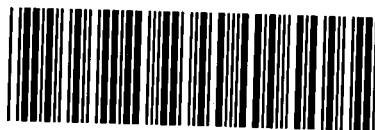


Portsmouth Water Limited

Annual Report & Accounts 2018

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Portsmouth Water At A Glance

A local company
with a proud history of
serving our customers
for over 160 years

160

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

100

On average our domestic
customers pay £100 per year
for their water supply.

726,000

Over 726,000 people use our
clean drinking water every day.

320,000

We provide clean drinking
water to 320,000 homes and
businesses in our area.

174

We serve the cities and towns
of Portsmouth, Chichester,
Fareham, Gosport, Havant
and Bognor Regis. On
average, each day we supply
approximately 174 million litres
of water.

3,337

Our area of supply has a
network of over 3,337 kilometres
of underground mains.

Highlights

- ▶ At £100 our average household bill continues to be the lowest in England and Wales
- ▶ Over 5,000 households have joined our Social Tariff scheme
- ▶ RoSPA Presidents Award winner for the fourth successive year
- ▶ Received the ServiceMark charter from the Institute of Customer Service and ranked top water utility company
- ▶ Established Wholesaler in the non-household Open Water market
- ▶ Completed and signed off all required environmental schemes

Turnover

£40.5m

2018	40.5m
2017	40.3m
2016	39.8m

Cash generated from operations¹

£12.6m

2018	12.6m
2017	10.6m
2016	13.7m

Capital expenditure

£7.5m

2018	7.5m
2017	9.4m
2016	9.3m

Operating profit²

£6.4m

2018	6.4m
2017	5.6m
2016	7.6m

(Loss)/profit before tax

£(1.1)m

2018	(1.1)m
2017	1.5m
2016	4.2m

¹After adjusting £11.0m atypical cash balance

²After loss on disposal of fixed assets and before other exceptional items

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Chairman's Statement

Mike Kirk
Chairman
24 May 2018



I have great pleasure in presenting the Annual Report and Accounts for what has been a productive year for Portsmouth Water. We have maintained our focus on delivering excellent customer service, alongside the lowest household bill in the county (by a significant margin) whilst maintaining a sound underlying financial performance. Our programme of capital works to maintain and, where necessary, to enhance our infrastructure progressed well during the year. Alongside this, we have seen a significant increase in the work required to prepare for the forthcoming 5-yearly price review that is undertaken by our economic regulator, Ofwat. This involves extensive consultation with our customers to ensure that our Business Plan delivers the Outcomes that are important to them.

This Business Plan will see the start of the delivery of the Havant Thicket Winter Storage Reservoir ("HTWSR") project. This will create a major new regional water resource and the associated works can also enhance operational resilience to Portsmouth Water's customers.

Our Customers

We were pleased to be ranked 4th 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 recording complaints and unwanted telephone contacts. We are mindful that our customers' expectations on customer service are driven not just by how we compare to other water companies, but to a wide range of companies that they have experience of. We therefore took the decision in 2015 to become a member of the Institute of Customer Service who conducted a satisfaction survey of our customers for the second time this year. The results were very positive, with our score being the highest of any water company member and the second highest of any utility company

member. The number of written complaints that we receive per 10,000 customers fell to 10.3, this is expected to be one of the lowest in the industry.

Although we have the lowest average water bills in the country, we realise that affordability remains an issue for some customers on low incomes and our Helping Hand Social Tariff provides support for those who have genuine difficulty paying bills. We now have over 5,300 customers signed up which is ahead of our target. This is part of our range of services to help support those in society that need help or support, either at specific times of increased vulnerability, or more generally.

In the third year of the current regulatory period, we achieved all but four of our Outcome Deliver Incentives (ODI's) – the measures that were agreed as representing how we are meeting the standards expected in those areas of our service that matter the most to our customers.

Leakage for the year at 32.9MI/day was higher than the target of 29.8MI/day (although this is a target that is measured over the whole five years of the review period and the average over the three years to date is 30.3MI/day). Whilst this was impacted by some extreme weather in the early part of 2018, this is not acceptable and we continue to make significant investment to reduce this to below the target level over the five year period.

Water quality contacts for taste and appearance remained over our target, despite being at a level which is amongst the lowest in the Industry and is indicative of the high standards we set ourselves.

Water Quality is fundamental to our business and whilst 99.93% of samples taken from customer taps met the standards set by the Drinking Water Inspectorate, this fell below our performance standard of 99.95%. This was driven by three customer-side failures; two

relating to household lead plumbing and the final relating to contamination due to the use of herbicide in a neighbour's garden.

The volume of water used by each household customer (per capita consumption) is higher than our target of 145 litres per day by 2 litres. Whilst we make significant efforts to advise customers how to use water efficiently we cannot control their usage which, in dry periods, increases significantly.

We are pleased with our strong performance in the other areas.

Our Infrastructure

Over many years we have invested in the operational 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 ultra violet (UV) treatment at our largest works at Farlington. The improvements were made to address the increased risk of cryptosporidium in the raw water, which, although low can, if left untreated, can cause illness.

During the year we invested a total of £5.5m replacing and repairing 23km of pipes and constructing a further 7km to maintain 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 completed a detailed study of the resilience of all our resources to pollution and flooding. Although the study showed we have a highly resilient infrastructure, we have identified the need for some focused investment, which we will bring forward into the PR19 Business Plan.

Our Business

During the year, we have committed significant resources to preparatory work for the PR19 Business Plan. This has involved multiple work streams across the business and support from a range of specialists. As highlighted earlier, our PR19 strategy builds on the Company's strong water resources position, with plans to support increasing levels of bulk water supply to our neighbouring water company, through the development of a major regional water resource, the HTWSR, over a period of eight years. Alongside this, we are planning ambitious reductions in levels of leakage and per capita consumption, to ensure that we use our existing resources in the most effective way. Our extensive customer engagement programme has progressed well, including the major

programme for consultation on the Water Resource Management Plan. We have also undertaken a major engineering programme to analyse operational risk and develop an optimised capital and operating programme for PR19.

Our People

We were delighted to receive the President's Award from the Royal Society for the Prevention of Accidents (RoSPA) for the fourth consecutive year. This recognises 14 consecutive years of winning 10 Gold Awards, four President's Awards and one Industry Sector award. Healthy and Safety remains our number one priority and we are immensely proud of this achievement.

This has been a busy year for our staff, achieving high levels of customer's service and preparing for the PR19 Business Plan submission. 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

During 2017/18 our work focused on actions to address the areas at higher risk of nitrate pollution. Our Catchment Management Team has been a successful partner in a European Union Interreg project bid to trial "payments for ecosystems services" across our area of supply. This involves looking at new and innovative ways of supporting farmers and landowners to alter their practices and behaviours to deliver cleaner groundwater in our catchments and so avoid the need for costly new processes at our treatment works to remove nitrates. We expect our Catchment Management work to be a long term programme and will see a step change in activity during PR19.

There were no general restrictions to customer supplies in 2017/18. Although the winter was very dry before Christmas, our groundwater levels have since recovered to a level above the long term average and we do not expect any restrictions this summer.

During the year we have constructed and began commissioning infrastructure to enable a new bulk supply to Southern Water from our River Itchen treatment works. This will increase the resilience of the water supply into their Hampshire zone, including Southampton, without reducing the security of supply for our own customers. This scheme is the first of three planned over the next ten years as part of the regional solution to meeting customer requirements across the South East. It is also an important element of the broader Water Resources in the South East plan to ensure

adequate supplies across the region now and in the future.

Our Investors

During the year the Group's majority owners, the South Downs Employee Benefit Trust, together with the other individual shareholders, took the decision to sell the entire share capital of the South Downs Capital Group to funds managed by Ancala Partners LLP ("Ancala"). Ancala is an independent mid-market infrastructure investment manager. The acquisition completed in March 2018. The Directors welcome David Owens, an Ancala Industry Partner, to the Board of Portsmouth Water.

The choice of Ancala will allow the Company to continue to maintain a level of independence and will support the Company in continuing to deliver on its strategy to achieve excellence for our customers, employees and the environment. Ancala's investment will also allow the Company to pursue growth opportunities by providing access to additional capital, which will be fundamental to pursuing the HTWSR project.

Financial Results

The results for the year show an operating profit of £6.4m (2017 - £5.6m) before exceptional items. The results benefited from lower infrastructure renewals expenses of £1.4m driven by higher amounts capitalised (due to the nature of specific schemes undertaken). In addition Turnover showed a modest £0.1m increase, staff costs rose by a total of £0.7m and depreciation and amortisation increased by £0.8m. These increases were offset by a range of smaller savings across operational activities.

Two exceptional items arose; a £1.8m gain following the disposal of the non-household retail business and exceptional employers NIC and related charges of £3.0m in connection with the distribution of proceeds to employees following the sale of the business (note 31).

Net interest payable has increased significantly from £4.1m to £6.4m due to higher indexation on the long term loan driven by higher RPI.

Gross capital expenditure in the year fell to £7.5m and reflects the two large projects undertaken in the prior year. The Company renewed 13.8km and built or replaced a further 16.8km of mains at a total cost of £5.5m of which £2.8m is charged to the income statement. The company also began an extensive capital programme of maintenance on above ground assets, which

is being executed through an innovative collaborative agreement with contractors. Finally works to enable a new bulk supply of water at the river Itchen have been substantially completed at a cost of £1m.

Higher closing cash of £26.7m (2017 - £11.6m) was impacted by timing differences of £11.0m in cash relating to the distribution of sale proceeds to employees. This relates to PAYE and NIC and was settled in April 2017. Gearing has been adjusted to reflect this atypical balance. In addition cash benefited from lower capital expenditure in the period and issue of equity shares of £3.0m offset by net reduction in borrowings of £1m.

Gearing, after adjusting for the £11m cash timing difference noted above, at 63.6% (2017 - 68.6%) reflects both improved cash and RCV growth.

The cash interest cover ratio of 2.20 times remains above the target of 1.4. Return on Regulatory Equity (RORE) 7.03% (also using an adjusted gearing of 63.6%) is consistent with the prior year of 7.5%.

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 726,000 over an area of 868km².

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

Delivering excellence
for our customers
our people and our
environment

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.

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 302,000 homes and 18,000 businesses in an area of 868km² 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 30 to 31)

- 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
Water quality standards (Mean Zonal Compliance) * (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.
Water quality contacts * (Calendar year)	A measure of customer contact for taste, odour, discolouration and illness calculated as the number of contacts per 1,000 population.
Bursts *	The number of burst mains calculated in accordance with Ofwat guidance. Defined in number of incidents per annum.
Interruptions to supply *	Average time of supply interruption per property (includes both planned and unplanned interruptions).
Service Incentive Mechanism (SIM) *	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.
Guaranteed Service Standards	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.
RoSPA accreditation *	The Company will apply for its Health and Safety accreditation annually.
Health & Safety Reportable accidents	An absence of more than 7 days as a result of an injury at work and reportable to the HSE.
Health & Safety Total accidents	All accidents including reportable accidents but excluding vehicle accidents.
Employee absence	The number of days absent from work per person.
Headcount	The number of staff employed by the Company.
Leakage *	The total level of leakage, including customer supply pipe leakage, as measured on an average mega litre per day (ML/d) basis.
Per Capita Consumption *	The weighted average water consumption per customer served calculated from the number of measured and unmeasured households.
Temporary Usage Bans *	Introduction of water restrictions in accordance with the Company's approved drought plan.
Operating Profit	Financial measure in accordance with UK accounting standards being turnover less operating costs.
Cash interest cover	The ratio represents the number of times that adjusted cash flow covers interest payment. A detailed calculation is included in Appendix I.
Gearing (Net debt: RCV)	The ratio of Net Debt (loans and debentures less cash) to RCV. A detailed calculation is included in Appendix I.
Return on Regulatory Equity (RoRE)	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.

Biodiversity Action Plan

Whilst the Company tracks progress against an agreed plan of biodiversity work this has a target for completion by 31 March 2020 and as such is not presented annually. We remain on track with this activity.

	2017/18 Target	Our performance				2017/18 target met?
	> 100.0% (Calendar year)	99.93%	99.99%	99.94%	99.97%	X
	< 0.421 contacts per 1,000 population (Calendar year)	0.549	0.665	0.570	0.841	X
	< 250 - 435 bursts per annum	347	298	219	294	✓
	< 6 minutes	4 mins 7 secs	4 mins 9 secs	3 mins 30 secs	8 mins 44 secs	✓
	Upper quartile > 85 (Total Score is out of 100)	87.9	87.7	89.6	82.0	✓
	< 180 payments	155	221	109	139	✓
	RoSPA awarded	Awarded	Awarded	Awarded	Awarded	✓
	0 accidents	0	1	0	2	✓
	< 12 accidents	6	5	9	6	✓
	< 2.5 days	2.5	2.5	2.43	New measure - no comparative	✓
	266 staff	261	255	252	243	✓
	< 29.9 Ml/d	32.9Ml/d	30.4Ml/d	28.2Ml/d	28.9Ml/d	X
	< 145.3 l/h/d	147.6 l/h/d	145.1 l/h/d	143.3 l/h/d	145.5 l/h/d	X
	0 bans	0	0	0	0	✓
	Better than budget	£6.4m ¹	£5.6m	£7.6m	£6.7m	✓
	> 1.40	2.20	1.44	1.96	1.80	✓
	< 80%	63.6% ²	68.6%	70.2%	72.4%	✓
	> 6.0%	7.03% ³	7.5%	10.8%	5.1%	✓

* These measures are also part of the Ofwat Outcome Delivery Incentive Mechanism.

Footnote¹ After loss on disposal of fixed assets and before other exceptional items.

Footnote² Adjusted to remove transaction related cash held (note 31 and Appendix 1)

Footnote³ Calculated using adjusted gearing

Strategic Report

Our Customers

We are proud to be a member of the Institute of Customer Service and ranked as the top water company

Customer Service Levels

We compare our service levels both within the water industry and outside. The outside comparison is principally via an annual survey that is conducted by the Institute of Customer Service. The Institute has over 450 members in the United Kingdom, representing a number of different sectors. We are pleased to report that our Customer Satisfaction score rose from 79.9 to 81.1. This gave us the highest score of any water company and made us the second highest utility. Our score was above the 'all company' average, as was our trust score.

Our scores from both the customer and staff survey allowed us to apply for the Institute of Customer Service's ServiceMark. We are pleased to confirm that following their audit we have been awarded this prestigious accreditation.

Within the water industry, customer service is 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 received when contacting us. Ofwat uses the SIM score as a metric with rewards and penalties attached.

Our total score for 2017/18 was 87.9, compared to 87.7 the previous year. The number of written complaints reduced to 10.3 per 10,000 customers which we expect to be amongst the very 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 and ultimately can take the matter to be reviewed under the Water Redress Scheme. During the year, no complaints were escalated to either CCW or the Water Redress Scheme.

The SIM survey score was 4.48 out of a maximum of 5. This compares to an industry average of 4.40, placing us 4th out of 18 water companies.

Affordability and Vulnerability

Portsmouth Water's charges, for household customers are the lowest in England and Wales. Our average bill is £100 (2017 - £98).

Our bills, whilst low relative to water supply bills elsewhere, will not be affordable to all customers. To assist those with the lowest household incomes, we introduced a 'Helping Hand' Social tariff in July 2016. Since then over 5,000 customers have applied for, and been accepted on the tariff. This tariff caps eligible customer's bills at our minimum charge, which is £76.86 for the 2017/18 billing year.

Most of us at times, or from time to time, are vulnerable. In the year our focus has been on building relationships with organisations that help support those at times of need and training our staff so that they are better able to both identify and deal professionally and empathetically with customers. An example is dementia training, which has been delivered to customer contact staff this year, and is a great example of where a relatively short

training session can provide a meaningful and memorable insight into understanding dementia.

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 4 of these measures.

Leakage

Portsmouth Water has not met its leakage target for 2017/18 despite increased resources, improved efficiencies and new detection equipment.

The Company has seen an increase in bursts, which has resulted in significantly above average leakage breakout throughout the year. This can be attributed to an early summer and four severe winter events, including the 'Beast from the East'.

We are committed to reducing leakage and have put in place further improvements and financial investment in additional resources. These are aimed at targeting leaks on trunk mains and adopting new innovations.

The Company is still expecting to reach its 5 year target.

Water Quality Contacts

This is the 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 reported annually (for the calendar year) to the Drinking Water Inspectorate. We set ourselves a challenging target of less than 0.421/1,000 population served. Whilst improving our performance we missed our target, having achieved 0.549/1,000. Despite not hitting our target, we remain significantly below the industry average.

Mean Zonal Compliance

We take almost 2,000 water samples at customer taps each year and aim for all to meet water quality standards. During the calendar year 2017, 3 samples failed the required standards, 2 because the customer's private plumbing contained lead pipes and 1 due to herbicide being present in a sample as a result of back siphonage following this chemical having been used in the neighbour's garden. The two customers when samples failed for lead, chose to replace their pipe work later in the year following discussions with the Company.

Per Capita Consumption

The volume of water used by each household customer has increased in the year by 2 litres per day. Whilst we make significant efforts to advise customers how to use water efficiently we cannot control their usage which, in dry periods, increases significantly. At present the Company can only meter its existing customer base if the customer chooses to move to a meter. We continue to discuss this issue with DEFRA to lobby a change in legislation to allow compulsory metering. We continue to believe that metering is the fairest way to charge customers and the most effective tool in managing water usage.

Guaranteed Standards Scheme

We are legally required to pay customers compensation where we do not meet the prescribed standards. This includes not responding to customer letters, not informing them that their supply may be interrupted as we work on the network and compensation if we miss an agreed appointment. In the year we reduced the number of payments we needed to pay to customers, reinforcing our value of providing high levels of service to all customers.

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.

We are committed
to the life long
development of our
people

Developing Our People

Staff development is very important to us as a business. As part of this approach we are big supporters of the Institute of Water (IoW). The IoW is an organisation focussed on the development of those that work in the water industry.

Each year they run a "weekend school" looking to develop people in areas such as how to present, network, understand leadership and also getting a better understanding of the industry they work in. The delegates consisted of people working in a number of companies throughout the South East.

We sent 9 delegates and as the photographs shows it was a mixture of serious work and some fun as well.

Some of the quotes about the weekend demonstrating some of the value we get by investing in 'our people':

"The weekend school was an outstanding occasion for personal development, networking and even a bit of fun"

"The training in this event was fantastic, and I hope that when I am further along in my career I will be able to utilise it when I manage people"

"After the development session had finished I felt so happy, empowered and confident and could not wait to try some of the ideas back in the workplace"

"I would recommend this course to anyone who is looking to learn and develop their public speaking and communication skills"

Health and Safety

Health and Safety has been the number 1 priority within the Company for a number of years and this has helped us reduce accident numbers alongside a number of company wide campaigns and initiatives. In summary, 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 we can and must strive to do better, remaining vigilant at all times. We must avoid the "won't happen to me" mentality.

Over the past 12 months we have seen some positive initiatives including improvements to our equipment, changes to the working environment, looking at staff wellbeing and how a healthy person equates to a safer workplace. Many of these initiatives have been driven pro-actively by departments and this is a positive step in ensuring H&S is always in the forefront of our thoughts and actions. Very much a "bottom up" approach to further improving H&S.

Number of Accidents in 2017

We measure the number of accidents for a calendar year. 2017 saw no reportable accidents for the year. A reportable accident means someone has been injured enough to be off work for over 7 days.

There were 6 accidents during the year. The graphs below show how far we have progressed in making the Company a safer place to work.

A measure of the positive impact H&S has had on our people is that in the 2017 employee satisfaction survey 88% said they are more safety conscious away from the workplace as a result of the Company's approach to Health & Safety.

RoSPA 2018 Presidents Award

2018 saw us awarded the RoSPA President's Award for the fourth 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&SA consistently for 10 years or more.

The President's Award acknowledges our achievements in the previous 14 years, winning ten gold awards, four presidents' awards and 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.

Employee Satisfaction Survey 2017

It is very important in order to deliver our vision of "delivering excellence for our customers, our people and our environment" that our people are happy and proud to work for Portsmouth Water. As a business we are committed to ensuring we all operate in a positive working environment so that everyone who works for Portsmouth Water both feels valued and fully understand their contribution to the business.

To help us understand, we carry out an annual employee survey. We have done this for a number of years now and the results help us to understand whether we are getting it right.

Recent results have showed as a business we have improved in this area year on year.

The 2017 survey saw the results of the survey produce very positive results with highlights such as:

- 96% are proud to work for Portsmouth Water
- 78% feel valued by the Company
- 74% are happy with their development opportunities
- 99% say they work at all times in with our values of Excellence, Respect and Integrity

Investing in our future

We are firmly committed to the development of our staff and that they all have the opportunity to reach their full potential and as a result we fully support those wanting to undertake further education such as Degrees, HNC's, NVQ's along with associated professional qualifications. As noted above, a number of employees have achieved degrees and professional qualifications whilst working for the Company.

Over the past 5 years 50 current members of staff have successfully undertaken further education.

2017 saw 20 of our people undertake further education fully funded and supported by the Company.

Apprentices

Modern Apprentices 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 catered to the specific requirements of the Apprenticeship offered and conducted by both the Company and the facilitating training organisation.

During 2017 we had 5 apprentices on permanent contracts working in Mechanical and Electrical and Customer Services

Supervisor Development

All new supervisors either appointed externally or internally promoted are required to undertake formal further education qualification in the management field. There is a minimum of a Level 3 qualification for all supervisor posts. Many have decided to take the Level 5 Management Diploma to further enhance their skills in this area.

In 2017 we had 6 people successfully completed the Level 5 Management Diploma.

Strategic Report

Our Environment**An improved environment supporting biodiversity**

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'.

Following the Ofwat price determination we 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 were completed in 2017/18.

- Opened up relic creeks / channels and created some shallow scrapes to allow enhanced tidal flooding and extend the existing saltmarsh plant community on a grazing marsh at Bedhampton.
- Removed trees and scrub to restore grassland habitat designated as a Site of Importance for Nature Conservation at Hoe Pumping Station meadow.
- Cleared trees and scrub in woodland along a watercourse at Fishbourne WTW to let more light into the channel and onto the banks, to help diversify the vegetation and create improved habitat for water vole.
- Deepened and doubled the size of a pond at Westergate WTW in order that it can hold water for longer through the summer.
- In partnership with Itchen Valley Country Park thinned out approximately 30% of the conifer from the woodland at Highwood Reservoir, letting in more light onto the slopes to help diversify the ground flora, and give more mixed native species the chance to grow. This is part of a project to restore the native ancient woodland which historically would have been present at the site.
- Chalk grassland restoration is ongoing at 3 sites (Farlington, Fort Southwick, Nore Hill) through a programme of scrub clearance and invasive species control, notably cotoneaster, pyracantha, tansy and budlejia removal.
- Invasive budlejia clearance and removal of non-native conifers at Northbrook WTW.
- Removal of invasive blackthorn and other scrub to restore a wet grassland paddock in woodland north of Hoads Hill.
- Removed invasive willow from the old lagoon at Itchen WTW to diversify and enhance the wetland habitat.
- Employed specialist consultants to complete invertebrate surveys at 4 high conservation value sites, a water vole survey at Itchen WTW lagoons, and a site visit to our Madehurst Reservoir to assess what would need to be done to convert it into a underground bat roost / hibernation site.
- Employed a botanist to carry out a detailed vegetation survey and map priority habitat at 3 sites.

Five staff voluntary conservation working parties were completed in 2017/18

In addition, options appraisal and design work has been taking place in advance of proposed wetland enhancement projects at three sites. At Fishbourne and the Itchen old lagoon the work will provide additional habitat for water voles. The water vole is the UK's most rapidly declining mammal and has been lost from 94% of places where they were once prevalent. In the last decade there has been a 30% decline in the places where these river mammals once lived across England and Wales. Habitat loss, water pollution and massive building development have led to declines in the voles since the 1960s; exacerbated by predation by North American mink, which originally escaped into the wild from fur farms.

Five staff voluntary conservation working parties were completed in 2017/18 with tasks ranging from, invasive Budleija removal at

Bedhampton, clearance of small trees from the grassland at Nelson Reservoir, brash clearance from tree thinning operations at Highwood Reservoir, and invasive species control at the Itchen Site of Special Scientific Interest.

The presence of Dormice has been confirmed in the hedgerow at a small site near West Marden. Dormouse boxes have been placed within the hedge to provide additional harbourage for these European protected species, and the management of the hedgerow adapted to allow hazel trees to flourish and produce the nuts which is the favoured food of this charismatic species.

A survey in spring 2017 identified that the population of reptiles at our Itchen WTW site

was surprisingly low. Habitat enhancement works over the past few years to clear scrub, thin woodland and provide log piles enabled us to support the relocation of a large number of reptiles from a development site near Winchester. In total 213 slow-worm, 39 common lizard and two common toad were released at the site. As part of the project two hibernacula were constructed to provide additional hibernating sites for these reptiles to overwinter.

New hedgerows have been planted at three sites (Fir Down Reservoir, Lavant WTW and Westergate WTW). Only native trees have been used in the planting. In addition to hawthorn species such as cherry, crab apple, hazel and spindle have been planted, as these trees will provide fruit, berries and nuts in time, which will provide food for birds and mammals, along with blossom to support insects, helping to enhance biodiversity at these sites.

Pond extension at Westergate Water Treatment Works

The pond at Westergate Water Treatment Works was quite small and shallow, which meant that it dried out quite quickly each summer and thus had very limited biodiversity value. We extended and deepened the pond, while trying to maintain and re-use the existing vegetation.

Strategic Report

Our Environment**Water Resources**

The Company is committed to ensuring a sustainable water supply for its customers now and in the future. We work closely with our key stakeholders, such as the Environment Agency, to ensure that we abstract water sustainably.

The Board continued to consider the risks to public water supply (see page 30) and to ensure that our system is resilient to climate change and changes to environmental legislation.

In 2014 the Company published its Water Resources Management Plan (WRMP) which looks 25 years ahead. In 2017 we submitted a draft of the next plan which covers the period from 2020 to 2045. We went out to consultation on this Plan in early 2018, receiving over 2,200 responses, and expect to have it in place by 2019. The new plan includes further bulk supplies to neighbouring water companies and the development of Havant Thicket Winter Storage Reservoir ("HTWSR").

Havant Thicket has been developed as a regional resource and is supported by the work of the Water Resources in the South East (WRSE) Group. The group, comprising seven water companies and the Regulators, has been modelling possible long-term solutions to the issue of sustainable water supplies with South East.

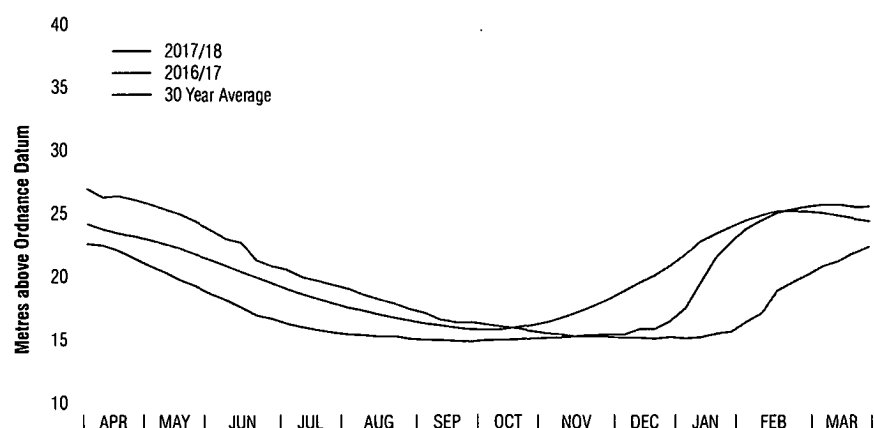
On average the Company supplies approximately 170 million litres of water per day. The chart below shows the sources of water used during the year.

Outlook for 2018

The majority of water supplied to customers comes from groundwater springs and boreholes fed by the South Downs. Groundwater levels are critical to maintaining supplies and for the health of the chalk streams in the area. The Company has, for many years, monitored groundwater levels at a site near Rowlands Castle. The graph below shows groundwater levels in 2017/18 compared to the long-term average (30 years).

Groundwater levels in the spring and summer of 2017 were below the long-term average and there was some concern that a drought might develop. Levels approached the first drought trigger in July but Portsmouth Water did not need to instigate any drought management actions. Heavy rain in July and September stabilised the situation but October and November were very dry. Heavy rain in December and January resulted in rapid recharge of the chalk aquifer and groundwater levels rose to above average levels in February.

The Company has not had to impose restrictions on our customers since 1976 and with current groundwater levels it is unlikely that we will do so this year.

Trends in Groundwater Levels

Enhancing saltmarsh habitat at Bedhampton

A vegetation survey revealed a saltmarsh plant community in relic channels at the Portsmouth Water Bedhampton "pony field" site. With support from our tenants we were able to develop a project to open up relic creeks / channels and create some shallow scrapes to allow enhanced tidal flooding. This will allow the existing saltmarsh plant community to expand into the new channels, helping to restore the unusual grazing marsh community.

Strategic Report

Our Environment

2018 saw the launch of our new Farmers Capital Grant Scheme

Catchment Management

The two principal pollution risks to our water sources are nitrates and leaks or spills from oil tanks. The past year has seen the Catchment Management Team develop new 'on the ground' initiatives to address these risks.

With regards to nitrate, the Company is a partner in the European Union Interreg France (Channel) England project 'Channel Payments for Ecosystem services'. This project is trialling innovative ways of financially supporting farmers and landowners to alter their practices to deliver cleaner groundwater in our catchments.

Related to this, we are also working in partnership with the Forestry Commission on ways of establishing long term relationships with farmers for the improvement of groundwater quality through woodland creation.

Both of these projects will help inform the catchment management measures we will fund through our next Business Plan (2020-2025).

In addition to this work, early 2018 saw the launch of our new Farmers Capital Grant Scheme – a scheme that directly assists farmers by part-funding capital items that will help reduce the risk of nitrate (and other pollutants) to groundwater. Measures eligible for funding include farmyard drainage systems and in-field water management items (for example sediment ponds and constructed wetlands for the treatment of pollution).

With regards to leaks and spills from oil tanks, in 2017 we launched our new oil tank campaign. This involves Portsmouth Water offering a 50% subsidy for any works to make domestic heating oil installations a low risk to groundwater; this can include tank and pipework replacement. The take up of this scheme has been excellent, delivering a very real reduction in the risk of groundwater contamination from oil spills and leaks across our catchments.

Restoring ancient woodland at Highwood Reservoir

In partnership with Itchen Valley Country Park (Eastleigh Borough Council) we used a harvester machine to thin out approximately 30% of the conifer from the woodland at Highwood Reservoir, letting in more light onto the slopes to help diversify the ground flora, and give more mixed native species the chance to grow. This is part of a project to restore the native ancient woodland which historically would have been present at the site.

The project aims to restore the native ancient woodland

Strategic Report

Our Business

The year ended 31 March 2018 was the third 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. We have seen a significant increase in work preparing the Business Plan for 2020-2015 (PR19). This has included detailed financial modelling and stress testing which has been aligned to our assessment of Going Concern and financial viability.

Ownership structure

On 16 March the Group's majority owners, the South Downs Employee Benefit Trust, together with the other minority shareholders sold the entire share capital of the South Downs Capital Group to funds managed by Ancala Partners LLP ("Ancala"). This was effected through Ancala Forna Holdco Limited the Group's new ultimate controlling party. Ancala is an independent mid-market infrastructure investment manager.

Ancala is committed to supporting the Company in its long-term strategy to achieve excellence for our customers, employees and the environment. Further information on the group structure is set out in page 39.

As beneficiaries of the Employee Benefit Trust the majority of current employees and certain former employees received a share of sale proceeds. These were distributed by the Company on behalf of the Trust.

Financing structure

Since 2001 the Company has largely been financed through an index linked fixed interest

loan with a base value of £66.5m. This was drawn in 2002, with inflation risks on the cost of the loan being effectively hedged against regulated revenues which are also currently 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 2018 was £103.3m (2017 - £99.6m).

Gearing and liquidity

Net debt to regulatory capital value is a key covenant defined by the Company's index linked loan documents. Gearing at 55.9% (2017 - 68.6%) improved as a result of higher cash balances, largely driven by transactions relating to the distribution of sales proceeds to employees which have resulted in a temporary increase in cash of £11m. This is explained further in note 31. Once adjusted for this, atypical cash increase gearing at 63.6% is largely consistent with the prior year. Gearing remained comfortably within the 86% ceiling imposed by the bond covenants.

The Company utilised £3m of the £10m revolving credit facility at the year end. The £2m overdraft facility was unused at the year end. These facilities, both with Lloyds Bank, 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. They are renewable in May 2021 and annually respectively.

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 2 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 2.20 times (2017 - 1.44 times) remains comfortably above the 1.4 times covenant required.

Return on regulatory equity (RoRE)

RORE, based on adjusted gearing, at 7.03% remains consistent.

Review of trading performance

Operating Profit

Operating profit at £6.5m shows an increase on the prior period of £5.8m. This was primarily driven by a reduction in infrastructure renewals charged to the income statement of £1.4m. This was offset by a number of one off costs and is discussed further below;

Revenue

The modest increase in turnover was largely driven by average tariff increases of 2% and 2,000 new properties. There was a £0.2 reduction in chargeable work due to levels of activity and a £0.3m increase due to the recognition of meter reading income.

Operating costs

Total operating costs fell by £0.3m which resulted from a number of movements the most significant of which are as follows;

Infrastructure renewals charged to the income statement fell by £1.4m primarily as a result of higher capitalisation due to the nature of programmes undertaken.

Depreciation increased by £0.5m as a result of ongoing increases in capital expenditure and accelerated depreciation on decommissioning of one membrane plant. In addition, amortization increased by £0.3m representing a full year's charge of significant additions in 2017.

Average headcount in the business has increased from 255 to 261 reflecting operational requirements. This, together with the annual salary increase of 1.75% and increased pension charges of £0.3m (due to higher FRS 102 charges) have resulted in increased employee costs (after amounts capitalised) of £0.7m.

Other exceptional items

Two items which we're exceptional in terms of their size and nature were charged to the income statement.

A gain on the disposal of the non-household retail business, which completed on 1 April 2017, of £1.8m (note 32).

As a result of the distribution of sales proceeds to employees, which was deemed to be by virtue of their employment, an exceptional charge of £2.9m arose relating to employers national insurance contributions and apprenticeship levy. To offset this charge share capital and share premium of the same value was injected by our investors. This is explained further in note 31.

Interest & other finance income

Interest payable shows an overall increase of £1.9m which is primarily due to £1.8m 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. Investment income fell by £0.1m due to lower interest rates.

Taxation

The tax charge in the period of £0.04m includes a current tax charge of £0.07m and deferred tax credit of £0.03m. The increase in current tax in the period was due to one off credits during the prior year primarily driven by R&D tax credits.

Deferred tax charges reversed primarily due to higher capital allowances.

Dividends

The dividends paid during the year totaled £1.1m (2017 - £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 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 second interim dividend (including amounts servicing intercompany debt) proposed for the year is £1.8m expected to be paid in June.

Capital investments

Gross capital investment in the year was £7.5m (2017 - £9.4m). Further information on the capital programme is set out in the Engineering Report on page 24.

Mains activity

	2017/18 £m	2016/17 £m
Renewals charged in the income statement	2.8	4.2
Mains capitalized	2.7	1.4
Total mains investments	5.5	5.6

During the year the Company renewed 13.8km of mains (2017 - 21.4km) at a cost of £2.8m (2017 - £4.2m) charged to the income statement. A further 16.8km (2017 - 13.9km), of new mains and enhancements to the network were capitalized at a cost of £2.7m (2017 - £1.4m).

Capital contributions

The Company receives capital contributions, primarily in connection with new mains for housing developments, which amounted to £1.1m (2017 - £1.2m). In accordance with the requirements of FRS 102 these contributions are deferred and amortised to the Income Statement.

Pensions

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 £24.8m (2017 - £11.4m). The overall increase in the surplus on actuarial valuation has largely been driven by a number of small movements in key assumptions as set out in note 25.

Financial Viability

The Company's financial position is set out in the financial statement on pages 56 to 76, including cash flows, liquidity position, borrowing facilities and loan maturities. The Strategic Report, on pages 6 to 35, also covers aspects such as the overall financial performance and financial risks. Finally the Viability Statement on pages 32 to 34 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 just under 7 years to the end of the next PR19 Business Plan.

The Company's current bankers are Lloyd's who provide a £2m 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 within the levels of our current facilities. Accordingly the Directors have concluded that there is a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. Consequently 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 32 to 34.

Cash and cash flow

In overall terms closing cash of £26.744m (2017 - £11.644) has been positively impacted by £11.037m of cash timing differences relating to the distribution of proceeds from the sale of the business (note 31).

The other significant movements relate to £3.0m lower purchases of tangible and intangible assets cash inflows for the issue of share capital of £3.0m offset by net repayment of borrowings of £1m.

Strategic Report

Engineering Report

As a capital intensive infrastructure business, maintaining and building our large network of above and below ground assets is a critical part of our operations. This activity also represents a significant proportion of the business' costs and, as such, is a key area of focus for efficiency and innovation in order to provide value for money for our customers.

Mains renewals (below ground assets)

The company has renewed and replaced 23km of mains during the year, 80% of which has been completed using "no dig" techniques. The continued use of no dig techniques to renew mains both reduces the impact of the works on customers & local communities and is a more efficient, faster way of completing the work. It has the added benefit of reducing the amount of material required to reinstate roads after work has been completed, reducing the Company's carbon footprint. Customer continue to give very positive feedback on the works completed with 83% rating the work and associated communication as either "good" or "very good". A further 7km of new mains has also been constructed.

Non infrastructure framework contract (above ground assets)

Non infrastructure works covers significant maintenance activity at our operational sites. The Company's innovative "collaborative non infrastructure framework contract" is now delivering results for our customers with the first schemes commencing construction. This is promoting the development of innovative solutions to works which will both reduce the overall cost of activities and

future maintenance costs. This is having a positive impact, for example by streamlining construction and installation times on site and using off site construction reducing both costs and H&S risks on site.

The framework arrangement continues to provide excellent value for customers by bringing new ideas and ways of working into the business and ensuring that the capital expenditure included in the business plan is delivered in the most cost effective manner.

Reservoirs

The company has continue to invest in its reservoirs during the year, works have been implemented at 6 sites, ensuring that the reservoirs remain in a serviceable condition.

River Itchen bulk supply of water

The Company has worked collaboratively with Southern Water during the year to complete a bulk transfer connection between the Company's river Itchen works and Southern Water's Hampshire network. This bulk transfer of water will be utilised to support Southern Water with water transfers when demand is high and there is spare water in Portsmouth Water's network.

Resilience schemes

The Company is committed to maintaining a resilient water supply for our customers. Over the past 2 years we have developed new detailed models to understand the impact of multiple operational scenarios on our ability to maintain water supplies to our customers. This has resulted in an enhanced understanding of the Company's resilience to both long and

short terms events. This will be a key part of informing the Asset Management Plan (AMP) put forward as part of the next Regulatory Review (PR19). This plan has been supported by extensive customer engagement work.

Surveys

Surveys of all the Company's boreholes have been completed in the year, which have shown that all are in good condition requiring minimal capital investment in the next AMP period. The work was delivered using a new technique which has reduced the time taken to complete the survey and the time the boreholes had to be taken out of service for and provided a cost saving.

A survey has also been carried out on the Hillsea tunnel, a tunnel which carries 2 of the main water supply pipes for Portsmouth city which was constructed in 1903/4 the survey showed the tunnel is in good condition and included a 3D photo survey, which allows engineers to view the condition of the tunnel, supports and pipes within without having to access the tunnel in the future.

Leakage

The company has continued to focus this year on improving the leakage levels experience in the Company's network of 3,300km of mains. It has been a challenging year in terms of leakage, particularly with a number of freeze/thaw events during the winter. The company remains confident that the hard work will result in reaching the 5 year target at the end of the AMP.

Water Quality

The Company's investment in additional water treatment at Eastergate and Westergate WTW, made in previous years, to combat the risk of cryptosporidium has proved successful with both works operating reliably throughout the year.

The investment at Farlington WTW to replace the membrane plant with UV treatment and construction of a wash-water recovery plant, to conserve water, has been completed and is now also fully operational.

Asset Planning

The Company has been working hard on its AMP for PR19 throughout the year and has delivered a step change in the approach to asset planning. This includes the development of more comprehensive asset models which have allowed for a highly robust assessment of the Company's assets and requirements for investment over the period 2020-25.

Strategic Report

Tax Strategy

Corporate Structure

The Group structure in which the Company resides, has recently changed and is set out on page 39. The Group is wholly owned by funds managed by Ancala Partners LLP ("Ancala") through a UK holding company Ancala Fonia Holdco Limited. Ancala is a UK based and domiciled independent infrastructure fund manager.

Portsmouth Water is committed to full compliance with UK tax laws. As a Company we understand that collecting and paying tax is an important part of contributing to the economic environment that we operate in and in addition to paying corporation tax we also contribute as a result of indirect taxes, employee related taxes and environmental taxes. The Company's tax affairs are managed in a way which takes into account the wider corporate reputation. At all times the tax affairs are managed in line with the Company mission statement of Integrity, Excellence and Respect.

Governance in relation to UK taxation

- The ultimate responsibility for the tax strategy of Portsmouth Water Limited sits with the Board.
- The Finance and Regulation Director is the Board member with executive responsibility for tax matters.
- The day-to-day management of the tax affairs is delegated to the Financial Controller who reports to the Finance and Regulation Director.
- Members of the Finance team are trained to a level that ensures tax compliance and a continuous cycle of training occurs to ensure all skills are relevant and up to date.
- For tax filing, specialist advice and support Portsmouth Water engage the services of specialist Finance and Accountancy professionals.

Risk Management

Attitude towards tax planning and level of risk

Portsmouth Water Limited manages risks to ensure compliance with legal requirements in a manner which ensures payment of the correct amount of tax.

Portsmouth Water's attitude towards tax planning is one of prudence; seeking to comply fully with relevant tax legislation and to achieve a high degree of certainty in the company's tax affairs. The wider group of Companies applies the same approach to tax planning as a whole.

At all-times Portsmouth Water seeks to act in a way which is legitimate and upholds its reputation as a good corporate citizen.

For any specific issue or transaction the Board is ultimately responsible for identifying the risks, including tax risks, which need to be address and for determining what actions should be taken to manage those risks. In doing so the Board has regard to the materiality of the amounts and where specific risks occur the Company will seek specialist professional advice.

In line with the Company's ethos to strive for continuous improvement through innovation we are able to utilise government tax initiatives such as the R&D Tax Credits scheme to reduce our corporation tax charge and therefore continue to maintain one of the lowest cost of service in the water industry.

Working with HMRC

Portsmouth Water seek to have a transparent, respectful and proactive relationship with HMRC at all times, be that directly or through intermediaries acting on our behalf.

Any inadvertent errors that may occur in any submission made to HMRC are fully disclosed as soon as reasonably practicable after they are identified and independent specialist advisors are commissioned to validate the value of any error. Following this, an internal review will then identify any required process changes of internal controls, to ensure full and ongoing compliance.

Future tax changes are considered through Water UK's Tax Forum, of which Portsmouth Water is a member. This group allows us the opportunity to discuss how future tax legislation can be interpreted and applied to the Water Industry.

Corporate Criminal Offences Code of Conduct

Tax evasion, tax fraud and attempts to facilitate such actions are unethical and inconsistent with the ethos of Portsmouth Water.

Portsmouth Water is committed to complying in full with the UK tax laws, and we expect everyone working with the Company to fully comply with their tax obligations. We believe in paying our fair share, and that everyone working with us should too.

Accountability & Governance

The board of our Company has approved a code of conduct policy and supports our commitment to no tolerance of tax evasion

or its facilitation. The Finance and Regulation director is responsible for monitoring compliance with the policy and is supported by the Board and the management team in doing so.

Employee responsibilities

Our code of conduct sets the standards of behaviour we expect all employees to adhere to if employees are ever asked to act in any way that could facilitate tax evasion, this must be reported without delay.

Risk assessment and mitigating factors

Our business risk assessment covers those areas of business operation where there is a risk of tax evasion. In relation to these risks we have considered relevant mitigating factors (including internal controls). Where necessary we have developed further activities and controls to mitigate areas of exposure.

Our commitment

Portsmouth Water is committed to the following principles:

- Our business is carried out fairly, honestly, and openly in every part of our work.
- Our values inform everything we do.
- We will never transact with any supplier where it is known or suspected that any aspect of the transaction is being misused, abused or otherwise corrupted for the purposes of tax evasion.
- We will immediately terminate any agreement or business relationship if we learn of or suspects tax evasion may be taking place.
- We will not do business with others who do not also hold to at least the same standard of preventing tax evasion.
- Any employee found in breach of our policy will be subject to disciplinary action.
- No employee will suffer demotion, penalty, or any other adverse action for reporting or from refusing to carry out an action which may lead to tax evasion.



Helen Orton
Finance & Regulation Director

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 key issues likely to impact the business over the next 5-10 years.

Regulation

The water industry is highly regulated (see page 29 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 third 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.

Customer Engagement

Ofwat have published its methodology for setting prices for the period 2020 - 2025. The document reaffirms the need to put customers at the heart of the business, both in terms of planning and delivery. The Company has undertaken significant engagement this year with many different customers, urban/rural, metered/unmetered, bill payers/future customers. This research will be used in preparing our Business Plan, due in September 2018.

We have also consulted extensively on our Water Resource Management Plan. Again, this is discussed with a number of relevant stakeholders, and to date over 1,600 customers have also commented on the plan.

Both exercises have supported the current service we provide to our customers and the plans we have to enhance the resilience and reliability of our supplies for the future.

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 disproportionately 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 Winter Storage Reservoir. This significant 8 year programme will require a highly collaborative approach between water companies and regulators in order to fund and develop. This scheme will be a key part of the Company's PR19 Business Plan. 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 302,000 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.

As explained more fully in the Corporate Governance section on page 39 the Group is owned by Ancala Fonia Holdco Limited an investment holding company for UK based infrastructure investment fund.

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.

CCG Report on ODI performance 2017/18

The CCG provides independent challenge and assurance on the quality of the Company's customer engagement and has a monitoring role to review the performance against the Company's Outcomes (Outcome Delivery Incentives).

Whilst the Company is meeting the majority of its target ODIs it is disappointing to see that four measures were not met; two of which (leakage and water quality contacts) were also not met in the preceding year. The Company implemented plans to improve performance in both of these areas. In particular the CCG has challenged the Company to understand what has caused the increase in leakage and how new technologies can be used to drive more rapid improvements. The company has also failed measures in relation to Mean Zonal Compliance and Per Capita Consumption. The Company states that the failure in MZC was primarily driven by three "customer side" problems two relating to internal lead plumbing and one relating to cross contamination by a herbicide used in a neighbour's garden. The CCG will continue to closely monitor the Company's progress in these areas.

Customer Engagement

During the year the Company undertook extensive customer engagement activity in preparation for PR19. This included detailed work in relation to PR19 ODIs and a range of wider business issues such as resilience, leakage, metering and concerns for future bill payers. A Customer Advisory Panel was also established to allow a deeper and better informed view from a panel of customers. The Company has kept the CCG informed on all of its engagement activities and responded positively to any challenges we have made.

Lakh Jemmett
CCG Chair

Our Regulators

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.

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.

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.

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.

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.

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.

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. MOSL is responsible for the effective and efficient operation of the non-household water retail market and plays a central role in it's 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
Our customers					
Operational	The significant loss of treatment works or failure of critical parts of the mains network	Failure to supply customers over an extended period.	Operational Reputational Financial	●	●
Water quality	Failure against drinking water quality standards.	Water not fit to drink.	Operational Reputational Financial	●	●
Business continuity	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 Reputational Financial	●	●
Our people					
Human resources	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 Reputational	●	●
Health & Safety	Failure to maintain appropriate health and safety standards.	Serious injury or death of employee or contractor. Prosecution by HSE.	Reputational Financial	●	●
Our environment					
Environmental	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 Reputational Financial	●	●
Our business					
Financial	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	●	●
Regulatory	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 Financial	●	●
Legal & governance	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 Financial	●	●
Competition 'Open Water'	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 Reputational	●	●
IT	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 Reputational 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 43.

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

Strategic Report

Viability Statement

1. Assessment of prospects

The Board has assessed the prospects of the Company over a period of 7 years.

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 model 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 this 5 year period. More information in respect of the regulatory regime is set out in pages 27 to 29.

The Company is currently in the process of finalizing its regulatory Business Plan submission for the following regulatory review cycle (from 1 April 2020 to 31 March 2025) which will be submitted to Ofwat on 3 September 2018 (the "Draft Business Plan"). Whilst this Draft Business Plan has not been submitted or approved, it does capture the Company's current business strategy into the next regulatory period together with detailed financial projections. The Company considers that this represents the best current indication of future operating activity and financial results at this time. This Draft Business Plan includes the development of a new water resource, Havant Thicket Winter Storage Reservoir ("HTWSR"), which will result in significant capital activity throughout the next 5 year period and beyond.

The Board continues to take a conservative 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 and as developed in the Draft Business Plan. 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 in the Draft Business Plan resulting from the development of HTWSR, the lower anticipated WACC, and more challenging regime of rewards and penalties.

The assessment process of the Company prospects**Budget process**

The Company's prospects are routinely 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 (2018/19) financial period.
- Five year analysis to 2019/20 comprising 3 year actuals, 1 year detailed budget and 1 year projection. These are compared against the Final Determination.
- Cash flow projections to 2019/20 (3 years detailed monthly and 2 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 & liquidity positions and future funding requirements.

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 2018.

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
- Levels of activity and cost related to leakage

5 year Business Plan process

In addition, given the proximity to the Draft Business Plan submission, the Company's prospects are also considered in relation to the financial modelling and overall Business Plan documents which will be provided to Ofwat to support the determination for the Period 2020-2025.

The Development of the Draft Business Plan for submission is a detailed and complex process including the following activities;

- Customer research
- Capital assessment and planning
- Optimization of schemes & activities
- Detailed financial modelling
- Design of rewards & penalties
- Assessment of resilience
- Financeability testing
- Assurance
- Governance & Board approval

These activities culminate in the development of a detailed business plan in line with Ofwat's guidance & methodology.

The critical assumptions underpinning the business plan include;

- A hybrid RPI/CPI WACC of 2.95% including a company specific premium
- Totex benchmarking and efficiencies
- Capex and mains renewals levels and profile
- Projected RPI & CPI
- Levels of rewards & penalties
- Any historic true up required
- Distribution levels
- Costs relating to HTWSR
- Bill level & profile
- Availability of financing

In addition the Company has produced financial modelling of the business performance for a further 10 year period beyond the Draft Business Plan. This is based, primarily, on a roll forwards of the Draft Business Plan, 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. It also reflects the impact of HTWSR construction and operating costs.

The further assumptions in the additional 10 year projections relate to;

- A hybrid RPI/CPI WACC of 2.95% real including a company specific premium
- Projected RPI and CPI (which 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.

Risk assessment

Alongside these activities, 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 2018. As part of the Draft Business Plan preparation the Company has performed an assessment of "resilience in the round" building form an understanding of operational risks through financial resilience and with regard to overall company resilience including Governance and management effectiveness. Board review and approval in relation to this assessment took place in February & March 2018. The overall summary of the principal risks and uncertainties (set out on pages 30 to 31) reflects this consideration of "resilience in the round".

Details of the Board risk assessment process are set out on page 43. The purpose of the principal risks table is, primarily, to summarise those matters that could prevent the Company 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.

In setting out specific scenarios for the Viability Statement we have reviewed the risk register together with resilience modelling prepared as part of the PR19 Business Plan together with Board analysis prepared to support "resilience in the round". Using this information we have developed a range of relevant severe, plausible and reasonable business scenarios which have been linked to the relevant business risks. These were reviewed and approved by the Board and are summarized in section 2 below.

The period of assessment

The Board conducted the assessment for a period of 7 years to 31 March 2025. The Board considers that this period of 7 years to be most appropriate given the current stage of the regulatory review cycle. This period covers the 2 years remaining of the current regulatory period and the period to the end of the next Price Review. This is consistent with the fact that, at this point, Ofwat's methodology for the next regulatory review cycle has been finalised and Company's Draft Business Plan (for the 5 years to March 2025) is sufficiently well developed.

The Board 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, the Draft Business Plan and the related Outcomes are significant drivers of the business strategy & performance. This is a key driver to the end of the next regulatory period of 2025. Whilst the Board considers 7 years to be an appropriate horizon to consider the continuing viability of the Company, they do also consider the viability over a longer term beyond this period as indicated above.

2. Assessment of viability

The Assessment of Viability therefore uses a period of 2 years of budgeted information to the end of the current regulatory period and the 5 years of financial performance modelled in the Draft Business Plan to 31 March 2025.

Although the budget and Draft Business Plan 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 (such as gearing, net debt:RCV and interest cover).

These scenarios (which are summarised on page 34), which have been driven from the Board's assessment of "resilience in the round" as part of the Draft Business plan (and are reflected in the principal risks and uncertainties set out in pages 30 to 31) represent 'severe, plausible and reasonable' circumstances that the Company could experience.

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 adverse impacts, set out on page 34, which may have an adverse but short lived (1 year) effect 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.

3. 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 seven year period ending 31 March 2025.

4. Going concern

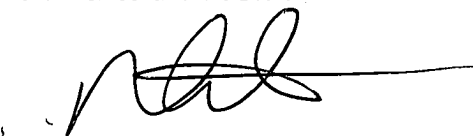
The directors also considered it appropriate to prepare the financial statements on the going concern basis, as explained in the Basis of preparation paragraph in note 1 to the financial statements.

5. 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

24 May 2018

Strategic Report

Viability Statement**Summary of Viability Scenarios Tested**

Scenario	Link to Risk	Outcome	Mitigation
The loss of a significant Water Treatment Works	Operational, Financial, Business continuity	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
A combination of 2 risk events (driven by operational risk scenario modelling)	Operational, Financial, Business continuity	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
A £12m pension deficit arising.	Financial	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by managing costs and additional debt finance.
A maximum one year ODI penalty.	Regulatory, Financial	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
A regulatory fine 3% turnover	Operational, Regulatory	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
Loss of a critical IT system for one month in combination with two different scenarios;	Business continuity	Cash flow deficit and minor deterioration of interest cover ratios.	No mitigation needed on a stand-alone basis.
i) loss of a significant treatment works (see assumption above);	Operational, Financial, Business continuity	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
ii)a £12m pension deficit arising.	Financial	Cash flow deficit and minor deterioration of interest cover ratios over the period of recovery.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
An upper limit capital expenditure test of £20m	Financial, Operational	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by increasing RFF and raising additional debt.
Development of Havant Thicket Winter Storage Reservoir	Financial, Operational	This major £90m, 8 year capital scheme has been modelled to assume funding through a combination of debt and equity. Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	N/A
Sensitivity testing of key assumptions - inflation -1% - WAAC to 2%	Financial	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Both mitigated by raising additional debt in the near term. In the longer term dividends may need to be restricted or equity injected to manage gearing (after 7+ years).

Report On Payment Practices and Performance

Ensuring a collaborative and good working relationship with all of our suppliers is key to the operational success of Portsmouth Water Limited.

We are aware of how important being paid on time and within a reasonable period is to all of the suppliers that we work in partnership with, and as such operate with fair payment terms. This is demonstrated by our payment practices which we have reported for the six months to 31st March 2018.

Through close relationships with our suppliers we are fortunate to have minimal instances where payment of invoices has been in dispute. Our current process means that both the Financial Controller and the Purchasing Manager are aware, on a day to day basis, of any payment disputes and these are actioned and resolved quickly. Statements are reconciled monthly and all of our spend is covered by a Purchase Order system which is also managed on a daily basis.

- ▶ Our standard terms are payment in 30 days from date of invoice
- ▶ The maximum contractual payment terms are 30 days from end of month
- ▶ Change of payment terms occur rarely however, this would be on an individual supplier basis and changed through a collaborative process

- ▶ Suppliers are encouraged to send their invoices to us electronically
- ▶ Supply chain finance is not available
- ▶ Portsmouth Water's business practices and policies do not cover deductions
- ▶ Portsmouth Water is not a member of a payment code

Invoices with a receipt date between 1 October 2017 and 31 March 2018

Total number of those invoices paid	9,549
Total number of those invoices unpaid	803
	<hr/>
Total number of those invoices unpaid but due	10,352
	<hr/>
	51

Breakdown of percentage paid

Average number of days taken to make payments within the dates above from receipt of invoice 15.43 days

Those due for payment within period up to 31 March 2018

Not paid	0.59%
Not paid within terms	25%
Not paid within 30 days of receipt	3%

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. Whilst at £100 our average bill is the lowest in the country, we have a number of options available to support these domestic customers.

We introduced our 'Helping Hand' Social Tariff in 2016. This tariff caps customers bills at our minimum charge, currently £76.86, 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 200 customers on this scheme with over 350 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 9,716 tCO₂e (2016/17 - 11,079 tCO₂e (restated)).

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

The significant reduction in gross greenhouse gas emissions is due to the conversion factor we apply in the calculation, which reflects the UK grid electricity generation mix, as determined by Department for Business, Energy & Industrial Strategy (BEIS).

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 almost 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, and now report annually.

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.

	Units	2017/18	2016/17	2015/16 Restated
Electricity used	MWh	22,793	22,551	21,689
Gross greenhouse gas emissions	tCO ₂ e	9,716	11,079	11,606
Water delivered - Distribution input	MI	63,667	62,065	60,880
Gross Greenhouse gas emissions per million litres of water delivered	KgCO₂/ML	153	179	191

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 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), 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 and begin the application of this work. This has included the launch of a Farmers Capital Grant Scheme and a scheme to subsidise surveys and repairs to domestic oil tanks situated in high risk areas. We continue to work in partnership with Downs & Harbours Clean Water Partnership and the Forestry Commission to develop new, innovative interventions to further drive sustainable land management across our catchments. This work will help us deliver water quality improvements 'today' and firmly establish 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.

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 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 2017/18 have included;

- Opening up relic creeks and channels to improve saltmarsh habitat.
- Removal of invasive species across a number of sites.
- Chalk grassland, ancient woodland and wetland restoration.
- Enlarging an existing pond.
- River restoration.

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

GDPR

As a utility, the Company is taking very seriously its obligations under the new Data Protection legislation which comes into force on 25 May 2018. The Board have reviewed the progress of a designated project team over the past 12 months and are confident the Company will be compliant with the new requirements.

Governance



Mike Kirk
Chairman
24 May 2018

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. This deviation from the Ofwat guidance is as a result of the recent change in ownership of the Company and is explained below.

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

A copy of the Portsmouth Water Governance Code can be found at: www.portsmouthwater.co.uk/wp-content/uploads/2015/02/D67ZBEE-1E4Z-42F6-BE30-3D086D7COZCZ.pdf

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), three Executive Directors and one newly appointed Investor Director. Previously, when I had the casting vote we believed we complied with the spirit of the proposal, however, the appointment of Mr Owens requires us to review the position. The Nomination Committee have been tasked with appointing a new Independent Non-Executive to the Board and we hope the appointment will be completed shortly. In addition Mr Porteous has given notice to the Board of his intention to retire in December 2018 and the Nomination Committee have commenced the search for his replacement.

Auditor Change

As reported last year, 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 2017 AGM KPMG were appointed as new auditors of the Company.

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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.

On 16 March 2018 the whole of the issued share capital of South Downs Capital was disposed of by South Downs Trustees Limited (73%) and individual shareholders (27%) to funds managed by Ancala Partners LLP ("Ancala") (as set out in the group structure above).

Ancala Partners LLP ("Ancala") is a UK based infrastructure fund manager. Its investors are primarily UK corporate and local authority pension plans. The acquisition of South Downs Capital Limited was implemented by a new company, Ancala Fornia Limited, which is incorporated in the UK. The ultimate parent undertaking is Ancala Fornia Holdco Limited ("AFHL") which is incorporated in the UK. The investors in AFHL comprise a number of investment vehicles, all focused primarily on UK long-term infrastructure investment and managed by Ancala Partners LLP.

Ancala manages approximately £850 million of funds with investment from UK and European pension plans and institutional investors with a long term investment horizon.

As noted in the group structure South Downs Employee Benefit Trust was the ultimate shareholder of 73% of the share capital of South Downs Capital Limited. By virtue of the sale of the investment in South Downs Capital Limited the beneficiaries of the Employee Benefit Trust (being the majority of employees and certain former employees) received a share of the net sales proceeds. This is explained further in note 31 to the financial statements.

We consider AFHL to be the ultimate holding company and ultimate controlling entity. Consolidated group financial statements have been prepared at the level of South Downs Capital Limited for the 12 months to 31 March 2018. Consolidated financial statement for the 54 weeks ending 31 March 2019 will be prepared at the level of Ancala Fornia Holdco Limited and this will be the largest Group for which consolidated financial statements are prepared.

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 £103.3m (2017 - £99.6m).

Governance

Board of Directors

Executive Directors

Shareholder Nominated Non-Executive Director

Neville Smith (61)
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 (48)
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 (61)**
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.

Rod has given notice to the Board of his intention to retire in December 2018.

David Owens (66)
Investor Representative

Appointed to the board
March 2018

Qualifications
C.Eng., B.Sc., F.I.E.T.

Experience
David has an extensive utility background and between 2006 and 2009 he served as CEO of Thames Water.

Prior to his role at Thames he was a Director at Macquarie and an alternate on the Board of NRE, a gas and electricity distribution network. He was also Managing Director of both Eastern Electricity and ABB Power T & D.

Since 2010 David has been involved with Enserve, a BZB service provider, first as CEO and since April as a Non-Executive Director.

David holds a First Class Honours Degree in Electrical Engineering. He is a chartered electrical engineer and fellow of the IET (Institution of Engineering and Electronics).

Independent Non-Executive Directors

Michael Peter Kirk (58)
Independent Non-Executive
Chairman

Appointed to the board
November 2012

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

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
(60)
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 (45)
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 Adelie
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

	Board	Audit Committee	Nomination Committee	Remuneration Committee
Number of meetings in the year	12	3	1	2
Chairman				
Mike Kirk	11/12	3/3	1/1	2/2
Independent non-executive directors				
Heather Benjamin	11/12	3/3	1/1	2/2
Martin Johnson	12/12	3/3	1/1	2/2
Executive directors				
Neville Smith	12/12	-	1/1	-
Rod Porteous	12/12	-	-	-
Helen Orton	11/12	-	-	-
Investment director				
David Owens	1/1	-	-	-

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, three Executive Directors and an Investor Director. Following the recent appointment of the Investor Director we will seek the appointment of a further Independent Non-Executive Director. With this change 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 was 100% purchased by Ancala Fornia Limited in March 2018. As part of this agreement Ancala are allowed one member on the Portsmouth Water Board and David Owens was appointed the representative on 16 March 2018.

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 2018 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 whistleblowing 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 26 April 2018, 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 42 to 51 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
24 May 2018

Audit Committee Members

Heather Benjamin (Chair)
Mike Kirk
Martin Johnson
David Owens

At the 2017 AGM, KPMG were appointed as the new Auditors of the Company and formally started from September 2017.

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
- Assessing Ofwat transparency of reporting of funds flow
- Assessing the calculations of the 2018 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, dealing with issues on the takeover 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 review of the Auditor's independence and objectivity was carried out as part of the Audit Tender. The current Auditors have been in tenure for one year.

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
24 May 2018

Nomination Committee Members

Mike Kirk (Chair)
Heather Benjamin
Martin Johnson
Neville Smith
David Owens

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, the Managing Director and the Investment Director.

Activities during the Year

The Committee met once during the year and again in April to seek to fill the vacancy due to the planned retirement of Rod Porteous in December 2018. Interviews have been conducted and an announcement is expected shortly. As noted previously the Nomination Committee is about to commence the process of appointing an additional Independent Non-Executive Director.

Board composition

Executive
43%



Male
71%



Age 40-49
29%



Non-Executive
43%



Female
29%



Age 50-59
29%



Investor Appointed Non-Executive
14%



Age 60-70
42%



Governance

Remuneration Committee



Martin Johnson
Chair of Remuneration Committee
24 May 2018

Remuneration Committee Members

Martin Johnson (Chair)
Mike Kirk
Heather Benjamin
David Owens

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 2017/18 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. It should be noted that, following the acquisition of the Group by Ancala the Executive Directors signed new service contracts. There were no significant changes in the terms. All Executive Directors are subject to retirement by re-election at the AGM.

Mrs. H. M. G. Orton serves as a Non-Executive Director for UKWIR, an organisation set up by the 20 water and sewerage undertakers in England, Wales, Scotland, Northern Ireland and the Republic of Ireland to identify and provide research requirements to meet the industry's business needs.

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

Element, purpose and link to strategy	Operation, performance measures, deferral	Maximum opportunity	Performance metric
Base Salary (Fixed Pay) 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. 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. Details of the outcome of the most recent salary review are provided in the annual report on remuneration.	None
Benefits (Fixed Pay) 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. 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
Pension (Fixed Pay) 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. Under the defined benefits scheme a maximum future accrual of 1/80th of career averaged earnings for each year of service.	None
Annual bonus (Variable Pay) 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. 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: 5% customer service measures 5% personal objective 10% key performance objectives
Long-term incentive bonus (Variable Pay) 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.
Employment contracts, and loss of office 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
New Executive Director appointments 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.

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

Remuneration is analysed by Director below:

	Salary/Fees £000	Benefits £000	Bonus Scheme £000	Discretionary Payment £000	Pension £000	Total 2018 £000	Total 2017 £000
Executive:							
H. M. G. Orton	110	10	16	10	12	158	143
R. C. Porteous	110	14	17	16	51	208	178
N. Smith	150	14	-	-	51	215	197
Non-Executive:							
H. V. Benjamin	25	-	-	-	-	25	25
M. Johnson	25	-	-	-	-	25	25
M. P. Kirk	39	-	-	-	-	39	38
	459	38	33	26	114	670	606

The Investor Director Mr D. W. Owens is not remunerated by Portsmouth Water Ltd as his primary employer is Ancala Partners LLP.

Share options

The Company does not operate an Executive Share Option Scheme. However, in connection with the disposal of the Employee Benefit Trust's 73% shareholding in South Downs Capital Limited, certain employees and former employees, (including Mrs H. M. G. Orton and Mr R. C. Porteous) were granted and exercised share options over South Down's Capital Limited. There was no gain on exercise of these options and they are not considered to form part of Directors' Remuneration.

Further information in connection with the sale of the South Downs Capital Group is set out both within the Corporate Governance section and in note 31 to the financial statements.

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.

	2018 £000	2017 £000
Car benefit	31	25
Medical insurance	7	8
Total	38	33

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 £
H. M. G. Orton	15.4%	16,193
R. C. Porteous	15.4%	16,524

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

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

	Customer Service Measure 1 %	Personal Objectives Measure 2 %	Financial/ Business Objectives Measure 3 %	Total %
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 Measure 1 %	Personal Objectives Measure 2 %	Financial/ Business Objectives Measure 3 %	Total %
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.

	Target %	Customer Service Measure 1 Value £	Target %	Personal Objectives Measure 2 Value £	Target %	Financial/ Business Objectives Measure 3 Value £	Uplift %	Uplift £	Maximum Variable Pay Achievable 2018 £	Maximum Variable Pay Achievable 2017 £
H. M. G. Orton	5	5,500	5	5,500	10	11,000	10	2,200	24,200	21,000
R. C. Porteous	5	5,500	5	5,500	10	11,000	10	2,200	24,200	21,000
N. Smith	N/A	-	N/A	-	N/A	-	N/A	-	-	-

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

	Achieved %	Customer Service Measure 1 Value £	Achieved %	Personal Objectives Measure 2 Value £	Achieved %	Financial/ Business Objectives Measure 3 Value £	Uplift %	Uplift £	Maximum Variable Pay Achieved* 2018 £	Variable Pay Achieved* 2017 £
H. M. G. Orton	3.5	3,680	4.5	4,732	6	6,309	10	1,472	16,193	13,000
R. C. Porteous	3.5	3,756	4.5	4,829	6	6,438	10	1,502	16,525	13,000
N. Smith	N/A	-	N/A	-	N/A	-	N/A	-	-	-

* final position awarded in respect of 2016/17 and paid in 2017/18

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 Objectives per annum %	5 Year Total %
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 Objectives Value £	Maximum Variable Pay Achievable 2018	Maximum Variable Pay Achievable 2017
R. C. Porteous	10	31,350	31,350	31,117
H. M. G. Orton	10	31,350	31,350	30,494
N. Smith	0	N/A	N/A	14,800

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

	Achieved %	Long-Term Objectives Value £	Maximum Variable Pay Achieved 2018	Maximum Variable Pay Achieved 2017
R. C. Porteous	7	23,375	23,375	24,143
H. M. G. Orton	7	23,375	23,375	23,659
N. Smith	N/A	N/A	N/A	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, who was a shareholder of the Parent Company, was 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 £11,750 (2017 - £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 increase in scheme benefit 2017/18 £000	Directors contributions 2017/18 £000	Total included in single figure 2017/18 £000	Value of increase in scheme benefit 2016/17 £000	Directors Contributions 2016/17 £000	Total included in single figure 2016/17 £000	Accrued Pension 31/03/18 £000pa	Accrued Pension 31/03/17 £000pa
R. C. Porteous ¹	56	5	51	37	5	32	59	56
N. Smith ²	59	8	51	44	8	36	97	93

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.

¹The pensionable salary used to calculate Mr. R. C. Porteous' accrued pension excludes £20,788 (2016/17 - £17,772) of non-pensionable salary.

²The pensionable salary used to calculate Mr. N. Smith's accrued pension excludes nil (2016/17 - nil) 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 six financial years. The Managing Director does not currently 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:	2013	2014	2015	2016	2017	2018
Total remuneration excluding pension (£000)	153	157	160	162	161	164

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 ¹	1.5%	1.75%
Benefits ²	0%	0%
Annual bonus ³	N/A	N/A

¹This increase represents the annual pay award.

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

³This 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 24 May 2018 and will be subject to shareholder approval at the Annual General Meeting to be held on 26 July 2018.



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 2018.

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 34.

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 30 and 31.

Financial Results and Dividends

The Company's loss (2017 - profit) before taxation amounts to £1.1m (2017 - £1.5m profit). After deducting the tax charge of £0.04m (2017 - adding the credit of £0.4m), a loss of £1.12m has been transferred to reserves (2017 - £1.9m profit).

The Directors are recommending the payment of a second interim dividend of £1.767m in June.

Fixed Assets

Capital expenditure on tangible fixed assets was £7.5m (2017 - £9.4m). 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.

Share Capital

During the year the Company issued 10 new ordinary shares of 10 pence each at a premium of £2,987,999 for cash.

Board of Directors

The Directors who held office at 24 May 2018 are shown on pages 40 and 41.

Mr D. W. Owens, a representative of the groups investors, Ancala Partners LLP, was appointed to the Board as a Non-Executive Director on 16 March 2018.

Mr. M. P. Kirk and Mr. M. P. Johnson, who retire by rotation, offer themselves for re-election. Mr D. W. Owens, who was appointed on 16 March 2018 offers himself for election.

No Directors have any interest in the Group shares. Previous interests are detailed in the Report on Remuneration on page 51.

The Company maintains appropriate Directors' indemnity insurance.

Substantial Shareholder

At 31 March 2018, 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.

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 thirteen years, been awarded twelve 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 four 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 9,716 tCO₂e.

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, KPMG were appointed as Auditors at the Annual General Meeting on 27 July 2017.

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 in Respect of the Annual Report, the Strategic Report, the Directors' Report and the Financial Statements

The directors are responsible for preparing the Annual Report the Strategic Report, the Directors' 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 they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

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 of the profit or loss of the company for that period. In preparing these 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 UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

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



By order of the Board

C. Hardyman ACIS

Secretary
PO Box 8
West Street
Havant
Hampshire
24 May 2018

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

Company Number: 2536455

Company Secretary: Christopher Hardyman ACIS

Ancala Fornia Holdco Ltd **Ultimate Holding Company**

Registered Office

c/o Ancala Partners LLP
40 Gracechurch Street
London
EC3V 0BT

Auditors

KPMG LLP
Gateway House
Tollgate
Chandlers Ford
SO53 3TG

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 of Portsmouth Water

Opinion

We have audited the financial statements of Portsmouth Water Limited ("the company") for the year ended 31 March 2018 which comprise the Income Statement, Statement of financial Position, Statement of Changes in Equity and the Statement of Cash Flows and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2018 and of its loss for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

Other information

The directors are responsible for the other information, which comprises the strategic report and the directors' report. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the other information;
- in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required 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.

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 53, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.


Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

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 auditor's 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.



James Ledward

Senior Statutory Auditor
25 May 2018

For and on behalf of
KPMG LLP, Statutory Auditor
Chartered Accountants
Gateway House
Tollgate
Chandlers Ford
SO53 3TG

Income Statement

For the year ended 31 March 2018

	notes	2018 £000	2017 £000
Turnover	3	40,489	40,342
Cost of sales		(22,643)	(22,872)
Gross profit		17,846	17,470
Net operating expenses	4	(11,384)	(11,720)
Operating profit before loss on disposal of fixed assets		6,462	5,750
Loss on disposal of fixed assets	6	(16)	(143)
Exceptional items:			
Exceptional staff costs relating to sale of business	5,31	(2,988)	-
Gain on disposal of non-household business	32	1,843	-
Operating profit after loss on disposal of fixed assets and exceptional items and before interest		5,301	5,607
Investment income	7	841	953
Other finance income	25	346	625
Interest payable and similar charges	8	(7,603)	(5,696)
(Loss)/profit on ordinary activities before taxation	6	(1,115)	1,489
Taxation of (loss)/profit on ordinary activities	9	(41)	368
(Loss)/profit for the financial year		(1,156)	1,857

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 2018

	notes	2018 £000	2017 £000
(Loss)/profit for the financial year		(1,156)	1,857
Remeasurement of net defined benefit asset	25	16,602	(4,147)
Movement on deferred tax relating to pension asset	21	(2,822)	705
Effect of change to corporation tax rate on pension asset	21	-	63
Total comprehensive income/(loss) for the year		12,624	(1,522)

Statement of Financial Position

For the year ended 31 March 2018

	notes	2018 £000	2018 £000	2017 £000	2017 £000
Fixed assets					
Intangible fixed assets	11	1,674		2,237	
Investment properties	12	440		440	
Tangible fixed assets	13	126,936		125,255	
Investments	14	55,484		55,484	
			184,534		183,416
Current assets					
Investments	15	2		2	
Stock		608		474	
Debtors	16	8,164		10,903	
Cash at bank and in hand	17	26,744		11,644	
		35,518		23,023	
Creditors: Amounts falling due within one year	18	(31,080)		(22,864)	
			4,438		159
Total assets less current liabilities			188,972		183,575
Creditors: Amounts falling due after more than one year	19		(103,294)		(99,613)
Accruals and deferred income: Capital contributions	20		(25,493)		(25,012)
Provisions for liabilities	21		(6,764)		(6,703)
Net assets excluding pension asset			53,421		52,247
Pension asset	25		24,794		11,446
Net assets including pension asset			78,215		63,693
Capital and reserves					
Called up share capital	23		1,078		1,078
Share premium account			4,527		1,539
Capital redemption reserve			3,250		3,250
Profit and loss account			69,360		57,826
Shareholder' funds			78,215		63,693

The accompanying notes form an integral part of these accounts.

The accounts were authorised for issue and approved by the Board on 24 May 2018 and signed on its behalf by



H. M. G. Orton
Director

Company Number: 2536455

Statement of Changes in Equity

For the year ended 31 March 2018

	Called up share capital £000	Share Premium account £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Balance as at 1 April 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 income for the year	-	-	-	(1,522)	(1,522)
Dividends	-	-	-	(1,205)	(1,205)
Balance at 31 March 2017	1,078	1,539	3,250	57,826	63,693
Profit for the year	-	-	-	(1,156)	(1,156)
New share capital/share premium issued	-	2,988	-	-	2,988
Remeasurement of net defined benefit asset	-	-	-	16,602	16,602
Movement on deferred tax relating to pension scheme	-	-	-	(2,822)	(2,822)
Effect of change to corporation tax rate on pension asset	-	-	-	-	-
Total comprehensive profit for the year	-	2,988	-	12,624	15,612
Dividends	-	-	-	(1,090)	(1,090)
Balance at 31 March 2018	1,078	4,527	3,250	69,360	78,215

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 2018 £69.072m (2017 - £57.538m) was distributable in accordance with company law and £0.288m (2017 - £0.288m) was not distributable.

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

The accompanying notes form an integral part of these accounts.

Statement of Cash Flows

For the year ended 31 March 2018

	notes	2018 £000	2018 £000	2017 £000	2017 £000
Cash generated from operations	24		23,601		10,589
UK corporation tax refund/(paid)		494		(555)	
Net payments for group relief		-		(167)	
			494		(722)
Net cash inflow from operating activities			24,095		9,867
Cash flows from investing activities					
Purchase of tangible assets		(7,884)		(11,144)	
Purchase of intangible fixed assets		(83)		(823)	
Capital contributions received		1,120		1,165	
Sale of tangible fixed assets		36		37	
Interest received		840		953	
Net cash used in investing activities			(5,971)		(9,812)
Cash flows from financing activities					
Proceeds from sale of non-household retail activities*	32	-		2,900	
Loan repayment from group companies		-		500	
Receipts from borrowings		3,000		4,000	
Repayment of borrowings		(4,000)		-	
Equity dividends paid		(1,090)		(1,205)	
Equity payment received		2,988		-	
Interest paid		(3,922)		(3,812)	
Net cash generated/(used in) financing activities			(3,024)		2,383
Net increase in cash and cash equivalents			15,100		2,438
Cash and cash equivalents at beginning of year			11,644		9,206
Cash and cash equivalents at end of year	17		26,744		11,644

*Payment in advance which includes the fair value of future meter reading services (note 32).

Notes to the Financial Statements

For the year ended 31 March 2018

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 £2m 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, betterment of the network such as upsizing and schemes where a significant proportion of the network in that area has been replaced.

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
Meters 7-12 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.

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.

Notes to the Financial Statements

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 (measured income accrual)

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.

Capitalisation and Useful Economic Lives of Mains Infrastructure

Judgement is used in determining the extent to which work on existing mains infrastructure represents "economic enhancement". To this extent such activity is capitalised. This is assessed by reference to the extent that such assets are physically enhanced. Appropriately qualified and experienced company engineers are consulted as part of this process.

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 and burst rates and industry averages. In particular the range applied of 40 to 100 years is consistent with wider industry practice which typically uses a range of between 50 and 200 years.

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. In addition, management review the sensitivity analysis provided by the actuaries and use external data to benchmark the range of assumptions used. Management also consider the relevant factors in determining the recoverability of any surplus arising.

Bad Debt Provision

The Company makes an estimate of the recoverable value of trade receivables. When assessing impairment of trade receivables, management considers factors including the aging profile of the receivables, stage of credit control and historical experience. The bad debt provision remains largely consistent year on year however a rise in 2018 was due to a specific provision for non-household debt (2018 - £4.6m, 2017 - £3.9m, 2016 - £3.5m, 2015 - £3.4m). The provisioning methodology was refined in 15/16 and continues to be consistently applied.

Deferral of Castle meter reading income

The proceeds for the disposal of the non-household retail business to Castle Water included the provision of meter reading services for a period of 5 years following the end of the operating agreement. As a consequence the Company is required to fair value (FV) the meter reading services and to defer these over the period of the service provided.

3. Turnover

	2018	2017
	£000	£000
Unmeasured supplies	21,374	21,637
Measured supplies	17,269	17,068
Bulk supply	92	60
Amortisation of developer contributions	638	582
Chargeable work	775	995
Deferred meter reading revenue	341	-
	40,489	40,342

Turnover is wholly attributable to water supply and related activities in the United Kingdom. Included within turnover is amortised meter reading revenue related to the disposal of the non-household retail business.

4. Net operating expenses

	2018	2017
	£000	£000
Administrative expenses	11,783	12,175
Other operating income	(399)	(455)
	11,384	11,720

5. Directors and employees

	2018	2017
	£000	£000
Employment costs:		
Wages and salaries	9,259	8,948
Social security costs	997	881
Defined benefit pension costs (note 25)	2,095	1,738
Defined contribution pension costs (note 25)	206	185
	12,557	11,752
Costs transferred to capital schemes	(671)	(560)
Ordinary net employment costs charged to the income statement	11,886	11,192
Exceptional National Insurance costs	2,884	-
Total employment costs	14,770	11,192

The total incremental amount of social security costs payable in relation to the transaction totalled £2,884,000, a further £104,000 related to additional apprenticeships levy arising. This is explained further in note 31.

Average numbers employed during year:

	2018	2017
	Number	Number
Operations	153	150
Administration	108	105
	261	255

	Highest Paid Director	Highest Paid Director	Total	Total
	2018	2017	2018	2017
	£000	£000	£000	£000
Total remuneration	164	161	567	527
Pension scheme benefit	51	36	101	79
	215	197	668	606

1 Director (2017 - 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 (2017 - 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 46 to 51. The information set out in that Report which is subject to audit forms part of these financial statements.

Notes to the Financial Statements

6. Profit on ordinary activities before taxation	2018	2017
	£000	£000
Profit on ordinary activities is stated after charging:		
Depreciation		
- infrastructure assets	1,119	1,082
- non infrastructure assets	4,644	4,145
Amortisation of intangible assets	646	367
Loss on disposal of fixed assets	16	143
Rates	2,267	2,163
Water abstraction charges	1,322	1,322
Hire of plant and machinery	6	8
Operating lease charges	33	191
Auditors' remuneration:		
Fees payable to the Company's current auditor for the audit of the Company's annual accounts	30	37
Fees payable to the Company's current auditor for other services:		
Audit related assurance services	10	14
Taxation compliance services	14	17
Other non-audit services	5	3
Fees in respect of Portsmouth Water Holdings Limited	5	-
Fees in respect of the Brockhampton Pension Scheme: Audit*	6	3
Fees payable to the Company's previous auditor for the audit of the prior year annual accounts and tax services	18	-

*Not paid by the Company

7. Investment income	2018	2017
	£000	£000
On loan from group company	832	914
Interest on short term deposit	9	39
	841	953

During the financial year 2018 interest received on intercompany loans reduced as a loan repayment occurred on 31 March 2017. The amount of funds available for short term deposit reduced during 2018.

8. Interest payable and similar charges	2018	2017
	£000	£000
£66.5m loan:		
Interest	3,733	3,621
Indexation	3,624	1,831
Amortisation of fees	57	57
Administration fees	92	79
Other bank loans and overdraft	84	97
Debenture stock	10	10
Other interest payable	3	1
	7,603	5,696

The rise in indexation year on year is due to the increase in RPI. (July 2017 - 272.9 and July 2016 - 263.4).

9. Taxation	2018	2017
	£000	£000
Current tax		
United Kingdom corporation tax at 19% (2017 - 20%)	69	191
Adjustment in respect of prior periods	-	(789)
	69	(598)
Deferred tax		
Origination and reversal of timing differences	(89)	141
Effect of change to corporation tax rate	-	(501)
Difference between pension cost charge and pension cost relief	-	28
Adjustment in respect of prior periods	61	562
	(28)	230
Tax on profit on ordinary activities	41	(368)
Factors affecting the tax charge for the year		
(Loss)/profit on ordinary activities before tax	(1,115)	1,489
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 19% (2017 - 20%)	(212)	298
Effect of:		
Expenses not deductible for tax purposes	6	2
Depreciation on assets not qualifying for capital allowances	176	89
Effect of change in tax rate	-	(501)
Other tax adjustments	10	(29)
Prior year adjustment - current tax	-	(789)
Prior year adjustment - deferred tax	61	562
Total tax charge/(credit) for year	41	(368)

No deferred tax balances are expected to reverse during the year to March 2019 (2018 - £nil).

10. Dividends	2018	2017
	£000	£000
Equity: Ordinary/"A" Ordinary		
Interim paid	544	602
Final paid	546	603
	1,090	1,205

The directors are proposing the payment of a second interim dividend of £1.767m for the year ended 31 March 2018. This dividend has not been accounted for within the current year financial statements, as it has yet to be approved.

Notes to the Financial Statements

11. Intangible fixed assets

	Software, consultancy and internal staff costs £000
Cost	
At 1 April 2017	2,840
Additions	83
At 31 March 2018	2,923
Amortisation	
At 1 April 2017	603
Charge for year	646
At 31 March 2018	1,249
Net book value	
At 31 March 2018	1,674
At 31 March 2017	2,237

As at 31 March 2018 there were no values to be included as intangible fixed assets work in progress.

12. Investment properties

	Investment properties £000
Valuation	
At 31 March 2017 and 31 March 2018	440

The historic cost of the investment properties at 31 March 2018 was £0.195m (2017 - £0.195m)

Investment properties were revalued at open market value as at 31 March 2018 by Vail Williams LLP, an independent valuer. The Group's entire 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.

13. Tangible fixed assets

	Freehold land, buildings, & reservoirs £000	Mains £000	Pumping £000	Vehicles, mobile plant & office £000	Total £000
Cost					
At 1 April 2017	54,886	56,539	50,796	19,091	181,312
Additions	414	4,163	1,205	1,715	7,497
Revaluation	-	-	-	-	-
Disposals	-	(63)	-	(448)	(511)
At 31 March 2018	55,300	60,639	52,001	20,358	188,298
Depreciation					
At 1 April 2017	12,742	3,772	26,003	13,540	56,057
Charge for year	790	1,119	2,251	1,603	5,763
Disposals during year	-	(30)	-	(428)	(458)
At 31 March 2018	13,532	4,861	28,254	14,715	61,362
Net book value					
At 31 March 2018	41,768	55,778	23,747	5,643	126,936
At 31 March 2017	42,144	52,767	24,793	5,551	125,255

Assets in the course of construction

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

	Freehold land, buildings, & reservoirs £000	Mains £000	Pumping Plant £000	Vehicles, mobile plant & office equipment £000	Total £000
Cost					
At 1 April 2017	727	196	886	37	1,846
Additions in to WIP during the year	347	3,586	1,304	809	6,046
Transferred into completed fixed assets	(271)	(1,525)	(2,374)	(791)	(4,961)
At 31 March 2018	803	2,257	(184)	55	2,931
Depreciation					
At 1 April 2017	-	-	-	-	-
Transferred to amortisation within intangible fixed assets	-	-	-	-	-
At 31 March 2018	-	-	-	-	-
Net book value					
At 31 March 2018	803	2,257	(184)	55	2,931
At 31 March 2017	727	196	886	37	1,846

14. Fixed asset investments

	Loans to Group undertakings £000
At 1 April 2017	55,484
Repayment of loan	-
At 31 March 2018	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 Investments £000
As at 1 April 2017 and 31 March 2018	2

Notes to the Financial Statements

16. Debtors	2018	2017
	£000	£000
Trade debtors	3,510	4,950
Amount owed by Group companies	774	281
Prepayments and accrued income	3,343	4,507
Other debtors	537	1,165
	8,164	10,903

All of the above amounts fall due within one year. Included within other debtors is corporation tax recoverable of £0.200m (2017 - £0.695m).

As at 31 March 2018, trade debtors had a carrying value of £6.853m (2017 - £8.833m) 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 £4.580m as at 31 March 2018 (2017 - £3.883m).

The ageing of these debtors was as follows:

	2018	2017
	£000	£000
Up to 12 Months	4,806	4,414
Over 12 Months	2,047	4,419
	6,853	8,833

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.

	2018	2017
	£000	£000
At 1 April 2017	3,883	3,545
Provision for bad debt required in the year	1,111	784
Debt written off in the year as uncollectable	(414)	(446)
At 31 March 2018	4,580	3,883

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 for routine trading debt, however, according to the Open Water Terms of Business collateral is now held in the form of cash and guarantees to cover any non-household risk.

17. Cash at bank and in hand

Of the total amount shown of £26.744m (2017 - £11.644m), £1.909m (2017 - £1.847m) is held specifically for the payment of the next half yearly loan interest charges.

£11.037m of the increase in cash is due to proceeds of sale and share options being transferred from Ancala. This is to settle future incremental employment related social security liabilities bought about by the transaction (note 31).

	2018	2017
	£000	£000
Cash at bank and in hand	26,744	11,644

18. Creditors: amounts falling due within one year

	2018	2017
	£000	£000
3% Perpetual debenture stock	60	60
3½% Perpetual debenture stock	185	185
4% Perpetual debenture stock	39	39
Payments received on account	2,820	2,351
Trade creditors	3,347	2,759
Amounts owed to group companies	1,619	1,571
Social security and other taxation	11,446	280
Other creditors	702	3,685
Balance outstanding on revolving credit facility	3,000	4,000
Accruals	837	1,510
Water rates paid by customers in advance	7,025	6,424
	31,080	22,864

19. Creditors: amounts falling due after more than one year	2018	2017
	£000	£000
In five years or more:		
Bank loan	104,118	100,494
Less: deferred arrangement costs	(824)	(881)
	103,294	99,613

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 £0.824m (2017 - £0.881m).

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	2018	2017
	£000	£000
Capital contributions	26,131	25,594
Release to turnover	(638)	(582)
	25,493	25,012

21. Provisions for liabilities	2018	2017
	£000	£000
Deferred taxation:		
At 1 April 2017	6,703	6,386
Charged during the year in income statement	61	317
At 31 March 2018	6,764	6,703

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

	2018	2017
	£000	£000
Total deferred taxation including deferred tax on pension asset:		
Accelerated capital allowances	7,697	8,068
Other timing differences	(933)	(1,365)
	6,764	6,703
Pension asset (note 25)	5,078	2,344
Total provision for deferred tax	11,842	9,047
	2018	2017
	£000	£000
At 1 April 2017	9,047	9,586
Deferred tax (credited)/charged in income statement (note 9)	(28)	230
Deferred tax charged/(credited) to the statement of comprehensive income	2,822	(768)
At 31 March 2018	11,842	9,047

Notes to the Financial Statements

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:

	2018 £000	2017 £000
Financial assets		
Fixed asset investment (note 14)	55,484	55,484
Current asset investment (note 15)	2	2
Cash at bank and in hand (note 17)	26,744	11,644
	82,230	67,130

	2018 £000	2017 £000
Financial liabilities		
Bank loans and overdrafts	103,294	99,613
Revolving credit facility	3,000	4,000
Debenture stock	284	284
	106,578	103,897

Sterling	Fixed Rate 2018 £000	Fixed Rate 2017 £000	Floating Rate 2018 £000	Floating Rate 2017 £000	Total 2018 £000	Total 2017 £000
Liabilities						
Bank loans and overdraft	103,294	99,613	3,000	4,000	106,294	103,613
Debenture stock	284	284	-	-	284	284
	103,578	99,897	3,000	4,000	106,578	103,897

Fixed Rate	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years	Weighted average period for which rate is fixed Years
2018	2017	2018	2017	2017
Sterling	3.6	3.6	14	15

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 2018 is detailed below:

	2018 £000	2017 £000
In one year or less	3,284	4,284
In more than five years	103,294	99,613
	106,578	103,897

The Company had undrawn borrowing facilities at 31 March 2018, in respect of which all conditions precedent had been met, as follows:

	2018 £000	2017 £000
Expiring within one year	2,000	4,000
Expiring between one and two years	7,000	6,000
	9,000	10,000

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

23. Called up share capital	2018	2017
	£000	£000
Authorised:		
Equity:		
6,000,000 Ordinary Shares of 10p each	600	600
10,500,000 'A' Ordinary Shares of 10p each	1,050	1,050
	1,650	1,650
Non-equity:		
3,250,000 Redeemable Preference Shares of £1 each	3,250	3,250
Total	4,900	4,900
Allotted, called up and fully paid:		
Equity:		
4,265,187 Ordinary Shares of 10p each	427	427
6,509,162 'A' Ordinary Shares of 10p each	651	651
	1,078	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.

On 28 March 2018 ten new Ordinary Shares at 10p each were issued at a premium of £298,799.90 per share which was fully paid up in cash for £2,988,000. This resulted in an increase in share capital of £1 and created a share premium of £2,987,999.

24. Cash generated from operations	2018	2017
	£000	£000
Profit on ordinary activities before taxation	(1,115)	1,489
Adjustments for:		
Finance costs recognised in income statement	7,603	5,696
Notional pension costs	866	463
Investment income recognised in income statement	(841)	(953)
Other finance income	(346)	(625)
Loss on disposal of asset	16	143
Depreciation and amortisation of tangible and intangible fixed assets	6,409	5,594
Amortisation of capital contributions	(638)	(582)
Amortisation of deferred meter reading revenue	(341)	-
Profit on disposal of non-household business	(1,843)	-
Movements in working capital:		
(Increase)/decrease in stocks	(134)	118
Decrease/(increase) in debtors	2,161	(1,970)
Increase in creditors	11,804	1,216
Cash generated from operations	23,601	10,589

Notes to the Financial Statements

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 2018 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 2018 is £1.3m (2017 actual - £1.2m). Of this amount, £1.1m is contributed directly by that Company and £0.2m is contributed by employees by salary sacrifice under the SMART arrangement.

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

	2018	2017	2016
	% per annum	% per annum	% per annum
RPI inflation	3.2	3.3	3.0
CPI inflation	2.3	2.4	2.1
Discount Rate	2.5	2.4	3.4
Pension increases	2.3	2.4	2.1
Salary growth	4.3	4.4	5.25

Life expectancy of a male aged 65 at the accounting date is 23.1 years and for a female is 25.2 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 24.8 years and for a female is 27.0 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:

		2018		2017		2016
		Fair		Fair		Fair
		Value		Value		Value
	%	£000	%	£000	%	£000
Equities	32	52,727	35	56,931	34	47,932
Absolute Return Fund	25	41,111	24	38,439	23	33,134
Bonds	-	-	-	-	-	-
LDI	23	38,205	22	36,552	21	29,557
Property	11	17,525	9	14,653	10	14,032
Cash	9	15,480	10	16,733	12	17,125
	100	165,048	100	163,308	100	141,780

	2018	2017
	£000	£000
Total fair value of scheme assets	165,048	163,308
FRS 102 value of scheme defined benefit obligation	(135,176)	(149,518)
Pension asset	29,872	13,790
Related deferred tax liability	(5,078)	(2,344)
Net pension asset	24,794	11,446

Under FRS 102, the scheme is represented on the statement of financial position at 31 March 2018 by an asset of £29.872m (2017 - £13.790m), which amounts to £24.794m net of deferred tax (2017 - £11.446m).

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 £205,772 (2017 - £184,794).

Movement in the net balance sheet position

	2018	2017
	£000	£000
The FRS 102 value of scheme assets moved over the period as follows:		
Opening asset	13,790	17,775
Expense charged to profit and loss	(1,749)	(1,113)
Gain recognised outside of profit and loss	16,602	(4,147)
Employer contributions	1,229	1,275
Closing asset	29,872	13,790

Movement in present value of defined benefit obligation

	2018	2017
	£000	£000
The FRS 102 value of scheme defined benefit obligation moved over the period as follows:		
Opening scheme liabilities	149,518	124,005
Employer's part of current service cost	2,095	1,738
Interest on scheme liabilities	3,546	4,145
Benefits paid	(3,537)	(4,245)
Actuarial (gain)/loss	(16,446)	23,875
Closing scheme defined benefit obligation	135,176	149,518

Movement in fair value of scheme assets

	2018	2017
	£000	£000
The FRS 102 value of scheme assets moved over the period as follows:		
Opening fair value of scheme assets	163,308	141,780
Interest on scheme assets	3,892	4,770
Contributions by Portsmouth Water Limited, including employee contributions under the SMART arrangement	1,229	1,275
Benefits paid	(3,537)	(4,245)
Actuarial gain	156	19,728
Closing fair value of scheme assets	165,048	163,308

Expense recognised in income statement

	2018	2017
	£000	£000
The following amounts have been included within operating profit:		
Current service cost (employer's part only)	(2,095)	(1,738)
Total operating charge	(2,095)	(1,738)
The following amounts have been included as other finance income under FRS 102:		
Interest on pension scheme assets	3,892	4,770
Interest on pension scheme defined benefit obligation	(3,546)	(4,145)
Net return	346	625
Total expense recognised in the income statement	(1,749)	(1,113)

Accounts recognised outside income statement

	2018	2017
	£000	£000
The following amounts have been recognised within the statement of changes in equity:		
Actual return less interest	(156)	(19,728)
Experience gains arising on scheme defined benefit obligation	(1,226)	(2,567)
(Gain)/loss due to changes in assumptions	(15,220)	26,442
Remeasurement (gain)/loss of net defined benefit asset	(16,602)	4,147

The actual return on plan assets was £4.048m in the year to 31 March 2018 (2017 - £24.498m).

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 no commitments for non-cancellable operating leases beyond one year.

27. Ultimate controlling party

On 16 March 2018 the entire share capital of the Company's ultimate parent Undertaking, South Down's Capital Ltd, was acquired by funds managed by Ancala Partners LLP ("Ancala") an independent infrastructure investment fund. The new group structure is set out on page 39 to the financial statements. The ultimate controlling party is Ancala Fornia Holdco Ltd. For the period ended 31 March 2018 South Downs Capital Limited is the parent of the smallest groups of which the Company is a member and consolidated accounts can be obtained on request from the Registered Office. Ancala Fornia Holdco Ltd is the parent of the largest group of which the Company is a member. Consolidated accounts for Ancala Fornia Holdco Ltd will be prepared for the 54 week accounting period ending 31 March 2019.

28. Capital commitments

	2018	2017
	£000	£000
Relating to fixed assets	2,223	1,567
Relating to intangible assets	-	22
	2,223	1,589

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. Related undertakings are set out in the Group structure on page 39 and have the same Registered Office as stated on page 54.

30. Post Balance Sheet Event

No events have occurred post 31 March 2018.

31. Disposal of the South Downs Capital Group

As noted in the Strategic Report and Corporate Governance sections of the Annual Report and Accounts, on 16 March 2018 the South Downs Capital Group (of which Portsmouth Water Limited is the primary trading company) was sold to funds managed by Ancala Partners LLP ("Ancala"), an infrastructure investment fund. The Group was previously owned 73% by an Employee Benefit Trust (EBT) and 27% by external shareholders (comprising former senior management and one current director).

As a result of this transaction, share options relating to the 73% EBT shareholding were issued to the trust beneficiaries at market value (the majority of current employees and certain former employees). These options were exercised immediately and the shares disposed of as part of the transaction.

External tax advice and HMRC clearance indicated that the sales proceeds, due to employees, were deemed to have arisen "by virtue of their employment" by the Group. As such these distributions were subject to PAYE and NI contributions. In order to tax effect these sale proceeds due to employees the gross consideration received was paid to the Company and processed through payroll with payments being made net to employees. As such, additional employee PAYE and NIC contributions were settled out of the gross proceeds and were paid during April 2018. This resulted in a beneficial cash flow position of £11.037m as at 31 March 2018 due to the timing of the receipt of proceeds for distribution and the settlement of PAYE and NIC liabilities.

It should be noted that the Company's role was merely one to distribute the proceeds and, therefore (with the exception of employer NIC and apprenticeship levy – discussed further below) no income statement charges arose on this transaction.

A further impact of the transaction and its manner of distribution was the liability arising in respect of employers NIC and apprenticeship levy. As these are payable on payroll costs, a total additional charge of £2,988,000 arose in relation to the sale proceeds paid to employees. As this could not be deducted from the employees' distribution it results in a charge to the income statement which has been treated as an exceptional cost. However, this has been compensated for by the injection of additional share capital and share premium of £2,988,000 (note 23).

32. Disposal of the Non-household Business

As previously disclosed, the non-household retail business was disposed of to Castle Water Limited on 1 April 2017, the date that the non-household market opened to competition. Proceeds of £2.9m, including deferred meter reading income, was received in the previous financial year. After taking into account transaction costs a profit of £1.8m was realised. Meter reading revenue has been deferred and amortised over 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 26th day of July 2018, on the following business:

1. To receive and consider the Directors' Report and Accounts for the year ended 31 March 2018 and the Auditors' Report thereon.
2. To approve the Report on Remuneration.
3. To re-elect Mr. M. P. Kirk a Director of the Company.
4. To re-elect Mr M. P. Johnson a Director of the Company.
5. To elect Mr D. W. Owens a Director of the Company.
6. To reappoint KPMG as Company Auditors and to authorise the Directors to fix their remuneration.

Registered Office

PO Box 8
West Street Havant
Hants PO9 1LG
24 May 2018



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

a) Gearing - Net Debt: RCV

	2018 adjusted* £000	2018 £000	2017 £000
(i) Debt			
Bank loan (note 19)	104,118	104,118	100,494
Revolving credit facility (note 18)	3,000	3,000	4,000
Debenture stock (note 18)	284	284	284
Cash at bank and in hand	(15,707)	(26,744)	(11,644)
Net debt	91,695	80,658	93,134
(ii) Regulatory capital value indexed to 31 March	144,195	144,195	135,697
(iii) Gearing - Debt: RCV ratio (i) ÷ (ii)	63.6%	55.9%	68.6%

For the purposes of this ratio, debt excludes the deferred arrangement costs of £0.824m (2017 - £0.881m) and the current asset investment of £0.002m (2017 - £0.002m).

*Included within the cash at bank and in hand value at the year end is amounts due of £11.037m to be paid to HMRC relating to social security taxes. Funds to cover this payment were received from Ancala Partners in advance of the required settlement date. An adjusted Gearing-Net Debt: RCV has been calculated to remove the effect of this atypical cash balance.

b) Cash interest cover

	2018 £000	2017 £000
Operating profit	6,462	5,750
Less exceptional National Insurance costs (below operating profit)	(2,988)	-
Add back exceptional gain on non-household business (below operating profit)	1,843	-
Less loss on disposal of fixed assets (below operating profit)	(16)	(143)
Add back Employee Benefit Trust payment	1,267	1,210
Notional pension costs (note 24)	866	463
Depreciation and amortisation charges (notes 12 and 13)	6,409	5,594
Interest received, excluding amounts for inter-company loan (note 7)	9	39
Taxation refund/(payment), excluding payments for group relief	493	(555)
Capital expenditure (net of contributions)	(6,712)	(10,802)
Amortisation of deferred capital contributions	(638)	(582)
Amortised meter reading	(341)	-
Cash received from investing activities	2,988	-
Loan repayment from Group company	-	500
Loan draw-down	3,000	4,000
Repayment of loan draw-down	(4,000)	-
	8,642	5,474
(ii) Interest paid	3,922	3,812
(iii) Cash interest cover ratio (i) ÷ (ii)	2.20	1.44

c) Return on regulatory equity

	2018 £000	2017 £000
Revenue	40,489	40,342
Operating costs, excluding Employee Benefit Trust payments depreciation and amortisation	(26,351)	(27,788)
Regulatory depreciation (run off rate)	(5,445)	(5,211)
Infrastructure depreciation	(1,119)	(1,082)
Earnings before interest and tax	7,574	6,261
Current tax credit/(charge)	(69)	597
Interest payable, excluding indexation and amortisation	(3,921)	(3,808)
(i) Return	3,584	3,050
(ii) Average Regulatory Capital Value, equity element only (adjusted gearing)	50,940	40,361
(iii) Return on regulatory equity (i) ÷ (ii)	7.03%	7.5%

*RORE has been calculated excluding exceptional items as set out as the face of the income statement and based on adjusted gearing, as set out above, in order to be comparable with prior periods.