduction in gearing, being top performing SIM company, KPI delivery and zero reportable accidents.

The achievements were:

|                | % of salary (out of possible 20%) | Bonus<br>£ |
|----------------|-----------------------------------|------------|
| H. M. G. Orton | 15.5%                             | 7,353      |
| R. C. Porteous | 15%                               | 15,315     |

The Managing Director does not receive a performance related element. This has been waived due to his shareholding in the holding company, South Downs Capital Limited.

Relative weighting of performance measures as described above for short term variable pay.

|                | Customer Service<br>Measure 1<br>% | Personal Objectives<br>Measure 2<br>% | Financial/<br>Business Objectives<br>Measure 3<br>% | Total<br>% |
|----------------|------------------------------------|---------------------------------------|---|------------|
| H. M. G. Orton | 25                                 | 25                                    | 50  | 100        |
| R. C. Porteous | 25                                 | 25                                    | 50  | 100        |
| N. Smith       | N/A                                | N/A                                   | N/A   | N/A        |

The above weightings convert into maximum percentages of salary payable as follows:

|                | Customer Service<br>Measure 1<br>% | Personal Objectives<br>Measure 2<br>% | Financial/<br>Business Objectives<br>Measure 3<br>% | Total<br>% |
|----------------|------------------------------------|---------------------------------------|---|------------|
| H. M. G. Orton | 5                                  | 5                                     | 10  | 20         |
| R. C. Porteous | 5                                  | 5                                     | 10  | 20         |
| N. Smith       | N/A                                | N/A                                   | N/A   | N/A        |

Summary of directors' performance targets and maximum variable pay achievable.

|                | Customer Service<br>Measure 1<br>Target % | Customer Service<br>Measure 1<br>Value £ | Personal Objectives<br>Measure 2<br>Target % | Personal Objectives<br>Measure 2<br>Value £ | Financial/<br>Business Objectives<br>Measure 3<br>Target % | Financial/<br>Business Objectives<br>Measure 3<br>Value £ | Maximum<br>Variable Pay<br>Achievable<br>2017 | Maximum<br>Variable Pay<br>Achievable<br>2016 |
|----------------|---|--|--|---|--|---|---|---|
| H. M. G. Orton | 5   | 5  | 5  | 5   | 10   | 11  | 21,000  | 8,400   |
| R. C. Porteous | 5   | 5  | 5  | 5   | 10   | 11  | 21,000  | 20,400  |
| N. Smith       | N/A                                       | -  | N/A  | -   | N/A  | -   | -   | -   |

Summary of directors' performance against measures set for the period.

|                | Customer Service<br>Measure 1<br>Achieved % | Customer Service<br>Measure 1<br>Value £ | Personal Objectives<br>Measure 2<br>Achieved % | Personal Objectives<br>Measure 2<br>Value £ | Financial/<br>Business Objectives<br>Measure 3<br>Achieved % | Financial/<br>Business Objectives<br>Measure 3<br>Value £ | Maximum<br>Variable Pay<br>Achieved<br>2017 | Variable Pay<br>Achieved*<br>2016 |
|----------------|---|--|--|---|--|---|---|-----------------------------------|
| H. M. G. Orton | 3.5   | 4  | 4.5  | 5   | 4  | 4   | 13,000                                      | 7,000                             |
| R. C. Porteous | 3.5   | 4  | 4.5  | 5   | 4  | 4   | 13,000                                      | 15,000                            |
| N. Smith       | N/A   | -  | N/A  | -   | N/A  | -   | -   | -                                 |

\*final position awarded in respect of 2015/16 and paid in 2016/17

## Governance

**Remuneration Committee****Long term bonus scheme**

The Directors can earn up to 10% per annum of basic salary for achieving long term objectives over the 5 years of the regulatory period. This long term bonus scheme commenced on 1 April 2015. This payment is made at the end of a five year performance period, subject to the achievement of performance conditions.

The long term objectives, paid in 2020 if achieved include the delivery of a comprehensive Open Water plan, achieving culture change targets, being the top performing company in SIM, refinancing, reducing leakage and per capita consumption, improving credit ratings and migration from the current IT mainframe system.

The maximum percentages of salary payable as follows:

|                | Long -Term<br>Objectives<br>per annum<br>% | 5 Year<br>Total<br>% |
|----------------|--|----------------------|
| R. C. Porteous | 10   | 50                   |
| H. M. G. Orton | 10   | 50                   |
| N. Smith       | 10   | 50                   |

Summary of directors' performance targets and maximum variable pay achievable.

|                | Target % | Long-Term<br>Objectives<br>Value £ | Maximum<br>Variable Pay<br>Achievable<br>2017 | Maximum<br>Variable Pay<br>Achievable<br>2016 |
|----------------|----------|------------------------------------|---|---|
| R. C. Porteous | 10       | 10,730                             | <b>10,730</b>                                 | 10,200  |
| H. M. G. Orton | 10       | 10,515                             | <b>10,515</b>                                 | 4,700   |
| N. Smith       | 0        | N/A                                | <b>14,800</b>                                 | 14,300  |

Summary of directors' performance against measures set for the period.

|                | Achieved % | Long-Term<br>Objectives<br>Value £ | Maximum<br>Variable Pay<br>Achievable<br>2017 | Maximum<br>Variable Pay<br>Achievable<br>2016 |
|----------------|------------|------------------------------------|---|---|
| R. C. Porteous | 7          | 7,243                              | <b>7,243</b>                                  | 7,000   |
| H. M. G. Orton | 7          | 7,098                              | <b>7,098</b>                                  | 3,300   |
| N. Smith       | N/A        | N/A                                | <b>N/A</b>                                    | N/A   |

All variable pay has been awarded in accordance with the remuneration policy and criteria outlined at the commencement of the period. No discretion has been exercised over any variable pay awarded.

Mr. R. C. Porteous and Mrs. H. M. G. Orton also received discretionary payment from the Employee Ownership Trust on the same basis as other employees. Mr. N. Smith, as a shareholder of the Parent Company, is not entitled to payments.

**Pension Entitlements (Audited Information)**

The Company participates in the Brockhampton Pension Scheme to provide pension benefits for its employees, including two of the Executive Directors - Mr. N. Smith and Mr. R. C. Porteous.

Mrs. H. M. G. Orton is a member of the defined contribution scheme. Contributions amounting to £11,205 were made on her behalf by the Company in the year. The Non-Executive Directors are not members of either of the pension schemes.

Benefits in kind relating to company cars are considered to be part of pensionable pay for all employees under both Schemes.

The Executive Directors who have accrued pension benefits under the Brockhampton Pension Scheme, which is a defined benefit scheme, during the year are detailed below:

|                             | Value of<br>increase in<br>scheme<br>benefit<br>2016/17<br>£000 | Directors<br>contributions<br>2016/17<br>£000 | Total<br>included<br>in single<br>figure<br>remuneration<br>table<br>2016/17<br>£000 | Value of<br>increase in<br>scheme<br>benefit<br>2015/16<br>£000 | Directors<br>Contributions<br>2015/16<br>£000 | Total<br>included<br>in single<br>figure<br>remuneration<br>table<br>2015/16<br>£000 | Accrued<br>Pension<br>31/03/17<br>£000pa | Accrued<br>Pension<br>31/03/16<br>£000pa |
|-----------------------------|---|---|--|---|---|--|--|--|
| R. C. Porteous <sup>1</sup> | 37  | 5   | 32   | 67  | 5   | 62   | 56                                       | 54                                       |
| N. Smith <sup>2</sup>       | 44  | 8   | 36   | -   | 8   | -  | 93                                       | 90                                       |

The value of the increase in accrued pension in excess of inflation, less each Directors' own contributions is included in the Directors' single figure remuneration table above.

The accumulated accrued pension is the leaving service benefit to which the Director would be entitled to if he were to leave service at the end of the year. It includes any benefits earned as an employee prior to becoming a Director, as well as those earned for qualifying services after becoming a Director.

<sup>1</sup>The pensionable salary used to calculate Mr. R. C. Porteous' accrued pension excludes £17,772 (2015/16 - £18,325) of non-pensionable salary.

<sup>2</sup>The pensionable salary used to calculate Mr. N. Smith's accrued pension excludes nil (2015/16 - £1,420) of non-pensionable salary.

No additional benefits will become available to directors who retire early. For further details regarding each of the pension schemes, please refer to note 25 in the financial statements.

#### **Payments to Past Directors**

No payments requiring disclosure were made to past directors during the period.

#### **Remuneration of the Managing Director**

The table below summarises the remuneration of the Managing Director for each of the last five financial years. The Managing Director does not receive a performance related element of remuneration. These figures do not include amounts accruing under defined benefit pension arrangements as the figures for historic years are not readily available.

| Year ending 31 March:                       | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|------|------|------|------|------|------|
| Total remuneration excluding pension (£000) | 137  | 153  | 157  | 160  | 162  | 161  |

Fuel benefit removed from 1 April 2016.

The above figures for Managing Director's remuneration are all in respect of Mr. N. Smith.

#### **Percentage Change in Remuneration of the Managing Director**

The following table shows the percentage change in the base salary, benefits and annual bonus of the Managing Director between the current and previous financial year compared to the average for all employees of the Company.

| % change in:              | Managing Director | Average for all employees |
|---------------------------|-------------------|---------------------------|
| Base salary <sup>1</sup>  | 1.0%              | 2.3%                      |
| Benefits <sup>2</sup>     | 0%                | 0%                        |
| Annual bonus <sup>3</sup> | N/A               | N/A                       |

<sup>1</sup>This increase represents the annual pay award.

<sup>2</sup>There were no changes made to the underlying value of benefit payments provided during the year.

<sup>3</sup>This does not include discretionary payments made to employees from the qualifying Employee Ownership Trust.

#### **Statement of Implementation of Remuneration Policy in the Following Financial Year**

The Remuneration Committee intends to continue to apply broadly the same key performance metrics as in the previous year and to assess performance taking account of strategic and annual expectations for the Company.

#### **Approval**

This report was approved by the Board on 25 May 2017 and will be subject to shareholder approval at the Annual General Meeting to be held on 27 July 2017.



**M. P. Johnson**

Chair of the Remuneration Committee

## Governance

# Directors' Report

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 March 2017.

### Principal Activity and Business Review

The principal activity of the Company and a detailed review of its operations, strategy and business model is provided in the Chairman's Statement on page 4 and the Strategic Report on pages 6 to 31.

The Company's Area of Supply is shown on page 1 of this report.

### Financial Risk Management Objectives and Policies

A detailed review of the Company's financial risk management objectives and the policies employed are set out in the Strategic Report on pages 28 and 29.

### Financial Results and Dividends

The Company's profit before taxation amounts to £1.5m (2016 - £4.2m). After adding the tax credit of £0.4m (2016 - deducting the charge of £0.7m), a profit of £1.9m has been transferred to reserves (2016 - £3.5m).

The Directors are recommending the payment of a final dividend of £0.5m.

### Fixed Assets

Capital expenditure on tangible fixed assets was £9.4m (2016 - £9.3m). Information relating to these and other changes in fixed assets is shown in note 13 to the accounts.

The Directors are of the opinion that the current market value of the land and buildings included in tangible fixed assets is in excess of the value shown in the balance sheet. As they are held for operational purposes, no professional valuation has been obtained and the excess has not, therefore, been quantified.

### Board of Directors

The Directors who held office at 25 May 2017 are shown on pages 36 and 37.

Mr. N. Smith and Mr. R. C. Porteous, who retire by rotation, offer themselves for re-election.

The interests of the Directors in Group shares are detailed in the Report on Remuneration on page 42.

The Company maintains appropriate Directors' indemnity insurance.

### Substantial Shareholder

At 31 March 2017, Portsmouth Water Holdings Limited owned the entire voting capital of the Company.

### Regulatory Accounts

A set of accounts for regulatory purposes is required by the Water Services Regulation Authority. These accounts relate solely to the regulated water supply business and copies may be obtained on request from the Registered Office or via our website at [www.portsmouthwater.co.uk](http://www.portsmouthwater.co.uk).

### Employees

Direct communication with employees is maintained through the Company in-house newsletter. In addition, the Joint Information and Consultative Committee met regularly and ensured effective communication with employee representatives.

The Directors consider health and safety to be an important issue within the Company, with the active participation of employee safety representatives taking place through the Health and Safety Committee. During the year, a number of initiatives were undertaken, which ensured that health and safety continues to maintain its high profile throughout the organisation.

The Company has, for the last twelve years, been awarded eleven Gold Awards in the RoSPA Occupational Health and Safety Awards and was also awarded an Industry Sector Award in 2009. In recognition of this the Company has been awarded the President's Award for the past three years.

### Environment

The Company is aware of its obligations to both customers and the environment. In recent years, it has adopted an active approach to environmental issues and further information is set out in the Strategic Report on pages 16 to 21. The total amount of gross Greenhouse Gas Emissions that resulted from the Company's operations in the financial year is estimated to be 11,079 tCO<sub>2</sub>e.

### Licence Requirement

In accordance with its Instrument of Appointment under the Water Industry Act 1991, the Directors are of the opinion that the Company is in compliance with paragraph 3.1 of Condition 'K' of that Instrument.



### Auditors

Following a tender process, the current Auditors, Saffery Champness will retire at the Annual General Meeting. The proposal at that meeting will be to appoint KPMG as Auditors.

In so far as the Directors are aware:

- there is no relevant audit information of which the Company's current auditors are unaware; and
- the Directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the current auditors are aware of that information.

### Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and the profit and loss of the Company for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The Directors are responsible for:

- keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 2006;
- safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities;
- under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Strategic Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the requirements of that law and those regulations. In relation to the latter, the Directors represent that, to the best of their knowledge and belief;
- the financial statements give a true and fair view of the assets, liabilities, financial position and financial result for the year ended 31 March 2017; and
- the Directors' Report, Strategic Report and information referenced therein, taken together, includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that they face.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



By order of the Board

**C. Hardyman ACIS**

Secretary

Havant

25 May 2017

Governance

## Company Information

### Registered Office

PO Box 8  
West Street  
Havant  
Hampshire  
PO9 1LG

Telephone: 023 9249 9888

Fax: 023 9245 3632

[www.portsmouthwater.co.uk](http://www.portsmouthwater.co.uk)

Company Number: 2536455

Company Secretary: Christopher Hardyman ACIS

**Auditors**

Saffery Champness LLP  
71 Queen Victoria Street  
London  
EC4V 4BE

**Bankers**

Lloyds Bank plc  
25 Gresham Street  
London  
EC2V 7HN

**Insurance Brokers**

Willis Watson Towers  
The Anchorage  
34 Bridge Street  
Reading  
Berkshire  
RG1 2LU

# Independent Auditor's Report to the Members

We have audited the financial statements of Portsmouth Water Limited for the year ended 31 March 2017 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows, the related notes and the part of the report on remuneration to be audited. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 102.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Strategic Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of affairs of the company as at 31 March 2017 and of its profit for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and the Strategic Report and the Directors Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report and the Directors' Report.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



**Nicholas Kelsey**  
Senior Statutory Auditor  
1 June 2017

For and on behalf of  
**Saffery Champness LLP**  
Chartered Accountants  
Statutory Auditors  
71 Queen Victoria Street  
London  
EC4V 4BE

# Statement of Financial Position

For the year ended 31 March 2017

|  | notes | 2017<br>£000    | 2017<br>£000    | 2016<br>£000 | 2016<br>£000 |
|--|-------|-----------------|-----------------|--------------|--------------|
| <b>Fixed assets</b>  |       |                 |                 |              |              |
| Intangible fixed assets  | 11    | 2,237           |                 | 77           |              |
| Investment properties  | 12    | 440             |                 | 440          |              |
| Tangible fixed assets  | 13    | 125,255         |                 | 123,003      |              |
| Investments  | 14    | 55,484          |                 | 55,984       |              |
|  |       |                 | <b>183,416</b>  |              | 179,504      |
| <b>Current assets</b>  |       |                 |                 |              |              |
| Investments  | 15    | 2               |                 | 2            |              |
| Stocks   |       | 474             |                 | 592          |              |
| Debtors  | 16    | 10,903          |                 | 7,897        |              |
| Cash at bank and in hand                                       | 17    | 11,644          |                 | 9,206        |              |
|  |       | <b>23,023</b>   |                 | 17,697       |              |
| <b>Creditors: Amounts falling due within one year</b>          | 18    | <b>(22,864)</b> |                 | (16,817)     |              |
|  |       |                 | <b>159</b>      |              | 880          |
| <b>Total assets less current liabilities</b>                   |       |                 | <b>183,575</b>  |              | 180,384      |
| <b>Creditors: Amounts falling due after more than one year</b> | 19    |                 | <b>(99,613)</b> |              | (97,724)     |
| <b>Accruals and deferred income: Capital contributions</b>     | 20    |                 | <b>(25,012)</b> |              | (24,429)     |
| <b>Provisions for liabilities</b>                              | 21    |                 | <b>(6,703)</b>  |              | (6,386)      |
| <b>Net assets excluding pension asset</b>                      |       |                 | <b>52,247</b>   |              | 51,845       |
| Pension asset  | 25    |                 | <b>11,446</b>   |              | 14,575       |
| <b>Net assets including pension asset</b>                      |       |                 | <b>63,693</b>   |              | 66,420       |
| <b>Capital and reserves</b>                                    |       |                 |                 |              |              |
| Called up share capital  | 23    |                 | <b>1,078</b>    |              | 1,078        |
| Share premium account  |       |                 | <b>1,539</b>    |              | 1,539        |
| Capital redemption reserve                                     |       |                 | <b>3,250</b>    |              | 3,250        |
| Profit and loss account  |       |                 | <b>57,826</b>   |              | 60,553       |
| <b>Shareholder funds</b>                                       |       |                 | <b>63,693</b>   |              | 66,420       |

The accompanying notes form an integral part of these accounts.

The accounts were authorised for issue and approved by the Board on 25 May 2017 and signed on its behalf by



**H. M. G. Orton**  
Director

Company Number: 2536455

# Income Statement

For the year ended 31 March 2017

|  | notes | 2017<br>£000    | 2016<br>£000 |
|--|-------|-----------------|--------------|
| <b>Turnover</b>  | 3     | <b>40,342</b>   | 39,795       |
| <b>Cost of sales</b>   |       | <b>(22,872)</b> | (19,756)     |
| <b>Gross profit</b>  |       | <b>17,470</b>   | 20,039       |
| Net operating expenses   | 4     | <b>(11,720)</b> | (11,837)     |
| <b>Operating profit before loss on disposal of fixed assets</b>  |       | <b>5,750</b>    | 8,202        |
| Loss on disposal of fixed assets   | 6     | <b>(143)</b>    | (562)        |
| <b>Operating profit after loss on disposal of fixed assets and profit on ordinary activities before interest</b> |       | <b>5,607</b>    | 7,640        |
| Investment income  | 7     | <b>953</b>      | 996          |
| Other finance income   | 25    | <b>625</b>      | 382          |
| Interest payable and similar charges   | 8     | <b>(5,696)</b>  | (4,778)      |
| <b>Profit on ordinary activities before taxation</b>   | 6     | <b>1,489</b>    | 4,240        |
| Taxation of profit on ordinary activities  | 9     | <b>368</b>      | (712)        |
| <b>Profit for the financial year</b>   |       | <b>1,857</b>    | 3,528        |

The accompanying notes form an integral part of these accounts.

The income statement has been prepared on the basis that all operations are continuing operations (note 30).

# Statement of Other Comprehensive Income

For the year ended 31 March 2017

|   | notes | 2017<br>£000   | 2016<br>£000 |
|---|-------|----------------|--------------|
| Profit for the financial year                             |       | <b>1,857</b>   | 3,528        |
| Remeasurement of net defined benefit asset                | 25    | <b>(4,147)</b> | 6,274        |
| Movement on deferred tax relating to pension asset        | 21    | <b>705</b>     | (1,129)      |
| Effect of change to corporation tax rate on pension asset | 21    | <b>63</b>      | 225          |
| <b>Total comprehensive (loss)/income for the year</b>     |       | <b>(1,522)</b> | 8,898        |

# Statement of Changes in Equity

For the year ended 31 March 2017

|   | Called up<br>share<br>capital<br>£000 | Share<br>Premium<br>account<br>£000 | Capital<br>redemption<br>reserve<br>£000 | Retained<br>earnings<br>£000 | Total<br>£000 |
|---|---------------------------------------|-------------------------------------|--|------------------------------|---------------|
| Balance as at 1 April 2015                                | 1,078                                 | 1,539                               | 3,250                                    | 52,820                       | 58,687        |
| Profit for the year                                       | -                                     | -                                   | -  | 3,528                        | 3,528         |
| Remeasurement of net defined benefit asset                | -                                     | -                                   | -  | 6,274                        | 6,274         |
| Movement on deferred tax relating to pension scheme       | -                                     | -                                   | -  | (1,129)                      | (1,129)       |
| Effect of change to corporation tax rate on pension asset | -                                     | -                                   | -  | 225                          | 225           |
| Total comprehensive income for the year                   | -                                     | -                                   | -  | 8,898                        | 8,898         |
| Dividends   | -                                     | -                                   | -  | (1,165)                      | (1,165)       |
| Balance at 31 March 2016                                  | 1,078                                 | 1,539                               | 3,250                                    | 60,553                       | 66,420        |
| Profit for the year                                       | -                                     | -                                   | -  | 1,857                        | 1,857         |
| Remeasurement of net defined benefit asset                | -                                     | -                                   | -  | (4,147)                      | (4,147)       |
| Movement on deferred tax relating to pension scheme       | -                                     | -                                   | -  | 705                          | 705           |
| Effect of change to corporation tax rate on pension asset | -                                     | -                                   | -  | 63                           | 63            |
| Total comprehensive loss for the year                     | -                                     | -                                   | -  | (1,522)                      | (1,522)       |
| Dividends   | -                                     | -                                   | -  | (1,205)                      | (1,205)       |
| <b>Balance at 31 March 2017</b>                           | <b>1,078</b>                          | <b>1,539</b>                        | <b>3,250</b>                             | <b>57,826</b>                | <b>63,693</b> |

The retained earnings balance represents accumulated profits and losses, including unrealised profits on the remeasurement of investment properties, net of dividends paid and other adjustments. As at 31 March 2017 £57.538m (2016 - £60.265m) was distributable in accordance with company law and £0.288m (2016 - £0.288m) was not distributable.

The share premium reserve contains the premium arising on the issue of equity shares, net of issue costs.

# Statement of Cash Flows

For the year ended 31 March 2017

|  | notes | 2017<br>£000 | 2017<br>£000   | 2016<br>£000 | 2016<br>£000   |
|--|-------|--------------|----------------|--------------|----------------|
| <b>Cash generated from operations</b>                    | 24    |              | <b>10,589</b>  |              | 13,651         |
| UK corporation tax paid                                  |       | (555)        |                | (180)        |                |
| Net payments for group relief                            |       | (167)        |                | (107)        |                |
|  |       |              | <b>(722)</b>   |              | <b>(287)</b>   |
| <b>Net cash inflow from operating activities</b>         |       |              | <b>9,867</b>   |              | 13,364         |
| <b>Cash flows from investing activities</b>              |       |              |                |              |                |
| Purchase of tangible assets                              |       | (11,144)     |                | (8,613)      |                |
| Purchase of intangible fixed assets                      |       | (823)        |                | -            |                |
| Capital contributions received                           |       | 1,165        |                | 1,194        |                |
| Sale of tangible fixed assets                            |       | 37           |                | 34           |                |
| Interest received  |       | 953          |                | 1,001        |                |
| <b>Net cash used in investing activities</b>             |       |              | <b>(9,812)</b> |              | <b>(6,384)</b> |
| <b>Cash flows from financing activities</b>              |       |              |                |              |                |
| Proceeds from sale of non-household retail activities*   | 30    | 2,900        |                | -            |                |
| Loan repayment from group companies                      |       | 500          |                | 350          |                |
| Receipts from borrowings                                 |       | 4,000        |                | -            |                |
| Equity dividends paid                                    |       | (1,205)      |                | (1,165)      |                |
| Interest paid  |       | (3,812)      |                | (3,735)      |                |
| <b>Net cash generated/(used in) financing activities</b> |       |              | <b>2,383</b>   |              | <b>(4,550)</b> |
| <b>Net increase in cash and cash equivalents</b>         |       |              | <b>2,438</b>   |              | 2,430          |
| Cash and cash equivalents at beginning of year           |       |              | <b>9,206</b>   |              | 6,776          |
| <b>Cash and cash equivalents at end of year</b>          | 17    |              | <b>11,644</b>  |              | 9,206          |

\*Payment in advance which includes the fair value of future meter reading services (note 30).



# Notes to the Financial Statements

For the year ended 31 March 2017

## 1. Accounting policies

Portsmouth Water Limited is a private company incorporated in England and Wales under the Companies Act 2006. The Company's registered office is PO Box 8, West Street, Havant, PO9 1LG and the registered number is 2536455.

The financial statements of Portsmouth Water Limited have been prepared in compliance with UK Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" ("FRS 102") and the Companies Act 2006.

The principal accounting policies applied in the preparation of these financial statements are set out below. The financial statements are presented in pounds sterling.

The Company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it in respect of its financial statements. Exemptions have been taken from disclosing information relating to financial instruments and key management personnel remuneration. The Company's financial statements have been consolidated into the accounts of South Downs Capital Limited, copies of which are available from the registered office.

In view of the licence conditions under which the Company operates as a water supplier, it is required to publish information about its annual results as if it were a company covered by the listing Rules of the Financial Conduct Authority, except where it is considered inappropriate to do so. Earnings per share disclosures are not presented as the Company is a wholly owned subsidiary. Segmental reporting has not been presented as, in the opinion of the Directors, the Company undertakes a single activity.

The principal accounting policies are as follows:

### 1.1 Basis of preparation

These financial statements have been prepared on a going concern basis, under the historical cost convention, as modified by the revaluation of certain assets which have been measured at fair value.

The preparation of financial statements requires the use of critical accounting estimates. They also require management to estimate judgement in the application of group accounting policies. Those areas that involve a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 2.

### 1.2 Going concern

The Company meets its day to day working capital requirements through its bank facilities including a £4m overdraft facility. Where necessary, in order to meet the needs of significant investment activities, the Company utilises a £10m revolving credit facility. The Company's forecasts and projections, taking account of reasonably possible changes in cash collection, infrastructure renewals & capital activity and ongoing servicing of debt, together with its financing covenant requirements, show that the Company should be able to continue to operate within the level of its current facilities. After making appropriate enquiries the Directors have a reasonable expectation that the Company will continue in operational existence for the foreseeable future. The Company, therefore, continues to adopt the Going Concern basis of preparation of the financial statements.

### 1.3 Turnover

Turnover, which excludes value added tax, represents the income receivable for goods and services provided to external customers in the ordinary course of business. It comprises the value of water supplied and other related charges. Revenue is recognised at the fair value of the consideration received or receivable.

Turnover from the regulated water business includes amounts billed for the year, together with an estimation of amounts unbilled at the year-end, for measured water customers.

Unmeasured income bills are based on the rateable value of properties. Unmeasured customers are billed annually in advance on 1 June and amounts invoiced in advance are not recognised in turnover until earned. Measured income arises from customers who have meters fitted at their premises and amounts billed, therefore, are based on actual water consumption. The estimation of the amounts unbilled at the year end uses a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

Turnover includes the amortisation of capital contributions received in connection with the enhancement of mains infrastructure. This is set out further below.

### 1.4 Investment properties

The Directors consider certain holdings of freehold land and buildings to be investment properties. In accordance with FRS 102, they are included in the statement of financial position at their open market value. The surplus or deficit on revaluation is recognised in the profit or loss for the year, along with the related deferred tax charge or credit. Depreciation is not provided in respect of these holdings. It is the Company's policy to obtain an external third party valuation of 1/5th of the property portfolio on a rolling basis with the remainder being valued based on a management review and using relevant indices.

# Notes to the Financial Statements

## 1.5 Tangible fixed assets

The Company holds both above ground assets and a below ground infrastructure network of mains.

### Mains infrastructure (below ground assets)

Infrastructure assets comprise a network of mains, communications pipes and boundary boxes. The Company undertakes expenditure on this network in order to maintain it in an ongoing serviceable condition. Where this expenditure meets certain criteria (set out below) it is capitalised. All other expenditure is expensed as incurred.

Expenditure on infrastructure assets relating to increases in capacity or other economic enhancement is capitalised. Other economic enhancements relate primarily to the installation of new boundary boxes, schemes addressing specific water quality issues or areas where mains have been diverted to avoid damage.

Such items are treated as additions and included in property, plant and equipment at cost. The cost of infrastructure assets is their purchase cost, together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company.

The assets are depreciated over their useful lives of between 40 and 100 years on a straight line basis. There are no expected residual values.

### Other fixed assets (above ground assets)

Other assets comprise buildings and reservoirs, pumping plant, vehicles, mobile plant and office equipment. The cost of other assets is the purchase cost, together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company.

Depreciation is provided on all fixed assets, with the exception of freehold land. It is calculated to write off the cost of assets over their estimated useful economic lives using the straight line method. There are no expected residual values. Those lives are estimated as follows:

Building and reservoirs 100 years  
Pumping and other plant (including solar panels) 15-25 years  
Office equipment 5-10 years  
Vehicles and mobile Plant 5-7 years  
Computer and network hardware 5 years

### Assets in the course of construction

Assets in the course of construction are included in tangible fixed assets at cost but are not depreciated until they come into use.

## 1.6 Intangible fixed assets other than goodwill

Intangible assets acquired separately from a business are recognised at cost and are subsequently measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised so as to write off the cost or valuation of assets over their useful lives on the following basis:

Software (acquired before 31 March 2016) 5 years  
Software (acquired after 31 March 2016) 3 years  
Consultancy and internal staff costs (acquired before 31 March 2016) 5 years  
Consultancy and internal staff costs (acquired after 31 March 2016) 3 years

### Intangible assets in the course of construction

Intangible assets in the course of construction are included in intangible fixed assets at cost but are not amortised until they come into use. The purchase date may therefore place them in one category but the commencement of their economic life places them in another. Where this occurs the post March 2016 policy shall apply.

## 1.7 Capital contributions

### Mains contributions

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. In accordance with the Companies Act 2006 and FRS 102 requirements to include fixed assets at cost, such contributions are treated as deferred income and released to the income statement over the useful economic life of the corresponding assets.

### Infrastructure charges

Infrastructure charges are made in respect of new connections in accordance with Condition 'C' of the Instrument of Appointment. These charges are treated as mains contributions as explained above.

## 1.8 Financial Instruments

Financial assets and financial liabilities are recognised when the Company becomes party to the contractual provisions of the instrument.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for financial assets classified as fair value through profit and loss, which are initially measured at fair value (normally transaction price excluding transaction cost).

If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Debt instruments which meet the applicable conditions are recognised as basic financial instruments and subsequently measured at amortised cost using the effective interest rate method. Instruments that are payable or receivable within one year of initial recognition and meet the applicable conditions are measured at the undiscounted amount of consideration expected to be paid or received, net of impairment.

Financial assets are derecognised when and only when the contractual rights to the cash flows from the financial assets expire or are settled, or the company transfers substantially all of the risks and rewards of ownership of the financial asset.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

#### **Investments**

Investments consist of non-current and current investments.

Non-current investments are in respect of loans to group companies. They are measured at amortised cost using the effective interest rate method.

Current asset investments are held at cost less impairment since fair value cannot be measured reliably.

#### **1.9 Impairment**

Assets other than those measured at fair value, are assessed for indicators of impairment at each statement of financial position date. If there is objective evidence of impairment, an impairment loss is recognised in the income statement.

#### **Non-financial assets**

Assets are impaired when evidence indicates that the assets recoverable amount is less than its carrying amount. Recoverable amount is the lower of fair value less cost to sell and its value in use.

#### **Financial assets**

For financial assets carried at amortised cost, the amount of impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial assets original effective interest rate.

For financial assets carried at cost less impairment, the impairment loss is the difference between the asset's carrying amount and the best estimate of the amount that would be received for the asset if it were to be sold at the reporting date.

#### **1.10 Stocks**

Stocks of raw materials are valued on a weighted average cost basis at the lower of cost or net realisable value. In accordance with established practice in the water industry, no value is placed upon the water in reservoirs, mains or in the course of treatment.

#### **1.11 Taxation**

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax is recognised on all timing differences where the transactions or events that give the Company an obligation to pay more tax in the future, or the right to pay less tax in the future, have occurred by the statement of financial position date. Deferred tax assets are recognised when it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax is recognised when assets are revalued and the gain or loss expected to arise on sale has been recognised in the financial statements.

#### **1.12 Leases**

All leases are regarded as operating leases. Operating lease payments are charged to the income statement on a straight line basis over the lease term. Lease income is recognised on a straight line basis over the lease term.

#### **1.13 Pension costs and other post-retirement benefits**

Portsmouth Water Limited, a subsidiary undertaking, is the principal employer and its parent company, Brockhampton Holdings Limited, is the participating employer in the Brockhampton Pension Scheme. This scheme is a defined benefit scheme. The assets of the scheme are held in a separate trustee administered fund. As principal employer Portsmouth Water includes the pension asset in its financial statements.

# Notes to the Financial Statements

The current service costs are charged to the income statement and included as staff employment costs. The interest cost and interest income are shown as a net amount within other finance income. Re-measurements of the net defined benefit asset are recognised immediately in other comprehensive income.

Pension scheme liabilities are measured on an actuarial basis using a projected unit method and are discounted to their present value using the AA corporate bond rate.

Pension scheme assets are valued at fair value at the statement of financial position date. The pension scheme surplus is recognised in full on the statement of financial position.

The deferred tax relating to a defined benefit asset is offset against the defined benefit asset and not included with other deferred tax liabilities. Detailed information regarding the surplus and actuarial position of the scheme is given in note 25 to the accounts.

The Company also operates a defined contribution pension scheme. The charge to the income statement amounts to the contributions payable to the scheme in respect of the accounting period.

## 1.14 Provisions

A provision is recognised when the Company has a legal or constructive obligation as a result of past events and it is probable that an outflow of economic benefits will be required to settle the obligation. The effect of the time value of money is not material and therefore the provisions are not discounted.

## 2. Critical accounting judgements and key sources of estimation uncertainty

Estimates and judgements are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting estimates made will, by definition, seldom equal the actual results that out-turn over time.

Those estimates and assumptions that have a risk of causing a material adjustment to the carrying values of assets and liabilities within the next financial year are set out below;

### Estimation of unbilled measured income

As set out in note 1.3 above, the estimation of the amounts unbilled at the year end uses a defined methodology based upon valuing an estimate of unbilled water consumed. This is calculated using known factors such as the date of the customers' last bill and the customer tariff rate together with an estimate of the water consumed. The estimated water consumed is calculated from various factors including; the number of days elapsed since the last meter read, historical consumption levels for each premises (which is calculated from historical customer billing data) or estimated average consumption per property type (where a historic actual is not available). The assumptions reflect historic experience and current data. Management review both the data sets used, the outcome of the calculation and quarterly trends in determining the year end position.

### Useful Economic lives of Mains Infrastructure

By the nature of below ground assets it is more difficult to directly establish remaining estimated useful economic lives ("UEL"). In setting the UELs the directors have consideration of a number of factors including the age and construction material of the pipes, historic experience in relation to both replacement & burst rates and industry averages.

### Defined benefit pension scheme

The Company has obligations to pay pension benefits to certain employees and former employees. The cost of these benefits and the present value of the related obligation depend upon a number of factors including; life expectancy, salary increase, asset valuations and the discount rate based on corporate bonds. Management estimate these factors in determining the net pension obligation in the balance sheet. The assumptions reflect historic experience and current trends and are set in consultation with appropriately qualified and experienced professional advisors.

## 3. Turnover

|   | 2017<br>£000  | 2016<br>£000  |
|---|---------------|---------------|
| Unmeasured supplies                     | 21,637        | 21,545        |
| Measured supplies                       | 17,068        | 16,126        |
| Bulk supply                             | 60            | 107           |
| Amortisation of developer contributions | 582           | 582           |
| Chargeable work                         | 995           | 1,435         |
|   | <b>40,342</b> | <b>39,795</b> |

Turnover is wholly attributable to water supply and related activities in the United Kingdom. Included within turnover is non-household retail revenue totalling £0.562m (note 30).

## 4. Net operating expenses

|                         | 2017<br>£000  | 2016<br>£000  |
|-------------------------|---------------|---------------|
| Administrative expenses | 12,175        | 12,219        |
| Other operating income  | (455)         | (382)         |
|                         | <b>11,720</b> | <b>11,837</b> |

**5. Directors and employees**

|  | <b>2017</b>   | 2016   |
|--|---------------|--------|
|  | <b>£000</b>   | £000   |
| <b>Employment costs:</b>                             |               |        |
| Wages and salaries                                   | <b>8,948</b>  | 8,774  |
| Social security costs                                | <b>881</b>    | 736    |
| Defined benefit pension costs (note 25)              | <b>1,738</b>  | 1,495  |
| Defined contribution pension costs (note 25)         | <b>185</b>    | 136    |
|  | <b>11,752</b> | 11,141 |
| Transferred to capital schemes                       | <b>(560)</b>  | (682)  |
| Net employment costs charged to the income statement | <b>11,192</b> | 10,459 |

**Average numbers employed during year:**

|                | <b>2017</b>   | 2016   |
|----------------|---------------|--------|
|                | <b>Number</b> | Number |
| Operations     | <b>150</b>    | 148    |
| Administration | <b>105</b>    | 103    |
|                | <b>255</b>    | 251    |

|                        | <b>Highest Paid Director</b> | Highest Paid Director | <b>Total</b> | Total |
|------------------------|------------------------------|-----------------------|--------------|-------|
|                        | <b>2017</b>                  | 2016                  | <b>2017</b>  | 2016  |
|                        | <b>£000</b>                  | £000                  | <b>£000</b>  | £000  |
| Total remuneration     | <b>161</b>                   | 162                   | <b>527</b>   | 456   |
| Pension scheme benefit | <b>36</b>                    | -                     | <b>79</b>    | 67    |
|                        | <b>197</b>                   | 162                   | <b>606</b>   | 523   |

1 Director (2016 - 1) is accruing benefits under a defined contribution pension scheme. The number of Directors for whom retirement benefits are accruing under defined benefit pension schemes amounted to 2 (2016 - 2).

No payments were made in respect of compensation for loss of office.

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 42 to 47. The information set out in that Report which is subject to audit forms part of these financial statements.

**6. Profit on ordinary activities before taxation**

|  | <b>2017</b>  | 2016  |
|--|--------------|-------|
|  | <b>£000</b>  | £000  |
| Profit on ordinary activities is stated after charging:                              |              |       |
| Depreciation   |              |       |
| - infrastructure assets  | <b>1,082</b> | 1,483 |
| - non infrastructure assets  | <b>4,145</b> | 4,626 |
| Amortisation of intangible assets  | <b>367</b>   | 50    |
| Loss on disposal of fixed assets   | <b>143</b>   | 562   |
| Rates  | <b>2,163</b> | 2,069 |
| Water abstraction charges  | <b>1,322</b> | 1,322 |
| Hire of plant and machinery  | <b>8</b>     | 23    |
| Operating lease charges  | <b>191</b>   | 192   |
| Auditors' remuneration:  |              |       |
| Fees payable to the Company's auditor for the audit of the Company's annual accounts | <b>37</b>    | 32    |
| Fees payable to the Company's auditor for other services:                            |              |       |
| Audit related assurance services   | <b>14</b>    | 53    |
| Taxation compliance services   | <b>17</b>    | 5     |
| Other non-audit services   | <b>3</b>     | 3     |
| Fees in respect of the Brockhampton Pension Scheme: Audit*                           | <b>3</b>     | 3     |

\*Not paid by the Company

# Notes to the Financial Statements

| <b>7. Investment income</b>    | <b>2017</b> | <b>2016</b> |
|--------------------------------|-------------|-------------|
|                                | <b>£000</b> | <b>£000</b> |
| On loan from group company     | 914         | 967         |
| Interest on short term deposit | 39          | 26          |
| Other interest receivable      | -           | 3           |
|                                | <b>953</b>  | <b>996</b>  |

| <b>8. Interest payable and similar charges</b> | <b>2017</b>  | <b>2016</b>  |
|--|--------------|--------------|
|  | <b>£000</b>  | <b>£000</b>  |
| £66.5m loan:                                   |              |              |
| Interest                                       | 3,621        | 3,564        |
| Indexation                                     | 1,831        | 994          |
| Amortisation of fees                           | 57           | 57           |
| Administration fees                            | 79           | 110          |
| Other bank loans and overdraft                 | 97           | 41           |
| Debenture stock                                | 10           | 10           |
| Other interest payable                         | 1            | 2            |
|  | <b>5,696</b> | <b>4,778</b> |

| <b>9. Taxation</b>   | <b>2017</b>  | <b>2016</b>  |
|--|--------------|--------------|
|  | <b>£000</b>  | <b>£000</b>  |
| <b>Current tax</b>   |              |              |
| United Kingdom corporation tax at 20% (2016 - 20%)             | 191          | 1,172        |
| Adjustment in respect of prior periods                         | (789)        | 64           |
|  | <b>(598)</b> | <b>1,236</b> |
| <b>Deferred tax</b>  |              |              |
| Origination and reversal of timing differences                 | 141          | 132          |
| Effect of change to corporation tax rate                       | (501)        | (695)        |
| Difference between pension cost charge and pension cost relief | 28           | 39           |
| Adjustment in respect of prior periods                         | 562          | -            |
|  | <b>230</b>   | <b>(524)</b> |
| <b>Tax on profit on ordinary activities</b>                    | <b>(368)</b> | <b>712</b>   |

|  |              |            |
|--|--------------|------------|
| <b>Factors affecting the tax charge for the year</b>   |              |            |
| Profit on ordinary activities before tax   | 1,489        | 4,240      |
| Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2016 - 20%) | 298          | 848        |
| Effect of:   |              |            |
| Expenses not deductible for tax purposes   | 2            | 68         |
| Depreciation on assets not qualifying for capital allowances   | 89           | 100        |
| Effect of change in tax rate   | (501)        | (695)      |
| Other tax adjustments  | (29)         | 88         |
| Prior year adjustment - current tax  | (789)        | 64         |
| Prior year adjustment - deferred tax   | 562          | 239        |
| <b>Total tax charge for year</b>   | <b>(368)</b> | <b>712</b> |

No deferred tax balances are expected to reverse during the year to March 2018 (2017 - £nil).

| <b>10. Dividends</b>                 | <b>2017</b>  | <b>2016</b>  |
|--------------------------------------|--------------|--------------|
|                                      | <b>£000</b>  | <b>£000</b>  |
| <b>Equity: Ordinary/"A" Ordinary</b> |              |              |
| Interim paid                         | 602          | 585          |
| Final paid                           | 603          | 580          |
|                                      | <b>1,205</b> | <b>1,165</b> |

The directors are proposing the payment of a final dividend of £0.546m for the year ended 31 March 2017. This dividend has not been accounted for within the current year financial statements, as it has yet to be approved.

**11. Intangible fixed assets**

|  | Software,<br>consultancy<br>and internal<br>staff costs<br>£000 |
|--|---|
| <b>Cost</b>                                |   |
| At 1 April 2016                            | 127   |
| Transferred from fixed assets              | 1,895   |
| Additions                                  | 823   |
| Disposals                                  | (5)   |
| At 31 March 2017                           | 2,840   |
| <b>Amortisation</b>                        |   |
| At 1 April 2016                            | 50  |
| Transferred from fixed assets depreciation | 188   |
| Disposals                                  | (2)   |
| Charge for year                            | 367   |
| At 31 March 2017                           | 603   |
| <b>Net book value</b>                      |   |
| At 31 March 2017                           | 2,237   |
| At 31 March 2016                           | 77  |

Intangible fixed assets primarily comprise software costs and the in house development of bespoke software and related IT solutions. Included in the numbers above are £25,000 intangibles work in progress.

**12. Investment properties**

|                                    | Investment<br>properties<br>£000 |
|------------------------------------|----------------------------------|
| <b>Valuation</b>                   |                                  |
| At 31 March 2016 and 31 March 2017 | 440                              |

The historic cost of the investment properties at 31 March 2017 was £0.195m (2016 - £0.195m)

Investment properties were revalued at open market value as at 31 March 2017 by Vail Williams LLP, an independent valuer. The property portfolio is valued on a five year cyclical basis with 1/5 of properties valued independently each year. This is then used as the basis of a Directors valuation to update the value of the total portfolio. The method of determining fair value was on an open market basis taking account of RICS guidance. There was no material uplift in values for the year.

There are no restrictions on the realisability of investment property. There are no contractual obligations to purchase, construct or develop investment property or to make any repairs or enhancements.

# Notes to the Financial Statements

## 13. Tangible fixed assets

|   | Freehold land,<br>buildings,<br>& reservoirs<br>£000 | Mains<br>£000 | Pumping<br>£000 | Vehicles,<br>mobile plant<br>& office<br>£000 | Total<br>£000 |
|---|--|---------------|-----------------|---|---------------|
| <b>Cost</b>                                 |  |               |                 |   |               |
| At 1 April 2016                             | 53,114   | 55,171        | 46,684          | 19,768  | 174,737       |
| Additions                                   | 1,856  | 1,442         | 4,418           | 1,647   | 9,363         |
| Revaluation                                 | -  | -             | -               | -   | -             |
| Disposals                                   | (84)   | (74)          | (306)           | (429)   | (893)         |
| Reclassification to intangible fixed assets | -  | -             | -               | (1,895)                                       | (1,895)       |
| At 31 March 2017                            | 54,886   | 56,539        | 50,796          | 19,091  | 181,312       |
| <b>Depreciation</b>                         |  |               |                 |   |               |
| At 1 April 2016                             | 12,259   | 2,717         | 24,177          | 12,581  | 51,734        |
| Charge for year                             | 516  | 1,082         | 2,083           | 1,546   | 5,227         |
| Disposals during year                       | (33)   | (27)          | (257)           | (399)   | (716)         |
| Reclassification to intangible fixed assets | -  | -             | -               | (188)   | (188)         |
| At 31 March 2017                            | 12,742   | 3,772         | 26,003          | 13,540  | 56,057        |
| <b>Net book value</b>                       |  |               |                 |   |               |
| At 31 March 2017                            | 42,144   | 52,767        | 24,793          | 5,551   | 125,255       |
| At 31 March 2016                            | 40,855   | 52,454        | 22,507          | 7,187   | 123,003       |

## Assets in the course of construction

Included in the above are assets in the course of construction as follows:

|  | Freehold land,<br>buildings,<br>& reservoirs<br>£000 | Mains<br>£000 | Pumping<br>Plant<br>£000 | Vehicles,<br>mobile plant<br>& office<br>equipment<br>£000 | Total<br>£000 |
|--|--|---------------|--------------------------|--|---------------|
| <b>Cost</b>  |  |               |                          |  |               |
| At 1 April 2016  | 239  | -             | 3,707                    | 2,122  | 6,068         |
| Transferred to intangible fixed assets                     | -  | -             | -                        | (1,895)  | (1,895)       |
| Completed tangible fixed assets                            | (239)  | -             | (3,707)                  | (227)  | (4,173)       |
| Additions  | 727  | 196           | 886                      | 37   | 1,846         |
| At 31 March 2017   | 727  | 196           | 886                      | 37   | 1,846         |
| <b>Depreciation</b>  |  |               |                          |  |               |
| At 1 April 2016  | -  | -             | -                        | 188  | 188           |
| Transferred to amortisation within intangible fixed assets | -  | -             | -                        | (188)  | (188)         |
| At 31 March 2017   | -  | -             | -                        | -  | -             |
| <b>Net book value</b>                                      |  |               |                          |  |               |
| At 31 March 2017   | 727  | 196           | 886                      | 37   | 1,846         |
| At 31 March 2016   | 239  | -             | 3,707                    | 1,934  | 5,880         |

## 14. Fixed asset investments

|                   | Loans to Group undertakings<br>£000 |
|-------------------|-------------------------------------|
| At 1 April 2016   | 55,984                              |
| Repayment of loan | (500)                               |
| At 31 March 2017  | 55,484                              |

Non-current asset investments represent a loan to the parent entity South Downs Limited. These loans are repayable other than by instalments and are held at amortised cost.

## 15. Current asset investments

|                                      | Unlisted<br>Investments<br>£000 |
|--------------------------------------|---------------------------------|
| As at 1 April 2016 and 31 March 2017 | 2                               |



**16. Debtors**

|                                | <b>2017</b>   | 2016  |
|--------------------------------|---------------|-------|
|                                | <b>£000</b>   | £000  |
| Trade debtors                  | <b>4,950</b>  | 3,631 |
| Amount owed by Group companies | <b>281</b>    | 14    |
| Prepayments and accrued income | <b>4,507</b>  | 3,845 |
| Other debtors                  | <b>1,165</b>  | 407   |
|                                | <b>10,903</b> | 7,897 |

All of the above amounts fall due within one year. Included within other debtors is corporation tax recoverable of £0.695m (2016 - creditor £0.361m).

As at 31 March 2017, trade debtors had a carrying value of £8.833m (2016 - £7.176m) before provision for bad debt. Trade debtors in arrears are provided for on a sliding scale depending on age of debt. The amount of the provision was £3.883m as at 31 March 2017 (2016 - £3.545m).

The ageing of these debtors was as follows:

|                 | <b>2017</b>  | 2016  |
|-----------------|--------------|-------|
|                 | <b>£000</b>  | £000  |
| Up to 12 Months | <b>4,414</b> | 4,040 |
| Over 12 Months  | <b>4,419</b> | 3,136 |
|                 | <b>8,833</b> | 7,176 |

The debtors provided for are mainly in respect of water charges for household customers where experience in the water industry has shown over time that it is likely that there will be difficulties in recovering the water charges for the periods concerned.

|   | <b>2017</b>  | 2016  |
|---|--------------|-------|
|   | <b>£000</b>  | £000  |
| At 1 April 2016                               | <b>3,545</b> | 3,355 |
| Provision for bad debt required in the year   | <b>784</b>   | 809   |
| Debt written off in the year as uncollectable | <b>(446)</b> | (619) |
| At 31 March 2017                              | <b>3,883</b> | 3,545 |

The other classes within debtors do not contain balances that may be irrecoverable. The maximum exposure to credit risk at the reporting date is the fair value of each class of debtor mentioned above. The Company does not hold any collateral as security.

**17. Cash at bank and in hand**

Of the total amount shown of £11.644m (2016 - £9.206m), £1.847m (2016 - £1.801m) is held specifically for the payment of the next half yearly loan interest charges.

|                          | <b>2017</b>   | 2016  |
|--------------------------|---------------|-------|
|                          | <b>£000</b>   | £000  |
| Cash at bank and in hand | <b>11,644</b> | 9,206 |

**18. Creditors: amounts falling due within one year**

|  | <b>2017</b>   | 2016   |
|--|---------------|--------|
|  | <b>£000</b>   | £000   |
| 3% Perpetual debenture stock                     | <b>60</b>     | 60     |
| 3½% Perpetual debenture stock                    | <b>185</b>    | 185    |
| 4% Perpetual debenture stock                     | <b>39</b>     | 39     |
| Payments received on account                     | <b>2,351</b>  | 4,114  |
| Trade creditors                                  | <b>2,759</b>  | 1,800  |
| Amounts owed to group companies                  | <b>1,571</b>  | 1,640  |
| Social security and other taxation               | <b>280</b>    | 624    |
| Other creditors                                  | <b>3,685</b>  | 411    |
| Balance outstanding on revolving credit facility | <b>4,000</b>  | -      |
| Accruals   | <b>1,510</b>  | 1,010  |
| Water rates in advance                           | <b>6,424</b>  | 6,934  |
|  | <b>22,864</b> | 16,817 |

Included in creditors is a liability for current year Corporation Tax of £nil (2015 - £0.361m).

# Notes to the Financial Statements

## 19. Creditors: amounts falling due after more than one year

|                                  | 2017<br>£000  | 2016<br>£000  |
|----------------------------------|---------------|---------------|
| <b>In five years or more:</b>    |               |               |
| Bank loan                        | 100,494       | 98,662        |
| Less: deferred arrangement costs | (881)         | (938)         |
|                                  | <b>99,613</b> | <b>97,724</b> |

The thirty year £66.5m index-linked loan was issued on 26 June 2002, is repayable on 30 September 2032, and is secured upon the assets of the Company. The capital value of the loan is adjusted by the change in the Retail Prices Index from year to year. The fees associated with the loan issue of £1.722m are amortised over the life of the loan. The balance shown above is net of deferred arrangement costs of £0.881m (2016 - £0.938m).

The loan interest is calculated by adjusting the value of the loan by the Retail Prices Index and then charging interest on this amount at 3.635% per annum.

## 20. Deferred income: Capital contributions

|   | 2017<br>£000  | 2016<br>£000  |
|---|---------------|---------------|
| Capital contributions                       | 25,594        | 25,011        |
| Release of capital contribution to turnover | (582)         | (582)         |
|   | <b>25,012</b> | <b>24,429</b> |

## 21. Provisions for liabilities

|  | 2017<br>£000 | 2016<br>£000 |
|--|--------------|--------------|
| <b>Deferred taxation:</b>                              |              |              |
| At 1 April 2016  | 6,386        | 6,949        |
| Charged/(credited) during the year in income statement | 317          | (563)        |
| At 31 March 2017                                       | <b>6,703</b> | <b>6,386</b> |

The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation.

|   | 2017<br>£000 | 2016<br>£000 |
|---|--------------|--------------|
| <b>Total deferred taxation including deferred tax on pension asset:</b> |              |              |
| Accelerated capital allowances  | 8,068        | 9,905        |
| Other timing differences  | (1,365)      | (3,519)      |
|   | <b>6,703</b> | <b>6,386</b> |
| Pension asset (note 25)   | 2,344        | 3,200        |
| Total provision for deferred tax  | <b>9,047</b> | <b>9,586</b> |

|  | 2017<br>£000 | 2016<br>£000 |
|--|--------------|--------------|
| At 1 April 2016  | 9,586        | 9,206        |
| Deferred tax charge in income statement (note 9)               | 230          | (524)        |
| Deferred tax credited to the statement of comprehensive income | (768)        | 904          |
| At 31 March 2017   | <b>9,047</b> | <b>9,586</b> |

**22. Financial instruments**

The Company has financial instruments in the form of inter-company balances and third party loans. The carrying values of Company's financial assets and liabilities are summarised by category below:

|                                    | 2017<br>£000  | 2016<br>£000  |
|------------------------------------|---------------|---------------|
| <b>Financial assets</b>            |               |               |
| Fixed asset investment (note 14)   | 55,484        | 55,984        |
| Current asset investment (note 15) | 2             | 2             |
| Cash at bank and in hand (note 17) | 11,644        | 9,206         |
|                                    | <b>67,130</b> | <b>65,192</b> |

|                              | 2017<br>£000   | 2016<br>£000  |
|------------------------------|----------------|---------------|
| <b>Financial liabilities</b> |                |               |
| Bank loans and overdrafts    | 99,613         | 97,724        |
| Revolving credit facility    | 4,000          | -             |
| Debenture stock              | 284            | 284           |
|                              | <b>103,897</b> | <b>98,008</b> |

| <b>Sterling</b>          | <b>Fixed<br/>Rate<br/>2017<br/>£000</b> | <b>Fixed<br/>Rate<br/>2016<br/>£000</b> | <b>Floating<br/>Rate<br/>2017<br/>£000</b> | <b>Floating<br/>Rate<br/>2016<br/>£000</b> | <b>Total<br/>2017<br/>£000</b> | <b>Total<br/>2016<br/>£000</b> |
|--------------------------|---|---|--|--|--------------------------------|--------------------------------|
| <b>Liabilities</b>       |   |   |  |  |                                |                                |
| Bank loans and overdraft | 99,613                                  | 97,724                                  | 4,000                                      | -  | 103,613                        | 97,724                         |
| Debenture stock          | 284                                     | 284                                     | -  | -  | 284                            | 284                            |
|                          | <b>99,897</b>                           | <b>98,008</b>                           | <b>4,000</b>                               | <b>-</b>                                   | <b>103,897</b>                 | <b>98,008</b>                  |

| <b>Fixed Rate</b> | <b>Weighted<br/>average<br/>interest rate<br/>%</b> | <b>Weighted<br/>average<br/>interest rate<br/>%</b> | <b>Weighted<br/>average<br/>period for<br/>which rate<br/>is fixed<br/>Years</b> | <b>Weighted<br/>average<br/>period for<br/>which rate<br/>is fixed<br/>Years</b> |
|-------------------|---|---|--|--|
| <b>Sterling</b>   | <b>3.6</b>  | <b>3.6</b>  | <b>15</b>  | <b>16</b>  |

Interest on the floating rate financial liability is based on London Interbank rates.

The maturity profile of the Company's financial liabilities at 31 March 2017 is detailed below:

|                         | 2017<br>£000   | 2016<br>£000  |
|-------------------------|----------------|---------------|
| In one year or less     | 4,284          | 284           |
| In more than five years | 99,613         | 97,724        |
|                         | <b>103,897</b> | <b>98,008</b> |

The Company had undrawn borrowing facilities at 31 March 2017, in respect of which all conditions precedent had been met, as follows:

|                                    | 2017<br>£000  | 2016<br>£000  |
|------------------------------------|---------------|---------------|
| Expiring within one year           | 4,000         | 4,000         |
| Expiring between one and two years | 6,000         | 10,000        |
|                                    | <b>10,000</b> | <b>14,000</b> |

The carrying amounts of the financial assets and liabilities shown above approximate their fair value.

# Notes to the Financial Statements

| <b>23. Called up share capital</b>                | <b>2017</b>  | <b>2016</b> |
|---|--------------|-------------|
|   | <b>£000</b>  | <b>£000</b> |
| <b>Authorised:</b>                                |              |             |
| <b>Equity:</b>                                    |              |             |
| 6,000,000 Ordinary Shares of 10p each             | <b>600</b>   | 600         |
| 10,500,000 'A' Ordinary Shares of 10p each        | <b>1,050</b> | 1,050       |
|   | <b>1,650</b> | 1,650       |
| <b>Non-equity:</b>                                |              |             |
| 3,250,000 Redeemable Preference Shares of £1 each | <b>3,250</b> | 3,250       |
| Total   | <b>4,900</b> | 4,900       |
| <b>Allotted, called up and fully paid:</b>        |              |             |
| <b>Equity:</b>                                    |              |             |
| 4,265,177 Ordinary Shares of 10p each             | <b>427</b>   | 427         |
| 6,509,162 'A' Ordinary Shares of 10p each         | <b>651</b>   | 651         |
|   | <b>1,078</b> | 1,078       |

The ordinary and 'A' ordinary shareholders are entitled to receive dividends pari passu according to the amount paid up or credited as paid up on their share. The Ordinary Shares are the only class of share to carry voting rights.

In a distribution on the winding up of the Company, the Ordinary and 'A' shareholders are entitled to share the balance of any surplus assets pari passu according to the amount paid up or credited as paid up on their shares.

| <b>24. Cash generated from operations</b>                             | <b>2017</b>    | <b>2016</b> |
|---|----------------|-------------|
|   | <b>£000</b>    | <b>£000</b> |
| <b>Profit on ordinary activities before taxation</b>                  | <b>1,489</b>   | 4,240       |
| <b>Adjustments for:</b>   |                |             |
| Finance costs recognised in income statement                          | <b>5,696</b>   | 4,778       |
| Notional pension costs  | <b>463</b>     | 168         |
| Investment income recognised in income statement                      | <b>(953)</b>   | (996)       |
| Other finance income  | <b>(625)</b>   | (382)       |
| Loss on disposal of asset   | <b>143</b>     | 562         |
| Depreciation and amortisation of tangible and intangible fixed assets | <b>5,594</b>   | 6,109       |
| Amortisation of capital contributions                                 | <b>(582)</b>   | (582)       |
| <b>Movements in working capital:</b>                                  |                |             |
| Decrease in stocks  | <b>118</b>     | 152         |
| (Increase) in debtors   | <b>(1,970)</b> | (1,351)     |
| Increase in creditors   | <b>1,216</b>   | 953         |
| <b>Cash generated from operations</b>                                 | <b>10,589</b>  | 13,651      |

## 25. Pensions

Portsmouth Water Limited, a subsidiary undertaking, is the principal employer and its parent company, Brockhampton Holdings Limited, is the participating employer in the Brockhampton Pension Scheme. This scheme provides defined benefits based primarily on pensionable earnings. The assets of the scheme are held in a separate trustee administered fund.

The formal actuarial valuation as at 31 March 2016 was updated to 31 March 2017 accounting date by an independent qualified actuary in accordance with FRS 102. As required by FRS 102, the value of the defined benefit liabilities has been measured using the projected unit method.

The estimated contributions expected to be paid to the Scheme by Portsmouth Water Limited for the year commencing 1 April 2017 is £1.3m (2016 actual - £1.4m). Of this amount, £1.0m is contributed directly by that Company and £0.3m is contributed by employees by salary sacrifice under the SMART arrangement.

The key FRS 102 assumptions used for the scheme were as follows:

|                   | <b>2017</b>        | 2016        | 2015        |
|-------------------|--------------------|-------------|-------------|
|                   | <b>% per annum</b> | % per annum | % per annum |
| RPI inflation     | <b>3.3</b>         | 3.0         | 3.1         |
| CPI inflation     | <b>2.4</b>         | 2.1         | 2.2         |
| Discount Rate     | <b>2.4</b>         | 3.4         | 3.2         |
| Pension increases | <b>2.4</b>         | 2.1         | 2.2         |
| Salary growth     | <b>4.4</b>         | 5.25        | 5.35        |

Life expectancy of a male aged 65 at the accounting date is 23.7 years and for a female is 26 years.

Allowances for future improvements in the life expectancy mean that life expectancy of a male aged 65 at the accounting date plus 20 years is 26 years and for a female is 27.9 years.

The fair value of assets in the scheme, a breakdown of the assets into the main asset classes, the present value of the FRS 102 defined benefit obligation and the surplus of assets over the FRS 102 defined benefit obligation (which equals the gross pension asset) are set out below:

|                      | <b>%</b>   | <b>2017<br/>Fair<br/>Value<br/>£000</b> | <b>%</b> | <b>2016<br/>Fair<br/>Value<br/>£000</b> | <b>%</b> | <b>2015<br/>Fair<br/>Value<br/>£000</b> |
|----------------------|------------|---|----------|---|----------|---|
| Equities             | <b>35</b>  | <b>56,931</b>                           | 34       | 47,932                                  | 44       | 63,285                                  |
| Absolute Return Fund | <b>24</b>  | <b>38,439</b>                           | 23       | 33,134                                  | 6        | 8,912                                   |
| Bonds                | -          | -                                       | -        | -                                       | 40       | 58,372                                  |
| LDI                  | <b>22</b>  | <b>36,552</b>                           | 21       | 29,557                                  | -        | -                                       |
| Property             | <b>9</b>   | <b>14,653</b>                           | 10       | 14,032                                  | 3        | 4,102                                   |
| Cash                 | <b>10</b>  | <b>16,733</b>                           | 12       | 17,125                                  | 7        | 9,544                                   |
|                      | <b>100</b> | <b>163,308</b>                          | 100      | 141,780                                 | 100      | 144,215                                 |

|  | <b>2017<br/>£000</b> | 2016<br>£000 |
|--|----------------------|--------------|
| Total fair value of scheme assets                  | <b>163,308</b>       | 141,780      |
| FRS 102 value of scheme defined benefit obligation | <b>(149,518)</b>     | (124,005)    |
| Pension asset                                      | <b>13,790</b>        | 17,775       |
| Related deferred tax liability                     | <b>(2,344)</b>       | (3,200)      |
| Net pension asset                                  | <b>11,446</b>        | 14,575       |

Under FRS 102, the scheme is represented on the statement of financial position at 31 March 2017 by an asset of £13.790m (2016 - £17.775m), which amounts to £11.446m net of deferred tax (2016 - £14.575m).

Portsmouth Water Limited paid contributions at a rate of 20.6% of earnings. Members pay contributions at a rate of 5% of earnings via salary sacrifice.

Portsmouth Water Limited also operates a defined contribution pension scheme. The contributions payable by Portsmouth Water Limited for the year in respect of the defined contribution scheme amounted to £184,794 (2016 - £136,433).

# Notes to the Financial Statements

## Movement in the net balance sheet position

|  | 2017<br>£000 | 2016<br>£000 |
|--|--------------|--------------|
| The FRS 102 value of scheme assets moved over the period as follows: |              |              |
| Opening asset  | 17,775       | 11,287       |
| Expense charged to profit and loss                                   | (1,113)      | (1,113)      |
| Gain recognised outside of profit and loss                           | (4,147)      | 6,274        |
| Employer contributions   | 1,275        | 1,327        |
| Closing asset  | 13,790       | 17,775       |

## Movement in present value of defined benefit obligation

|  | 2017<br>£000 | 2016<br>£000 |
|--|--------------|--------------|
| The FRS 102 value of scheme defined benefit obligation moved over the period as follows: |              |              |
| Opening scheme liabilities   | 124,005      | 132,928      |
| Employer's part of current service cost  | 1,738        | 1,495        |
| Interest on scheme liabilities   | 4,145        | 4,191        |
| Benefits paid  | (4,245)      | (3,971)      |
| Actuarial loss/(gain)  | 23,875       | (10,638)     |
| Closing scheme defined benefit obligation  | 149,518      | 124,005      |

## Movement in fair value of scheme assets

|   | 2017<br>£000 | 2016<br>£000 |
|---|--------------|--------------|
| The FRS 102 value of scheme assets moved over the period as follows:                                    |              |              |
| Opening fair value of scheme assets   | 141,780      | 144,215      |
| Interest on scheme assets   | 4,770        | 4,573        |
| Contributions by Portsmouth Water Limited, including employee contributions under the SMART arrangement | 1,275        | 1,327        |
| Benefits paid   | (4,245)      | (3,971)      |
| Actuarial gain/(loss)   | 19,728       | (4,364)      |
| Closing fair value of scheme assets   | 163,308      | 141,780      |

## Expense recognised in income statement

|   | 2017<br>£000 | 2016<br>£000 |
|---|--------------|--------------|
| The following amounts have been included within operating profit:               |              |              |
| Current service cost (employer's part only)                                     | (1,738)      | (1,495)      |
| Total operating charge  | (1,738)      | (1,495)      |
| The following amounts have been included as other finance income under FRS 102: |              |              |
| Interest on pension scheme assets   | 4,770        | 4,573        |
| Interest on pension scheme defined benefit obligation                           | (4,145)      | (4,191)      |
| Net return  | 625          | 382          |
| Total expense recognised in the income statement                                | (1,113)      | (1,113)      |

## Accounts recognised outside income statement

|   | 2017<br>£000 | 2016<br>£000 |
|---|--------------|--------------|
| The following amounts have been recognised within the statement of changes in equity: |              |              |
| Actual return less interest   | (19,728)     | 4,364        |
| Experience gains arising on scheme defined benefit obligation                         | (2,567)      | (4,398)      |
| Loss/(gain) due to changes in assumptions   | 26,442       | (6,240)      |
| Remeasurement loss/(gain) of net defined benefit asset                                | 4,147        | (6,274)      |

The actual return on plan assets was £24.498m in the year to 31 March 2017 (2016 - £0.209m).

The Accounting Standards Board have published guidance relating to best practice for disclosure of pensions information. The Company have decided not to follow the guidance at this time.

**26. Lease commitments**

At the reporting date the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

|                            | <b>2017</b> | 2016        |
|----------------------------|-------------|-------------|
|                            | <b>£000</b> | <b>£000</b> |
| Within one year            | -           | 192         |
| Between one and five years | -           | -           |
| In more than five years    | -           | -           |
|                            | -           | 192         |

During 2017 the mainframe leased from Fujitsu was decommissioned and therefore no future liability exists.

**27. Ultimate controlling party**

At 31 March 2017 the Company's ultimate parent undertaking was South Downs Capital Limited, which is the parent of both the smallest and largest groups of which the Company is a member. There is no ultimate controlling party but South Downs Capital Limited is controlled by the Directors of the Employee Benefit Trust which is the ultimate controlling shareholder. Copies of the consolidated accounts can be obtained on request from the Registered Office.

**28. Capital commitments**

|                               | <b>2017</b>  | 2016        |
|-------------------------------|--------------|-------------|
|                               | <b>£000</b>  | <b>£000</b> |
| Relating to fixed assets      | <b>1,567</b> | 6,734       |
| Relating to intangible assets | <b>22</b>    | 200         |
|                               | <b>1,589</b> | 6,934       |

**29. Related Party Transactions**

The Company has taken advantage of the exemption available in FRS 102 "Related Party Disclosures" whereby it has not disclosed transactions with any wholly owned subsidiary undertaking of the Group.

**30. Post Balance Sheet Event**

On 1 April 2017, as previously disclosed, the Company disposed of its non-household retail activities to Castle Water Limited upon opening of the new non-household retail market. The Directors do not consider that this represents a separate major line of business as the Company will retain retail activity for household customers together with the wholesale activity for both household and non-household customers. In addition retail non-household represents an immaterial portion of annual turnover of under £0.6m (1% of turnover). As such it has not been treated as a discontinued operation. Total proceeds of £2.9m were paid in advance and include the fair value of meter reading services for a period of 5 years.

## Notice of Meeting

Notice is hereby given that the Annual General Meeting of Portsmouth Water Limited will be held at the Company's Registered Office, PO Box 8, West Street, Havant, Hants, at 11.00am on Thursday, the 27th day of July 2017, on the following business:

1. To receive and consider the Directors' Report and Accounts for the year ended 31 March 2017 and the Auditors' Report thereon.
2. To approve the Report on Remuneration.
3. To re-elect Mr N. Smith a Director of the Company.
4. To re-elect Mr R. C. Porteous a Director of the Company.
5. To approve a total final dividend of £0.546m to be made to the holders of Ordinary and 'A' Ordinary Shares.
6. To appoint KPMG as Company Auditors and to authorise the Directors to fix their remuneration.

### Registered Office

PO Box 8  
West Street Havant  
Hants PO9 1LG  
25 May 2017

By order of the Board  
**C. Hardyman ACIS**  
Secretary

### Notes:

- i) Debenture holders are reminded that the holding of debenture stock does not entitle them to attend or vote at the meeting.
- ii) Shareholders are reminded that no voting rights attach to the 'A' Ordinary Shares. 'A' Ordinary Shareholders are not entitled to attend the meeting.
- iii) A proxy form is enclosed for Shareholders entitled to vote at the meeting.
- iv) To be valid proxies must reach the Company's Registered Office not later than forty-eight hours before the time fixed for the meeting.



# Appendix 1 KPI Calculations

| <b>a) Gearing - Net Debt: RCV</b>            | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|
|  | <b>£000</b> | <b>£000</b> |
| (i) Debt                                     |             |             |
| Bank loan (note 19)                          | 100,494     | 98,662      |
| Revolving credit facility (note 18)          | 4,000       | -           |
| Debenture stock (note 18)                    | 284         | 284         |
| Cash at bank and in hand                     | (11,644)    | (9,206)     |
| Net debt                                     | 93,134      | 89,740      |
| Regulatory capital value indexed to 31 March | 135,697     | 127,912     |
| (iii) Gearing - Debt: RCV ratio (i) ÷ (ii)   | 68.6%       | 70.2%       |

For the purposes of this ratio, debt excludes the deferred arrangement costs of £0.881m (2016 - £0.938m) and the current asset investment of £0.002m (2016 - £0.002m).

| <b>b) Cash interest cover</b>  | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|
|  | <b>£000</b> | <b>£000</b> |
| Operating profit   | 5,750       | 8,202       |
| Add back Employee Benefit Trust payment                              | 1,210       | 1,209       |
| Notional pension costs (note 24)                                     | 463         | 168         |
| Depreciation and amortisation charges (notes 12 and 13)              | 5,594       | 6,109       |
| Loss on disposal of fixed assets (below operating profit)            | (143)       | (562)       |
| Interest received, excluding amounts for inter-company loan (note 7) | 39          | 29          |
| Taxation, excluding payments for group relief                        | (555)       | (180)       |
| Capital expenditure (net of contributions)                           | (10,802)    | (7,419)     |
| Amortisation of deferred capital contributions                       | (582)       | (582)       |
| Loan repayment from Group company                                    | 500         | 350         |
| Loan draw-down   | 4,000       | -           |
|  | 5,474       | 7,324       |
| (ii) Interest paid   | 3,812       | 3,735       |
| (iii) Cash interest cover ratio (i) ÷ (ii)                           | 1.44        | 1.96        |

| <b>c) Return on regulatory equity</b>  | <b>2017</b> | <b>2016</b>               |
|--|-------------|---------------------------|
|  | <b>£000</b> | <b>Restated*<br/>£000</b> |
| Revenue  | 40,342      | 39,795                    |
| Operating costs, excluding Employee Benefit Trust payments depreciation and amortisation | (27,788)    | (24,275)                  |
| Regulatory depreciation (run off rate)   | (5,211)     | (4,994)                   |
| Infrastructure depreciation  | (1,082)     | (1,483)                   |
| Earnings before interest and tax   | 6,261       | 9,043                     |
| Current tax credit/(charge)  | 597         | (1,236)                   |
| Interest payable, excluding indexation and amortisation                                  | (3,808)     | (3,727)                   |
| (i) Return   | 3,050       | 4,080                     |
| (ii) Average Regulatory Capital Value, equity element only                               | 40,361      | 37,881                    |
| (iii) Return on regulatory equity (i) ÷ (ii)   | 7.5%        | 10.8%                     |

\*2016 Regulatory depreciation has been restated to reflect the new methodology in use for the current Business Plan (run off rate).



