PORTSMOUTH WATER LIMITED
REPORT & ACCOUNTS 2007

COMPANY NUMBER 2536455

Contents

150 Years of Portsmouth Water

Portsmouth Water in 2007 is very different from the Company founded in the mid 19th century – in 1857 to be precise We now provide an uninterrupted supply of some of the highest quality drinking water in England and Wales to over 280,000 households and 15,000 businesses Every day of the year we supply over 180 million litres of water but it was not always like this This summary outlines how Portsmouth Water has become the Company we know today

On 13th July 1857, a new company, the Borough of Portsmouth Waterworks Company, was established by an Act of Parliament It was created following a report by the Inspector of the General Board of Health criticising the intermittent supplies by the existing Company, which served only 4,000 of the 10,000 homes in the Borough of Portsmouth The new Company accepted the Inspector's recommendations by developing the Havant and Bedhampton Springs, which remain today as its principal source of supply Its Head Office was established in 1884 at Commercial Road, Portsmouth

The 1860 Havant Pumping Station

Farlington Marshes Pumping Station in 1928 (just prior to demolition)

1869 saw the Company construct two open-topped reservoirs at Farlington on Portsdown Hill and, for the first time in 1880, constant water supplies were provided to customers in Portsmouth In 1884 supplies were extended to the north of Portsdown Hill by the construction of a service reservoir adjacent to the George Inn in London Road

Following criticisms of poor water quality after heavy rainfall, an Act of Parliament in 1906 required the Company to filter the spring supplies On 1st January 1910, the Farlington Filtration Works first supplied filtered water to Portsmouth

Dosing of small quantities of chlorine gas at Havant and Bedhampton began in 1926 so as to destroy any harmful bacteria in supplies

As a precaution against attack during the Second World War, an alternative 36-inch supply to Portsmouth from Farlington and also a 'bomb-proof' second pumping station at Bedhampton were constructed

Major air raid damage occurred on the night of 10th/11th January 1941, when 63 mains were fractured in southern Portsmouth The extensive loss of water through broken mains and service pipes and the heavy demand by the Fire Service caused the average daily demand to rise from 13 to 23 million gallons for two days

Having supplied Hayling Island via a bulk supply since 1928, the Company took over responsibility for water supplies from the Havant and Waterloo Urban District Council in 1950

In 1953 a new source at Worlds End, near Hambledon, was developed to augment supplies to the growing residential areas north of Portsdown Hill For the first time in nearly 100 years, the Company had an alternative supply to Havant and Bedhampton Springs

In 1955 the Company amalgamated with the Gosport Waterworks Company The Gosport Company, which had initially been established at Bury Cross in 1858, had been forced by saline intrusion of the Foxbury well to develop an alternative source at Soberton in 1906 Further sources at Hoe and Northbrook, near Bishop's Waltham, had subsequently been developed

Further amalgamation took place in 1959 when the Portsmouth & Gosport Water Company took over responsibility for the supplies for the Fareham area from the Urban District Council

The Company's Centenary was celebrated in 1957 with exhibitions and public visits to its Works

Cold weather for two and a half months in early 1963 resulted in 140 broken mains and 6,250 households with no supply because of frozen service pipes The experience prompted new water byelaws for new households to prevent a recurrence

1963 saw a major expansion into the West Sussex area which was coupled with the Company's development of a new source at Walderton, north of Emsworth Supplies for the Bognor Regis area were taken over from the Bognor Regis Urban District Council The Fishbourne well (constructed in 1874), Funtington wells and boreholes, the Lavant Reservoir and West Wittering Water Tower serving the Chichester Corporation area were also absorbed Responsibilities for the Selsey Water Company's bulk supply from Chichester Corporation were taken over, as were the Chichester Rural District Council's boreholes and reservoir at Woodmancote, north-east of Westbourne

The Company developed its own Laboratory in 1964 to carry out more frequent sampling and analysis At the same time, the Government asked water companies to consider the addition of fluoride to supplies to improve the population's dental health!

Laying a 60 inch overflow pipe at Hermitage Stream

150 Years of Portsmouth Water

Farlington Filtration Works in 1927 ***Inset Sand Washing at Farlington***

Joint studies in the 1960s with the Water Resources Board identified the long-term need for new water resources

The Company bought land at Havant Thicket for a storage reservoir and plans were developed for a river abstraction at Gaters Mill on the lower reaches of the River Itchen

In the same decade, new borehole sources were developed at Westergate, Lavant, Lovedean and West Street, Soberton, to meet the growing demand for water supplies

In 1967, the Company moved its Head Offices to purpose-built buildings at Brockhampton Springs in West Street, Havant At the same time the Company purchased its very first computer!

The River Itchen intake, treatment works and pumping station were completed in 1973 Costing £4 million, this was the largest project the Company had undertaken since its inception The Works were used to augment supplies to the Fareham, Gosport and Waterlooville areas

The drought of 1976 resulted in the imposition of a hosepipe ban, the first (and so far, the only one) in Portsmouth Water's history The experience resulted in a number of major schemes to link the supply networks across the whole of the Company's area The need to provide short-term storage led to a major programme of service reservoir construction

The 1980s saw the Company invest in a number of distribution and trunk mains schemes to improve water pressures throughout the area At the end of the decade, a rolling programme was established to replace old mains that burst frequently

The Water Act 1989 'privatised' the Water Industry and Portsmouth Water converted to a plc The Company's activities and charges were for the first time regulated by a number of new Government bodies

Major refurbishment schemes at almost all treatment works were carried out in the 1990s During further service reservoir storage and trunk mains improvements, significant archaeological discoveries were made at Lavant and Wickham

To meet new water quality requirements, schemes to minimise lead, nitrates and cryptosporidium oocysts in supplies were developed from 2000 onwards In 2004, the Company installed new infrastructure to provide a bulk supply to Southern Water to help alleviate water shortages during droughts in the Crawley and Horsham areas

This is a very short summary of the history of Portsmouth Water as it exists today It is drawn from a book to be launched on 13th July 2007 entitled 'Portsmouth Water 1857 to 2007 - 150 years of Service' It will be available in local book shops or by contacting the Company

Throughout the last 150 years, the Company has maintained high quality supplies and service by careful forethought and planning We intend to continue to do so in the years ahead!

New Head Offices opened in Commercial Road, Portsmouth - May 1884

Highlights

During the past year, Portsmouth Water has again been recognised for sector leading performance

- The Company has maintained its position for operating and capital maintenance efficiency
- Levels of service amongst the highest in the water industry
- Water supply maintained with no need for restrictions in the summer of 2006
- Significant progress achieved in the AMP4 capital expenditure programme
- The RoSPA Gold award for occupational health and safety was achieved for the second successive year

In 2007 Portsmouth Water Limited celebrates its 150th anniversary Throughout this report photographs are displayed which reflect the history of the Company On pages 2 and 3 a brief history of the Company is displayed For full information see the Company's website

	2007
Turnover	**£32 8m**
Operating profit	**£8 6m**
Profit before taxation	**£10 5m**
Net debt	**£73 6m**
Capital expenditure	**£14 8m**

Board of Directors

Executive

Nicholas John Roadnight
F C A [3]
Managing Director
Joined in 1978 Previously with Thornton Baker Appointed to the Board in October 1994 and appointed Managing Director in July 1997

John Edward Cogley
B Sc , C Eng , M I C E , M C I W E M
Customer Services Director
Joined in 1978 Previously with Anglian Water Appointed to the Board in June 1997

Andrew Richard Neve
B Sc , C Eng , M I C E , M C I W E M , M C M I
Technical Director
Joined in 1981 Previously with Thames Water Appointed to the Board in June 1997

Neville Smith
B A , FC M A
Finance Director and Company Secretary
Joined as Finance Director in February 1998 and became Company Secretary in June 2003 Previously with Smiths Industries and GEC

Non-Executive

Terence Michael Lazenby
FR Eng [123]
Independent Non-Executive Chairman
Chairman of the Audit, Remuneration and Nomination Committees
Joined in June 2002 and appointed Chairman in January 2003 Chairman of the Engineering Construction Industry Training Board Non-executive director of MTL Instruments Group plc and Expro International plc Previously held a number of senior executive positions with British Petroleum

Robert Leonard Sullivan
B Sc , C Dir [123]
Independent Non-Executive Director
Joined in June 2002 Previously held senior executive positions with Scapa Group plc, Sellotape Group and SmithKline Beecham Consumer Brands

Raymond John Tennant
B A ,FC C A ,C PFA [123]
Independent Non-Executive Director
Joined in June 2002 Former Managing Director of South East Water plc and SAUR Water Services plc Former Chairman of the Water Companies Association and WTI Training Group Ltd

[1] Member of the Audit Committee
[2] Member of the Remuneration Committee
[3] Member of the Nomination Committee

Chairman's Statement

The Company has again produced an impressive financial performance and continues to perform well in the Ofwat efficiency and customer service tables

The Company continues to provide services to customers which are in line with the best in the Industry, at a price which is the lowest in the country at an average of 22 pence per day In 2006, much of the South of England was suffering from drought conditions, but I am pleased to say that Portsmouth Water did not impose any water use restrictions on its customers last summer The Company did however join forces with other companies in the South East to ask customers to use water wisely and although not subject to restrictions, they did respond by using significantly less water than in previous periods of hot and dry weather Rainfall in the autumn/winter of 2006/07 was above average and the Company foresees no need to impose any restrictions this coming summer Leakage is a highly important issue for the Industry and the Company once again achieved its leakage target

Portsmouth Water is the only water company to have achieved the highest efficiency band for operating costs and capital maintenance in Ofwat's assessment for each of the last 5 years and is determined to remain at the leading edge of Industry performance for efficiency and quality of service to customers The Company recognises that in this competitive age customers rightly expect increasing improvements in service Recognising this the Company has this year, despite its already good ratings, launched an initiative 'CUSTOMER FIRST' to enhance customer service and to increase awareness of this throughout the organisation

The financial results for the year ended 31 March 2007 show an increase in operating profit of £1 6m (22%) to £8 6m This included a one-off credit to the FRS17 pension charge of £1 1m following a change to the rules of the pension scheme to permit retirees to commute more of their pension to a lump sum, which results in a lower liability for the scheme Revenue from the bulk supply to Southern Water was also £0 2m higher as the facility was used throughout the year to help their effort to deal with the drought of 2006 The sale of three properties generated a profit of £0 9m which resulted in an increase in profit before tax to £10 5m (2006 - £7 6m)

In the light of these results the Directors are recommending a final dividend of £1 8m, which will be paid in May 2007

Significant progress was achieved with the Company's capital programme in accordance with its 5 year Business Plan determined for the last periodic review Gross capital investment for the year amounted to £14 8m (2006 - £7 1m), which included £4 1m on infrastructure renewals A new membrane filtration plant at the River Itchen Treatment Works is almost complete at a total cost of £4 6m and will be commissioned in summer 2007 Remedial work on trunk mains in the Company's largest supply area, aimed at reducing the risk of discoloured water incidents was completed at a total scheme cost of £1 8m Construction of further membrane filtration plants at Soberton and Fishbourne Treatment Works is also well advanced and should be completed in 2008

Portsmouth Water is an important part of the Community it serves and we strive to play an appropriate role in its development by providing education, promoting the health benefits of drinking water, and the environmental need to use water wisely and efficiently In the summer of 2006 we launched a 3 year initiative with Staunton, the local country park, as part of an education programme for young children about the natural water cycle In its first year, over 500 children attended this programme through pre-arranged school trips

The Board is committed to providing a safe and healthy working environment for its employees and I am pleased to report that the Company achieved the RoSPA Gold Award for occupational health and safety for the second successive year

The high standards of performance highlighted in this report are the result of the skill, hard work, innovation and dedication of the employees I am grateful for their efforts and the Company will continue to provide the support and training required to develop its people and create continued improvements in all its activities

2007 is a milestone in the Company's history as it celebrates its 150th anniversary Its employees and pensioners are rightly proud of its achievements Throughout its history, the Company has maintained high quality water supplies and service by careful forethought and long term forward planning I am confident that it is well positioned for the future and that it will continue to maintain high standards and performance going forward

T M Lazenby
Chairman

Operating and Financial Review
Our Business

Portsmouth Water provides water to 297,000 homes and businesses in an area covering 868 square kilometres from the River Meon in Hampshire to the River Arun in West Sussex The Company serves the cities and towns of Portsmouth, Chichester, Fareham, Gosport, Havant and Bognor Regis On average, each day it supplies approximately 179 million litres of water through a network of over 3,200 kilometres of underground mains Water supplied, which is generally of high quality, is derived from the chalk of the South Downs and is abstracted from wells, boreholes, springs and the River Itchen The table below shows the major sources used by the Company during the year The springs at Havant and Bedhampton, which provide between 30% and 35% of the total supply, are thought to be the largest group of springs used for public supplies in Europe

Source	Actual 2006/07 Abstraction (Million Litres)	% of Supply 2006/07	% of Supply 2005/06
Springs at Havant & Bedhampton	20,108	31	32
River Itchen	6,069	9	8
Boreholes, Wells & Adits	39,182	60	60
Totals	**65,359**	**100**	**100**

A map showing the Company's area of supply and the location of its sources and treatment works is shown on page 22

Water from the springs at Havant and Bedhampton is treated at the Farlington treatment works and there are also treatment works at the River Itchen and Lovedean, which accounts for approximately 3% of supplies Water from the remaining sources requires less sophisticated treatment

Portsmouth Water's charges are the lowest in England and Wales, the average annual bill for water being £80 per household, the equivalent of 22p per day In real terms, the price of water for household customers has fallen by 14% over the last 10 years This compares with a real increase of 7 3% for the industry as a whole, as illustrated in the chart below, where the 1996/97 prices are indexed at 100

Comparison of Average Household Bills with Average Industry Tariffs

The water industry is subject to a range of UK and EU legislation Standards, particularly those relating to the environment, are being tightened on a regular basis and require increasing levels of investment The standards of service provided by Portsmouth Water are monitored by three main regulators - the Office of Water Services (Ofwat) for customer levels of service, the Environment Agency (EA) for environmental protection and the Drinking Water Inspectorate (DWI) for drinking water quality Customers are represented by the Consumer Council for Water (CCW), which monitors the quality of service provided by the Company Portsmouth Water works closely with these and other organisations interested in the services it provides

Ofwat is the water industry's economic regulator, and its principal duties are exercised through the price-setting process Ofwat sets price limits for Portsmouth Water every five years The last determination of prices was in December 2004 for the period 2005 to 2010 The price setting process is known as the Periodic Review and involves a series of consultations between water companies, Ofwat and the other regulators over a two year period The review examines all aspects of the business and requires the Company to submit a detailed Business Plan to Ofwat Water companies are allowed to increase prices to customers annually by inflation (RPI) plus or minus the price limit set by Ofwat The price limits for Portsmouth Water are shown in the table on page 18 and reflect the revenue, which the regulator believes an efficient company needs in order to finance its operations and capital programme, after making an assessment of potential future efficiency gains

Operating and Financial Review
Our Business

Water companies are largely natural monopolies and, in recognition, the Government, following Ofwat's advice and wide consultation, is cautiously opening up to competition the market for provision of water to large industrial and commercial customers Although these customers have been able to switch supplier since December 2005, none have done so to date

Portsmouth Water is recognised as one of the most efficient water companies in England and Wales (Source - Water and Sewerage Service Unit Costs and Relative Efficiency 2005/06 Report - published by Ofwat), and this has benefited customers through lower bills over many years, as shown on page 7

Over the last twenty years, the Company has experienced falling demand for water, particularly from commercial customers The future, however, is expected to see rising demand from domestic customers, with a significant house building programme planned in the Company's area of supply A twenty five year Water Resources Plan is also produced at each Periodic Review The plan is reviewed annually and enables the Company to balance supplies with forecast demand even at times of dry conditions Future plans incorporate a twin-track approach of demand management and additional sources of supply

The Company is committed to sustainable development It must balance the provision of water supply with the needs of the environment and play a part in ensuring that the UK complies with European and National environmental legislation

The shaft section used on Hilsea Pipe Tunnel

Emergency Water Tank being filled in Soberton during World War II

Operating and Financial Review
Business Strategy

Mission Statement
'We aim to supply drinking water of the highest quality, providing high levels of customer service and excellent value for money'

The Company has a well developed, focused strategy which will meet the demands of all its stakeholders The key objectives are

- To maintain services to customers at the highest level
- To balance the provision of water supply with the needs of the environment
- To maintain the health and welfare of employees
- To ensure that customers continue to enjoy secure and reliable water supplies
- To meet present and future water quality obligations
- To maintain its leadership position at the water industry efficiency frontier
- To maintain the ability to finance its function

The strategy will be achieved by focusing on four key issues

- Having a well developed and frequently updated long term water resources plan, which will meet the needs of the customer, through secure water supplies, whilst respecting the environment
- Putting customers at the heart of everything we do, and ensuring that they continue to receive excellent value for money
- Setting goals for efficiency which outperform regulatory targets
- Maintaining a motivated workforce, whilst ensuring that the health and safety of employees is given the highest priority

The progress of the Company against these objectives is measured by a number of key performance indicators (KPI) and these are highlighted in the following section of the Review

Brockhampton Springs Head Office opens, 1967

Operating and Financial Review
Current Development and Performance

Financial Performance

Profit before tax
Turnover for the year increased by 2 1% to £32 8m This reflected the 1 8% overall tariff increase implemented in July 2006, and additional income of £0 2m from the bulk supply arrangement with Southern Water Although this arrangement was established to assist Southern Water at peak demand in dry years, the extent of the drought conditions in 2006 meant that it was operating for most of the year

Operating costs, excluding depreciation and the FRS17 pension charge rose by £0 2m (1 1%) This was below the level of inflation despite a 39% rise in energy costs from November 2006 and in part was due to lower expenditure on addressing leakage which had been higher than usual in 2005/06 The current service cost for the pension scheme was reduced by £1 0m to £1 1m due to a one-off credit to the charge following a change in the rules of the scheme allowing retirees to commute more of their pension to a lump sum, which has the effect of reducing the ongoing pension liability

The Company sold three properties in 2006/07, generating proceeds of £1 2m and profit on disposal of £0 9m

An increase in other finance income of £0 6m represents an increase in the expected return on Pension Fund assets

Interest payable at £5 3m (2006 - £5 1m) includes a £2 4m indexation of the loan provided by Artesian Finance plc (2006 - £2 1m) Interest on the capital sum amounted to £2 7m (2006 - £2 6m)

As a result of the above, profit before tax increased by 38% to £10 5m (2006 - £7 6m)

Taxation
Despite the higher profit, the tax charge for the year reduced by £0 2m to £2 5m mainly as a consequence of a major element of the increase in pre tax profits being the result of a net gain on the return on pension assets which is not taxable

Dividends
Following the adoption of FRS21, dividends are now reported on a paid basis The dividends paid during the year amounted to £4 471m (2006 - £3 755m), and include a special dividend of £0 3m which represents an element of the profit on the sale of one of the properties Dividends are paid up to the parent company and largely used to service debt held by the group

Cashflow and Balance Sheet
Net cashflow from operations at £16 1m (2006 - £16 4m) reduced as a result of an increase in trade and other debtors Net cash outlay on fixed assets at £11 8m (2006 - £6 1m) reflected an increase in activity for the investment programme determined at the last periodic review Sale of properties and other assets added £1 2m to the cashflow

Net debt at £73 6m (2006 - £70 1m) increased during the year by £3 5m as a result of the relatively high capital programme At the year end, net debt to regulatory capital value was 71 3% (2006 - 74 7%)

Interest Rate, Liquidity and Credit Risk
The major financial risks faced by the Company are interest rate, liquidity and credit risks The Company assesses these risks on an ongoing basis and its policies for managing them remain unchanged from previous periods

The Company's exposure to interest rate fluctuations is now limited by the fixed interest rate applicable to the index-linked loan drawn in 2002, with inflation risks on the cost of the loan being effectively hedged against regulated revenues which are also linked to the Retail Prices Index Interest is charged at a fixed rate of 3 635% on the indexed amount of the loan The indexed value of the loan at 31 March 2007 was £75 7m (2006 - £73 3m)

The Company seeks to manage financial risk, to ensure sufficient liquidity is available to meet foreseeable needs through an appropriate borrowing structure and to invest cash assets safely and profitably on the short term market Short term liquidity is achieved through a £15m working capital facility and an overdraft arrangement At the end of the year, £1 5m of this facility had been drawn (2006 - Nil), while the overdraft arrangement remained unutilised

The Company's exposure to credit risk results from the continuing impact of bad debt on its ability to collect water revenues It seeks to minimise this risk by utilising all available means, including the use of a dedicated debt recovery section, agencies for collecting outstanding debt and following best practice guidelines

Accounting Policies
The accounts have been prepared in accordance with the accounting policies described in note 1 to the accounts on pages 35 to 36 and with UK GAAP

Operating and Financial Review
Current Development and Performance

Under its licence of appointment, Portsmouth Water Limited, a private company, is required to publish information about its annual results as if it were a company covered by the Listing Rules of the Financial Services Authority From April 2005, listed groups are required to prepare accounts in accordance with International Financial Reporting Standards (IFRS) It is the Company's view that these standards are not appropriate for a regulated water business and it has been granted exemption, by Ofwat, such that it need only adopt IFRS when non-listed companies are required by statute to do so

Pensions
The Company accounts for the Brockhampton Pension Scheme in which it is a participating employer, in accordance with FRS17 The latest actuarial valuation carried out for the purposes of FRS17 showed a surplus after deferred tax of £15 3m (2006 - £14 6m)

Key Financial Performance Indicators
Gearing (net debt/regulatory capital value) and cash interest cover are recognised as key indicators for the Company Performance in 2007 against the target ratios is shown in the table below

KPI - 1[1]	Target	Performance 2006/07	Performance 2005/06
Gearing - Debt/RCV[2]	<83%	71 3%	74 7%
Cash interest cover[2]	>2 2	2 75	2 4

[1] Each KPI is defined in the Appendix on page 47
[2] Definition of terms is contained in the Appendix on page 47

Customer Service
The Company measures its services to customers in three key areas

- The Overall Performance Assessment provided by Ofwat
- The DG indicators provided by Ofwat
- Drinking Water Quality

KPI - 2 The Overall Performance Assessment

Target	Performance 2005/06
To be in the upper quartile of performance for all water companies	Placed 4th out of 22 companies

The Overall Performance Assessment for 2006/07 will be published by Ofwat after the Report and Accounts have been completed and therefore the performance shown above is for 2005/06

KPI - 3 DG Service Indicators

The DG service indicators data shown below is as recorded by the Company for 2006/07 and will be reported to Ofwat in the annual regulatory June Return

DG Service Indicator	Target	Performance 2006/07	Performance 2005/06
DG2 No of properties at risk of inadequate pressure	≤ 120	90	90
DG3 Unplanned interruptions to supply	≤ 0 3	0 23	0 19
DG4 Population subject to hosepipe bans	Nil	Nil	Nil
DG6 Billing contacts - answered within 5 days	100%	100%	100%
DG7 Written complaints - answered within 10 days	100%	100%	100%
DG8 Bills for metered customers - no receiving bill based on meter reading	100%	100%	100%
DG9 Telephone contact - no of calls abandoned	≤ 2 5%	6 2%	4 3%
- all lines busy	≤ 0 7%	Nil	Nil

In all categories Ofwat assessed the Company as having good performance for 2005/06 The Ofwat assessments for 2006/07 will not be published until September, but the results recorded by the Company meet the criteria for being assessed as good

Operating and Financial Review
Current Development and Performance

KPI - 4 Water Quality

The Company carries out an exhaustive programme of testing to ensure that water of the highest quality is supplied to customers The table below shows the percentage number of samples which pass the strict standards set out in the Water Supply (Water Quality) Regulations

Water Quality	Target	Performance 2006	Performance 2005
Compliance samples passing standards	99 90%	99 96%	99 97%

The water quality performance indicator relates to the calendar year

Operating Efficiency
Ofwat publishes a report each year which includes its assessment of the comparative operating efficiency of all water companies in England and Wales using econometric modelling Companies are put in bands A to E according to their performance for both operating and capital maintenance efficiency, A being the top band The latest report published is for the financial year 2005/06, which showed that Portsmouth Water was assessed in the top bands for both operating and capital maintenance expenditure and the only water company in England and Wales to have been placed in band A for both categories in each of the last five years In the medium term this benefits customers through relatively lower prices and the Company intends to maintain its position in the efficiency rankings

KPI - 5 Efficiency

Target	Performance 2005/06
To be ranked in Band A for Operating Efficiency	Operating Efficiency Band A
To be ranked in Band A for Capital Maintenance Efficiency	Capital Maintenance Efficiency Band A

Capital Investment
The Company made good progress with the five year capital programme agreed with the Regulator for the period 2005 to 2010 which included

Infrastructure Assets
- Renewal of 25km of mains each year

Water Quality
- Installation of membrane filtration plants at three treatment works, including at the River Itchen, to minimise the risk of cryptosporidium
- Remedial work on trunk mains in the Company's largest supply area to reduce the risk of discoloured water incidents
- The installation of blending facilities at sources at risk from increasing nitrate levels

Water Resources
- Commencement of planning for a winter storage reservoir which is required in 2020 This work will include environmental investigation and should lead to a planning application by 2010

Security Measures
- The Company will implement a number of measures to increase security in response to advice from the Government

Optional Water Meters
- At the 2004 Periodic Review, it was anticipated that the Company would be required to install 2,200 new meters per annum for domestic customers wanting to switch from an unmeasured to a measured supply

Gross capital investment during the year was £14 8m (2006 - £7 1m) and included £4 1m (2006 - £3 1m) on infrastructure renewals After receiving capital contributions and infrastructure charges of £0 9m, net capital expenditure was £13 9m (2006 - £5 8m) The chart below shows the level of net capital investment over a six year period in outturn prices

Operating and Financial Review
Current Development and Performance

Net Capital Expenditure

Work is nearing completion on the membrane filtration plant at the River Itchen treatment works and this is scheduled to be commissioned in June 2007 Expenditure during the year on this project was £3 6m, and at completion the total cost will have been £4 6m

Remedial work on trunk mains in the area supplied by the Farlington treatment works was completed in the year, with £1 8m incurred to March 2007

During the year, 26km (2006 - 21km) of mains were renewed at a cost of £4 1m (2006 - £3 1m) This brings the length of mains renewed in this regulatory period to 47km compared to 50km in the original plan The shortfall will be recovered in the coming year

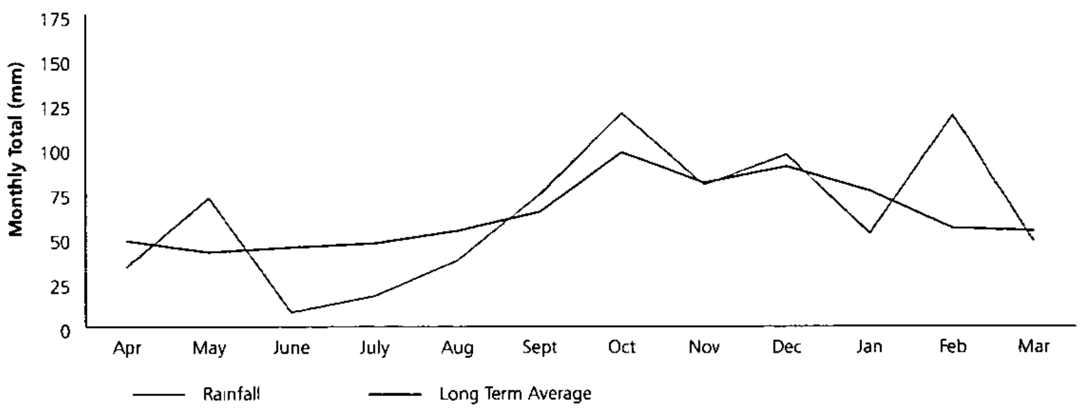
The number of customers opting to change to a measured supply increased substantially and the Company installed 5,797 meters for such customers (2006 - 3,578) This increase is believed to be the result of price increases announced by Southern Water, whose waste water charges for measured customers are based on meter readings from Portsmouth Water The capital cost of installing meters was £1 1m, compared to an allowance in the last determination of £0 5m

Water Resources - Outlook for 2007

As detailed on page 7, over 90% of water supplied to customers is from groundwater springs, boreholes and wells which abstract from the underground chalk of the South Downs Groundwater levels are therefore critical to maintaining supplies to customers The Company has for many years monitored the groundwater level at Idsworth Well, Rowlands Castle, which is unaffected by abstraction and is representative of groundwater conditions in the South Downs chalk

Following two relatively dry winters, rainfall in the Autumn and Winter of 2006/07 was above the long term average as shown in the chart below

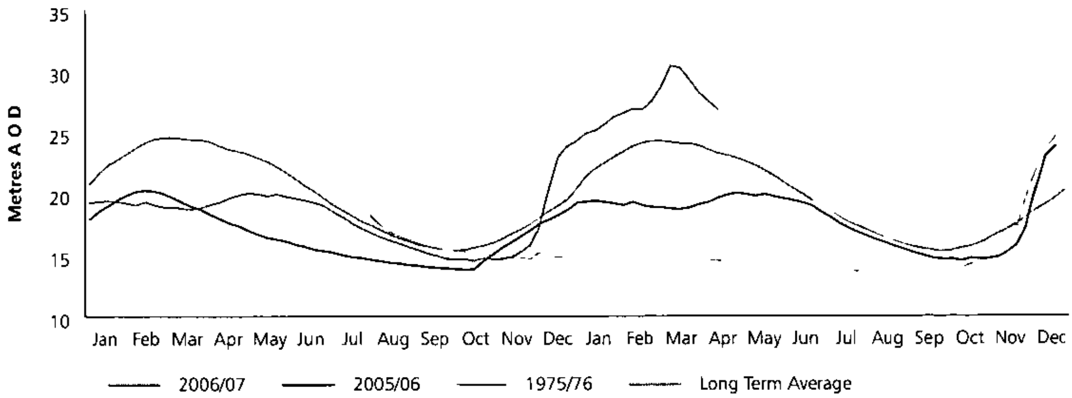
Rainfall at Havant 2006/07



As a result of this rainfall, the groundwater of the South Downs chalk, as measured at Idsworth Well, received significant recharge during the winter and, at the end of April, was above the long term average This is outlined on the two year graph below, which includes the thirty year long term average and the drought year of 1976, when the Company last imposed a hosepipe ban

Operating and Financial Review
Current Development and Performance

Idsworth Well



Water resources are therefore expected to be sufficient to meet peak demands in the summer of 2007 and a hosepipe ban is not expected in our area of supply However, the Company has used its newsletter, website and press releases to stress to customers the need to be conservative in their use of water

Long Term Resource Planning
The Company's twenty five year Water Resources Plan, which examines the likely key influences on the demand for water from customers and on the Company's ability to meet that demand, was last updated in 2004 The plan also identifies the actions required to ensure that the supply/demand balance is met A number of key assumptions were made

- The number of households in the Company's area of supply will grow from 276,000 in 2005 to 310,000 in 2020 and over 340,000 by 2030 (Source - Hampshire County Council)
- There will be a rise in average year per capita consumption from 156 litres/head/day in 2005 to 188 litres/head/day in 2030 (Source - Company projections) The principal driver behind this movement will be the reduction of occupancy levels in households caused by a number of demographic factors
- The peak demand during a dry summer is 1 4 times that of average demand

Projections show that, whilst at average demand the Company has sufficient resources and treatment capacity until 2030, there may be insufficient capacity to meet summer peak demand by approximately 2020 To address this shortfall, the Company has developed a twin track approach of demand management and additional sources of supply consisting of

- Maintaining leakage below its current target of 29 7Ml/d until 2015, when a leakage saving initiative will be needed to further reduce the level below 26 7Ml/d This initiative is expected to increase operating costs by £0 2m per annum
- Continued promotion of water efficiency measures
- The development of a washwater recovery plant at its largest treatment works at Farlington This will be constructed in the period 2015 to 2020
- The construction of the Havant Thicket winter storage reservoir with commissioning expected in 2019 The reservoir will store surplus winter water from the Company's springs in Havant and Bedhampton for use at peak demand in the summer It is anticipated that the necessary planning permissions, design and construction will take fifteen years, and initial work on the planning process, including environmental assessments, has begun The Company already owns the 413 acre site on which the reservoir is planned to be built The total cost of the reservoir is expected to be in the order of £30m, much of which will be spent in the period 2015 to 2020

Leakage
Leakage for the year was recorded at an average of 29 2Ml/d, which was within the leakage target of 29 7Ml/d The leakage targets were set out in the Company's Business Plan for the last Periodic Review and agreed by Ofwat as part of the Final Determination in 2004 Portsmouth Water had the sixth lowest leakage level of all the water companies in 2005/06

KPI - 6 Leakage

Target	Performance 2006/07
Average leakage of 29 7Ml/d	Average leakage of 29 2Ml/d

Operating and Financial Review
Current Development and Performance

Employees
The Company employs 230 people and believes it recruits and retains the best people The Company are firmly committed to the development of its employees and this is achieved through a medium of both further education and operational training Last year saw 27 employees undertake formal personal education including Degrees, HNCs, Management NVQs and IT skills Staff turnover, excluding retirees, was 8 2% in 2007 (2006 7 8%), which compares favourably with the national average which was 12 81 in 2005 (Source - EEF Absence and Labour Turnover Survey 2006)

Total absence fell to 4 38 days per employee per year (2006 5 07) and is below the average for private companies of the same size at 7 2 (Source CIPD Annual Survey Report 2006)

Health and Safety
The health and safety of employees is fundamental to the success of the business and the Company is committed to achieving high standards across the organisation It has implemented a number of campaigns and initiatives, aimed at increasing staff awareness of health and safety issues, and the benefits are shown in the chart below, which shows a reduction in the level of accidents over the last 5 years

Total Accidents

Reportable Accidents

The efforts of all employees were rewarded in March 2007, when the Company received a Gold Award for occupational health and safety from RoSPA (for the second successive year)

Operating and Financial Review
Corporate Responsibility

Environmental Performance
The Company recognises its impact on the environment and seeks to carry out its activities in a sustainable manner, which is highlighted by the initiatives shown below

Conservation
The Company's total licensed area of supply covers an attractive part of Southern England between the South Downs and the coastal areas of Hampshire and West Sussex It includes the historic cities of Portsmouth and Chichester, and the popular holiday resorts of Bognor Regis, Selsey and Hayling Island The harbours of Portsmouth, Langstone, Chichester and Pagham have a number of important environmental designations under the EU Habitats Directive and are popular water activity venues

Biodiversity Action Plan
The Company's policy is to conserve and enhance the natural environment of its land and water areas and to preserve historic buildings and equipment, so far as is consistent with the primary duty of providing a sufficient supply of wholesome water at reasonable cost Where possible, the Company explores opportunities to encourage recreational use

Sustainable Procurement
In procuring goods and services, the Company has a policy which seeks to ensure that its impact on the environment is minimised This includes the use of low sulphur content diesel fuel, timber from replanted forests and predominantly recycled material for reinstatement

Specific Environmental Projects
The Company has been involved in three environmental investigations into the impact of water abstraction on species identified by the Habitats Directive The investigations at the River Itchen, Chichester Harbour and Langstone Harbour are covered in more detail on page 19

Water Efficiency
The Company has continued, through various channels of communication such as its newsletter and website, to promote the need for the efficient use of water, both by domestic and commercial customers Specific initiatives have included

Cistern Devices
Approximately 15,000 'Save-a-Flush' bags were issued to customers during the year

Measured Customers
All customers opting to install a meter received a leaflet, 'Saving Water at Home,' to ensure that customers most likely to benefit from water efficiency are reminded of the advantages, and each customer receives two savaflush bags

Commercial Water Audits
A leaflet entitled 'Saving Water in Your Business' is included on the Company website and a copy sent to every business in 2006

In-House Efficiency Study
A series of initiatives at the Company's Head Office has resulted in an overall saving since 2004 of 50% of previous water usage

Work in the Community

Amenities and Recreation
In 2005/06 Portsmouth Water launched a new partnership with the Sir George Staunton Country Park to deliver a water themed learning programme to schools entitled 'Water is Life' The programme, which has been designed with the National Curriculum in mind, is initially targeted at children aged between 5 and 11 It is intended to educate them, both about the natural water cycle and how we provide public water supplies

This programme will challenge children to understand how the planet recycles its water and why both humans and all inhabitants of the Earth need water to survive They will also be shown how we ensure that public water supplies are safe to drink and how it gets to the tap

At the end of the learning experience, children will have an understanding of the key role water plays in all our lives and how important it is to conserve this valuable, but renewable resource

In 2006 over 500 children attended the programme through pre-arranged school trips

Charitable Trust Fund
Since 2004 the Company has been supporting a Charitable Trust Fund, which aims to provide assistance for customers who have difficulty paying their bills

Operating and Financial Review
Corporate Responsibility

Drinking Water Bottles
The Company has continued to promote the benefits to children of drinking water and, as part of our 'Water for Health' initiative, has offered for the last four years a free drinking water bottle to every child in local primary, infant and junior schools Many schools have also replaced their water bottles at a subsidised cost of 15p per bottle A further 25,000 were delivered during 2006 The drinking water bottle initiative has seen nearly 130,000 water bottles delivered to local schools over the last four years

Community Talks
Employees continue to give community talks about the Company and water supply to local schools, colleges, clubs and groups, such as Age Concern, Rotary and the Women's Institute

The Company again supported the Primary Schools Science Fair, promoted by the Portsmouth and South East Hampshire Business and Education Partnership

The new Laboratory, 1967

The Company's first computer, 1967

Operating and Financial Review
Future Development and Performance

Cautionary statement regarding forward-looking statements
This section should be read in conjunction with the financial statements and notes thereto included elsewhere in this Annual Report This Annual Report contains certain forward-looking statements with respect to the financial condition, results of operation and business of Portsmouth Water

Statements that are not historical facts, including statements about Portsmouth Water's beliefs and expectations, are forward-looking statements Words such as 'believes', 'anticipates', 'expects', 'intends', 'seeks' and 'plans' and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements These statements are based on current plans, estimates and projections and, therefore, undue reliance should not be placed on them Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events

The Company will continue to focus on service delivery to customers It will aim to remain at the efficiency frontier for operating and capital maintenance expenditure and complete its AMP4 investment programme

Financial Performance will be influenced by the price limits set by the Regulator in 2004, which, for the five year period to 2010, are as follows

	2005/06	2006/07	2007/08	2008/09	2009/10
% increase above inflation	-0 7	-0 6	1 5	2 5	1 0

Capital expenditure in 2008 will be £16 3m (2007 - £14 8m), as the construction of membrane filtration plants at the River Itchen, Fishbourne and Soberton are completed Expenditure will reduce to £11 3m and £8 6m in the following two years

Energy costs represent 6% of total operating costs In November 2006 prices increased by 39% in an agreement which fixed prices until October 2008

Codes of Practice are currently being developed to allow the Traffic Management Act 2004 to be enacted This will introduce fixed penalty notices for offences under the National Roads and Streetworks Act and allow local authorities to issue permits to utilities for work in the highway As at the end of April, elements of this were scheduled to be introduced in October 2007 The full cost of implementing the regulations are estimated to add 2% to operating costs During the process of consultation the Company has expressed the concern that its customers will suffer the cost of this legislation which will not have a significant effect on congestion

As a result of these factors, the Company anticipates that debt will rise from the March 2007 level of £73 6m to £85 0m in 2009 before falling to £83 4m in 2010 The increase in debt will be met by existing loan facilities It is anticipated that, by 2010, net debt to RCV will be approximately 77%

The River Itchen Treatment Works (completed in 1973)

Highwood Reservoir (completed in 1982)

Operating and Financial Review
Risks and Uncertainties

The Company identifies risks under six main headings - Operational, Water Quality, Financial, Environmental, Regulatory and Health and Safety of Employees Individual risks facing the Company are identified and recorded in a risk register For each risk the consequences, impact and likelihood of failure are identified, together with the management controls in place The register also clearly allocates management responsibility and whether any further actions are required to control the risks

The Board reviews the risk register and the controls established to mitigate these risks on an annual basis It also receives regular reports on operational matters, including a monthly review of water quality matters directly with the Water Quality Manager and a quarterly review of health and safety matters with the Personnel and Safety Manager The Directors also receive reports from independent regulatory bodies, which comment on the performance of the core water business

The Audit Committee meets at least three times a year, monitors the effectiveness of the systems which are in place and reports to the Board as a whole

The key operational risks facing the Company are the loss of a treatment works or part of the mains network, which would result in a failure to supply water to customers To mitigate this risk, the supply network has been enhanced over several years to connect different supply areas, such that in most situations water can be transferred to compensate for a failure at a treatment works The Company also has a fully documented Emergency Plan which is initiated in the event of an incident, impacting either its ability to supply water to the public or resulting in a water quality issue

Water quality is monitored by a comprehensive sampling regime in accordance with DWI standards Furthermore, a telemetry system linked to all treatment works provides an alarm if there is a failure of equipment The Company also maintains two days' storage of treated water in service reservoirs to provide sufficient time for any water quality issues at treatment works to be rectified before supply to customers In addition, it has membrane filtration at two treatment works considered most at risk from cryptosporidium being present in the raw water and will commission additional plants at three more works by 2008

The risk of financial loss is addressed through comprehensive insurance cover for a range of risks, including damage to property, public and employee liability, fraud and terrorism A system of internal controls is in place to manage the risks, the details of which are included in the Statement on Corporate Governance on pages 25 to 27 In 2007, the auditors conducted a special review of the Company's internal control systems The review did not reveal any significant weaknesses A disaster recovery plan is also in place to enable the Company to operate in the event of an incident disrupting its computer systems At a remote site ten miles from its Head Office, the Company has an additional mainframe computer, which is 'backed up' every evening, and several workstations for employees to operate

The major environmental risk faced by the Company at the present time is a potential loss of abstraction licence resulting from measures that may be required by the EA to allow the UK to comply with the European Habitats Directive Investigations have been carried out into the impact of abstraction by the Company at a number of sites covered by the Habitats Directive

A study into the sustainability of abstraction from the River Itchen is complete and options have been reviewed with the EA and Southern Water for minimising the potential impact of abstraction on salmon migration, southern damselfly and invertebrates

Chichester and Langstone Harbours are Special Protection Areas (SPA) under the Habitats Directive A comprehensive ecological and hydrological study carried out by the Company examined the effects on Chichester Harbour and its wildlife of operating the Company's

Construction of Farlington Reservoir No 8, 1994

The remains of a 'henge' found during main laying at Lavant, 1996

Operating and Financial Review
Risks and Uncertainties

Fishbourne source within the existing abstraction licence The study has focused particularly on the significance of an adequate freshwater flow into the Harbour for wading birds and on maintaining a habitat for the rare Desmoulins Whorl Snail Another study conducted by the EA considered the importance of freshwater flows into Langstone Harbour from the Springs at Havant and Bedhampton

The EA will shortly be announcing its decisions in respect of any changes deemed necessary to our abstraction licences in order to safeguard species and habitats relying on freshwater flows in the River Itchen and into Chichester and Langstone Harbours

The loss of licence could result in bringing forward some of the measures required to address the potential supply/demand imbalance in 2020, identified in the Water Resources Plan on page 14

Regulatory risk relates to decisions taken by Ofwat at the five yearly price review and the potential failure to meet the monitoring plan agreed with Ofwat, containing targets for the period 2005 to 2010 for the capital programme, customer service and leakage Failure to meet the monitoring plan targets could result in Ofwat taking action, including financial penalties The last price review was completed in 2004, for the period 2005 to 2010, and the next review will be in 2009, for the period 2010 to 2015 The price review is conducted in an open and transparent manner and the Company actively participates in the process The performance against the monitoring plan is reviewed on a monthly basis by the Board or the Executive Directors The performance against the measures in the monitoring plan are discussed on pages 11 to 13

The health and safety of employees is taken very seriously and a number of initiatives have been introduced over several years to reduce the number of accidents and the impact of injury

These include

- A Health and Safety Committee
- A risk assessment programme that has seen over 500 assessments produced
- A system of workplace inspection ensuring that all manned premises are inspected at least twice per year
- Specific training for those at high risk of injury
- A limited free physiotherapy service for employees to deal with injuries

N J Roadnight
Managing Director

N Smith
Finance Director

Company Information

Registered Office
PO Box 8
West Street
Havant
Hampshire
PO9 1LG

Telephone 023 9249 9888
Facsimile 023 9245 3632
Website www portsmouthwater co uk

Company Number 2536455

Facts and Figures

Area of Supply	868 km²
Population	652,000
Number of Properties Served	297,000
Length of Mains	3,262 km
Average Daily Output	179 Ml

Auditors
Saffery Champness
Lion House
Red Lion Street
London WC1R 4GB

Bankers
National Westminster Bank plc
PO Box 34
15 Bishopsgate
London EC2P 2AP

Corporate Solicitors
Blake Lapthorn Linnell
New Court
1 Barnes Wallis Road
Segensworth Fareham
Hampshire PO15 5UA

Insurance Brokers
AON Limited
Richmond House
College Street
Southampton
Hampshire SO14 3PS

Area of Supply

Portsmouth Water has been supplying water to Portsmouth and the surrounding area since 1857 The area supplied by the Company extends through South East Hampshire and West Sussex from the River Meon in the West to the River Arun in the East encompassing 868 square kilometres

The Company provides high quality public water supplies to a domestic population of 638,000, as well as many important industries, large defence establishments and varied commercial businesses

Directors' Report

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 March 2007

Principal Activity and Business Review
The Company is a water supplier operating under an Instrument of Appointment granted by the Secretary of State for the Environment under the Water Industry Act 1991

Water is supplied to 652,000 domestic and commercial customers in an area of 868 square kilometres in Hampshire and West Sussex through a mains network of 3,262 kilometres

The Company's Area of Supply is shown on page 22 of this report

A detailed review of operations for the year is provided in the Chairman's Statement and the Operating and Financial Review on pages 6 to 20

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 Financial Review on page 10 and in note 18 to the accounts on page 41

Financial Results and Dividends
The Company's profit before taxation amounts to £10 495m (2006 - £7 578m) After deducting £2 529m for taxation (2006 - £2 705m), a profit of £7 966m has been transferred to reserves (2006 - £4 873m)

The Directors are recommending the payment of a special dividend of £0 143m and a final dividend of £1 644m (2006 - final £1 418m)

Fixed Assets
Capital expenditure on tangible fixed assets was £14 823m (2006 - £7 081m), including £4 117m on infrastructure renewals (2006 - £3 099m) Information relating to these and other changes in fixed assets is shown in note 10 to the accounts on page 39

The Directors are of the opinion that the current market value of the land and buildings included in tangible fixed assets is in excess of the value shown in the balance sheet

As they are held for operational purposes, no professional valuation has been obtained and the excess has not, therefore, been quantified

Board of Directors
The Directors who held office at 31 March 2007, all of whom served throughout the year, are shown on page 5

Mr T M Lazenby and Mr A R Neve, who retire by rotation, offer themselves for re-election Mr A R Neve has a one year service contract with the Company

The interests of the Directors in Group shares are detailed in the Report on Remuneration on page 28

The Company maintains appropriate Directors' indemnity insurance

Creditor Payment Policy
The Company does not intend to follow any specific code or standard in relation to payment practice In the absence of dispute, bills will be settled in accordance with the suppliers' terms Where such terms are considered unreasonable, the Company will seek to agree alternative payment arrangements to suit both parties At 31 March 2007, the Company's creditor days were 28 (2006 - 12)

Substantial Shareholder
At 31 March 2007, 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 Director General of Water Services These accounts relate solely to the regulated water supply business and copies may be obtained on request from the Registered Office

Employees
Direct communication with employees is maintained through the Company in-house newsletter In addition, Joint Consultative Committees meet regularly and ensure 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 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 second consecutive year, submitted an application to the RoSPA Occupational Health and Safety awards scheme and has again received the Gold Award

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 handicapped or disabled person 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

The pension scheme to which the Company's employees belong makes provision for retirement due to ill-health or disablement

Environment
The Company is most aware of its obligations to both customers and the environment In recent years, it has adopted a more active approach to environmental issues and further information is set out in the Operating and Financial Review on pages 7 to 20

Donations
The Company actively supports the Water Industry charity WaterAid and, during the year, customers were invited to make donations to WaterAid at the time of paying their water bills The Company also makes donations to a Charitable Trust Fund, which aims to provide assistance for customers who have difficulty paying their bills Due to the fact that the Fund is in credit it was not necessary to make any donations this year (2006 - £39,000)

Directors' Report

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
The Auditors, Saffery Champness, have expressed their willingness to continue in office and a resolution providing for their reappointment will be proposed at the Annual General Meeting

In so far as the Directors are aware

- there is no relevant audit information of which the Company's 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 auditors are aware of that information

By order of the Board

N Smith
Secretary
Havant
25 May 2007

Corporate Governance

The Directors are committed to high standards of corporate governance and support the principles set out in the Combined Code, which was issued in 2006 and replaces the original code issued in 2003 This report and the Report on Remuneration describe how the Company complies with those principles

COMPLIANCE

The Company has complied throughout the year with the provisions of the Combined Code, other than as indicated below

As the ultimate shareholders of the Company have representation at Board meetings, it is not therefore considered necessary to have a senior independent non-executive Director (code provision A 3 3)

In accordance with the Company's Articles of Association, the Managing Director is not required to retire by rotation and seek re-election (code provision A 7 1)

The remuneration package of the executive Directors does not include a performance related element The Board does not believe that this diminishes the incentive to perform at the highest level to meet the needs of the Company and its customers (code provision B 1 1)

In the year to March 2007 Mr T M Lazenby acted as Chairman of the Remuneration Committee The Company recognises that this does not meet the recommendations of the 2006 Combined Code and, in May 2007, Mr R L Sullivan was appointed Chairman Mr T M Lazenby will continue as a member of the Remuneration Committee (code provision B 2 1)

DIRECTORS

The Board

The Board of Directors retains full and effective control of the Company and is collectively responsible for setting its strategy, ensuring appropriate resources are in place to meet objectives and monitoring performance

The non-executive Directors play a full part by constructively challenging and contributing to the development of strategy They are responsible for determining appropriate levels of remuneration for the executive Directors and for recommending new appointments to the Board

The members of the Board and the roles of each Director are shown on page 5, together with biographical notes The Chairman is Mr T M Lazenby and the Managing Director is Mr N J Roadnight The Board has not appointed a senior independent non-executive Director

The Board meets monthly and has a schedule of matters specifically reserved to it for decision It has control of the Company, but delegates the day to day conduct of business to the executive Directors and their senior management colleagues However, there are a number of matters which must only be decided by the Board as a whole, including strategy, all contracts over £150,000, dividend policy and certain regulatory matters

Committee membership, number of formal meetings held during the year and attendance are shown in the following table

	Number of meetings held	Number of meetings attended
Audit		
T M Lazenby (Chairman)	3	3
R L Sullivan	3	3
R J Tennant	3	3
Remuneration		
T M Lazenby (Chairman)	1	1
R L Sullivan	1	1
R J Tennant	1	1
Full Board		
J E Cogley	12	12
T M Lazenby (Chairman)	12	11
A R Neve	12	12
N J Roadnight	12	11
N Smith	12	12
R L Sullivan	12	12
R J Tennant	12	12

The Nomination Committee did not meet during the year

The Chairman talks with and holds meetings on an informal basis with the other non-executive Directors without the executives present The non-executive Directors meet without the Chairman present annually to appraise his performance

There were no circumstances arising during the year where it was necessary to record unresolved concerns in the Board minutes

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

Board Balance and Independence

The Board comprises a non-executive Chairman, four executive Directors and two other non-executive Directors The non-executive Directors bring a wide range of experience and knowledge to the Board, which complements the expertise of their executive Director colleagues They are all considered to be independent of management

The Board considers that its structure achieves an appropriate balance of authority at the head of the Company, such that no one individual has an unfettered power of decision

Appointments to the Board

The Nomination Committee,which did not meet during the year, comprises the Managing Director, Mr N J Roadnight, and the three independent non-executive Directors, Mr T M Lazenby (Chairman), Mr R L Sullivan and Mr R J Tennant It is responsible for recommending new appointments to the Board Decisions regarding the appointment of Directors are taken by the Board as a whole

The terms and conditions of appointment of non-executive Directors are available for inspection

Corporate Governance

Information and Professional Development

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

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

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

Re-Election

In accordance with the Company's Articles of Association, all Directors, with the exception of the Managing Director, are required to retire by rotation and one third of the Board must seek re-election each year All Directors are subject to election at the first Annual General Meeting after their appointment

REMUNERATION

Policy and practice in relation to Directors' remuneration is dealt with in full in the Report on Remuneration on pages 28 and 29

ACCOUNTABILITY AND AUDIT

Financial Reporting

The Board believes that the Annual Report and Accounts play an important part in presenting a clear, balanced and understandable assessment of the Company's position and prospects This is supported by the Chairman's Statement, together with a more detailed analysis of operations and financial matters in the Operating and Financial Review

Internal Control

The Directors are responsible for the Company's system of internal control and for reviewing its effectiveness Such a system is designed to minimise rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss There has been no change in the system of internal control during the year

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 2007 and up to the date of approval of the Annual Report and Accounts, that it is regularly reviewed by the Directors and that it accords with the internal control guidance for Directors in the Combined Code

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 at least monthly to consider a schedule of matters required to be brought to them for decision A standing sub-committee of the Board meets fortnightly 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 Board approval is required for any project exceeding a quantified expenditure level

Business, Operational and Compliance Risks
The Company assesses the risks facing its business on an ongoing basis and has identified them under six main headings - operational, water quality, financial, environmental, regulatory and health and safety of employees 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

At the April 2007 Board meeting, the Directors carried out their annual assessment for the year to 31 March 2007, including consideration of events since the year end

Audit Committee and Auditors

The Audit Committee comprises the three non-executive Directors, Mr T M Lazenby (Chairman), Mr R L Sullivan and Mr R J Tennant

In May 2007 Mr T M Lazenby stepped down as Chairman of the Audit Committee and was replaced by Mr R J Tennant Mr T M Lazenby will continue as a member of the Audit Committee

It meets at least three times during the year The purpose of the Committee is to ensure the preservation of good financial practices throughout the Company, to monitor that controls are in force to ensure the integrity of those practices, 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

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 the 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

Corporate Governance

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 only non-audit services provided during the year were those expected to be provided by the external auditors

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

GOING CONCERN
The Directors are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future For this reason, they continue to adopt the going concern basis in preparing the financial statements

Report on Remuneration

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 and the Listing Rules of the Financial Services Authority

INFORMATION NOT SUBJECT TO AUDIT

Remuneration Committee

The Remuneration Committee met only once during the year to consider and approve, on behalf of the Board, the conditions of service of the executive Directors of the Company It comprises the three independent non-executive Directors, Mr R L Sullivan (Chairman of the Remuneration Committee), Mr T M Lazenby and Mr R J Tennant

The Level and Make-up of Remuneration

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 package of the executive Directors does not include a performance related element

All four executive Directors have one year service contracts with the Company, which are in accordance with the Combined Code None of the executive Directors serves as a non-executive Director for another company The non-executive Directors do not have service contracts

Fees payable to the non-executive Directors are determined by the Board as a whole and reflect the time, commitment and responsibilities of the role

No Director is involved in deciding his own remuneration

INFORMATION SUBJECT TO AUDIT

Directors' remuneration	**2007**	2006
	£000	£000
Total remuneration	**531**	516
Highest paid Director	**147**	143

Remuneration is analysed by Director below	Salary/Fees £000	Benefits £000	Total 2007 £000	Total 2006 £000
Executive				
J E Cogley	95	11	**106**	103
A R Neve	95	7	**102**	100
N J Roadnight	134	13	**147**	143
N Smith	100	14	**114**	111
Non-executive				
T M Lazenby (Chairman)	24	-	**24**	23
R L Sullivan	19	-	**19**	18
R J Tennant	19	-	**19**	18
	486	45	**531**	516

Fees paid in respect of Mr T M Lazenby are paid to Seamab Consultancy Ltd
Benefits comprise company cars and medical insurance

Long-term incentive schemes

The Company does not operate any long-term performance linked bonus scheme

Share options

The Company does not operate an Executive Share Option Scheme
The Directors' holdings of shares in South Downs Capital Limited, the ultimate parent undertaking, are detailed below and, in total, represent 15% of the issued share capital of that Company They have no interests in the shares of Portsmouth Water Limited

	'C' Ordinary Shares
J E Cogley	30
A R Neve	30
N J Roadnight	48
N Smith	42

Report on Remuneration

Pensions

The Company participates in the Brockhampton Pension Scheme to provide defined benefits based primarily on final pensionable pay for its employees, including the executive Directors The maximum pension payable under this Scheme is $2/3$ of final pensionable pay

Benefits in kind relating to company cars are considered to be part of pensionable pay for all employees under the Scheme

The executive Directors have accrued pension benefits under the Brockhampton Pension Scheme during the year as detailed below

	Increase in Accrued Pension During Year to 31 March 2007 £000	Transfer Value of Increase £000	Accumulated Accrued Pension at 31 March 2007 £000	Accumulated Accrued Pension at 31 March 2006 £000
J E Cogley	1	19	60	56
A R Neve	1	19	60	57
N J Roadnight	3	40	80	75
N Smith	3	39	48	43

The accumulated accrued pension is the leaving service benefit to which the Director is entitled if he were to leave service at the end of the year

The increase in accrued pension excludes any increase for inflation

The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 The transfer value of the increase is then reduced by the amount of each member's contribution paid during the year

By order of the Board

T M Lazenby
Chairman
Havant
25 May 2007

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards

Company law in the United Kingdom requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit or loss of the Company for that period In preparing those financial statements, the Directors are required to

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

The Directors are responsible for

- keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985,
- safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities, and
- the maintenance and integrity of the corporate and financial information included on the Company's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Audit Report

Independent Auditors' report to the members of Portsmouth Water Limited

We have audited the financial statements of Portsmouth Water Limited for the year ended 31 March 2007, which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the cash flow statement and the related notes These financial statements have been prepared under the historical cost convention and the accounting policies set out therein We have also audited the information in the Report on Remuneration that is described as having been audited

Respective Responsibilities of Directors and Auditors
The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities

Our responsibility is to audit the financial statements and the part of the Report on Remuneration to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an Auditors' Report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Report on Remuneration to be audited have been properly prepared in accordance with the Companies Act 1985 and whether the information given in the Directors' Report is consistent with the financial statements We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and other transactions is not disclosed

We also, at the request of the directors (because the Company applies the Financial Services Authority Listing Rules as if it were a listed company), review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2006 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements This other information comprises only the Directors' Report, the unaudited part of the Report on Remuneration, the Chairman's Statement and the Operating and Financial Review We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any other information

Basis of Audit Opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Report on Remuneration to be audited It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Report on Remuneration to be audited are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Report on Remuneration to be audited

Opinion
In our opinion

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2007 and of its profit for the year then ended,
- the financial statements and the part of the Report on Remuneration to be audited have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements for the year ended 31 March 2007

Saffery Champness
Chartered Accountants
Registered Auditors
Lion House
Red Lion Street
London
WC1R 4GB
25 May 2007

Profit and Loss Account
For the year ended 31 March 2007

	Notes	2007 £000	2006 £000
Turnover	2	**32,816**	32,133
Cost of sales		**(16,406)**	(16,316)
Gross profit		**16,410**	15,817
Net operating expenses	3	**(7,794)**	(8,768)
Operating profit		**8,616**	7,049
Profit/(loss) on sale of fixed assets		**912**	(10)
Profit on ordinary activities before interest		**9,528**	7,039
Interest receivable	5	**3,612**	3,573
Other finance income	28	**2,688**	2,042
		15,828	12,654
Interest payable and similar charges	6	**(5,333)**	(5,076)
Profit on ordinary activities before taxation	7	**10,495**	7,578
Taxation on profit on ordinary activities	8	**(2,529)**	(2,705)
Profit for the financial year	20	**7,966**	4,873

The profit and loss account has been prepared on the basis that all operations are continuing operations

Statement of Total Recognised Gains and Losses
For the year ended 31 March 2007

	Notes	2007 £000	2006 £000
Profit for the financial year		**7,966**	4,873
Actuarial (loss)/gain on pension scheme	28	**(519)**	4,527
Deferred tax relating to actuarial loss/(gain) on pension scheme	17	**155**	(1,358)
Total recognised gains and losses relating to the year		**7,602**	8,042

The accompanying notes form an integral part of these accounts

Balance Sheet
As at 31 March 2007

	Note	2007 £000	2007 £000	2006 £000	2006 £000
Fixed assets					
Tangible assets	10	**82,903**		75,701	
Investments	11	**59,940**	**142,843**	59,500	135,201
Current assets					
Stocks		**462**		594	
Debtors	12	**1,776**		1,415	
Investments	13	**4**		4	
Cash at bank and in hand	14	**2,460**		2,009	
		4,702		4,022	
Creditors amounts falling due within one year	15	**(16,747)**		(13,416)	
Net current liabilities			**(12,045)**		(9,394)
Total assets less current liabilities			**130,798**		125,807
Creditors amounts falling due after more than one year	16		**(74,282)**		(71,821)
Provisions for liabilities	17		**(9,565)**		(9,455)
Net assets excluding pension asset			**46,951**		44,531
Pension asset	28		**15,280**		14,569
Net assets including pension asset			**62,231**		59,100
Capital and reserves					
Called up share capital	19		**1,078**		1,078
Share premium account	20		**1,539**		1,539
Capital redemption reserve	20		**3,250**		3,250
Profit and loss account	20		**56,364**		53,233
Shareholders' funds	21		**62,231**		59,100

The accompanying notes form an integral part of these accounts
The accounts were authorised for issue and approved by the Board on 25 May 2007, and signed on its behalf by,

Tim Lazenby

T M Lazenby
Chairman

Cash Flow Statement
For the year ended 31 March 2007

	Notes	2007 £000	2007 £000	2006 £000	2006 £000
Net cash inflow from operating activities	22		**16,136**		16,422
Returns on investments and servicing of finance					
Interest received		**3,156**		3,575	
Interest paid		**(2,869)**	**287**	(2,959)	616
Taxation					
UK corporation tax paid		**(1,124)**		(935)	
Payments for group relief		**(1,133)**	**(2,257)**	(1,281)	(2,216)
Capital expenditure and financial investment					
Purchase of tangible fixed assets		**(12,748)**		(7,397)	
Sale of tangible fixed assets		**1,167**		19	
Capital contributions received		**945**	**(10,636)**	1,270	(6,108)
Equity dividends paid			**(4,579)**		(4,220)
Cash (outflow)/inflow before management of liquid resources and financing			**(1,049)**		4,494
Management of liquid resources					
(Purchase)/sale of short term deposits			**(50)**		100
Financing					
New/(repayment of) loans			**1,500**		(4,500)
Increase in cash in the year	23		**401**		94

The accompanying notes form an integral part of these accounts

Notes to the Accounts

1 Accounting Policies

The accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and company law, except for the treatment of capital contributions as detailed in note 1 (c)

In view of the licence conditions under which the Company operates as a water supplier, it has to publish information about its annual results as if it were a company covered by the Listing Rules of the Financial Services Authority, except where it is considered inappropriate to do so Earnings per share disclosures required by FRS 22 are not presented as the Company is a wholly owned subsidiary

The principal accounting policies are as follows

(a) 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 Turnover from the regulated water business includes amounts billed for the year Unmeasured income bills are based on the rateable value of properties Measured income arises from customers who have meters fitted at their premises and amounts billed, therefore, are based on actual water consumption

(b) Fixed assets

(i) Infrastructure assets - mains
Infrastructure assets comprise a network of systems Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service is treated as an addition and included in tangible fixed assets at cost

The depreciation charge on infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, based on an independently certified asset management plan

(ii) Other assets
Depreciation is provided on all other fixed assets with the exception of freehold land It is calculated to write off the cost of assets less estimated residual values over their estimated useful economic lives using the straight line method Those lives are estimated as follows

Buildings and Reservoirs	100 years
Pumping Plant	15-25 years
Vehicles and Mobile Plant	5-7 years
Office Equipment	7 years

(c) Capital contributions

(i) Mains contributions
In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets They are treated as capital contributions and the Directors consider it appropriate that, in order to present a true and fair view, they should be deducted from fixed assets, as shown in note 10 to the accounts on page 39 In accordance with the Companies Act 1985 requirement to include fixed assets at cost, such contributions would normally be treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets However, the assets to which they relate do not have determinable finite lives and, accordingly, no basis exists on which to recognise those contributions as deferred income

(ii) 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 capital contributions and deducted from fixed assets, as more fully explained in note 1 (c)(i) above

(d) Investments

Investments are stated at the lower of cost or net realisable value

(e) Stocks

Stocks of raw materials are valued 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

Notes to the Accounts

(f) Deferred taxation

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 balance sheet 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 balance sheet date
The deferred tax balances have been discounted using a post-tax yield to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred tax liabilities

(g) Leases

All leases are regarded as operating leases Operating lease payments are charged to the profit and loss account on a straight line basis over the period of the lease

(h) Pension costs and other post retirement benefits

Portsmouth Water 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

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

Pension scheme assets are valued at market value at the balance sheet date The pension scheme surplus is recognised in full on the balance sheet

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 28 to the accounts on pages 44 and 45

(i) Financial instruments

The Company's financial instruments consist of loans and receivables, financial assets at fair value through profit or loss, available-for-sale financial assets and held-to-maturity investments

The Company has adopted the disclosure and presentation requirements of FRS 25 and the measurement requirements of FRS 26 When a financial asset or liability is recognised initially it is measured at its fair value plus or minus transaction costs The Company subsequently categorises financial instruments as follows

Fixed asset investments consist of loans to Group undertakings, which earn interest based on London Interbank rates and are classified as loans and receivables in accordance with FRS 26 They are measured at amortised cost using the effective rate method

Other financial assets consist of short term bank deposits and are classified as financial assets at fair value through the profit and loss account in accordance with FRS 26 They are measured at fair value

The Company's financial liabilities consist of fixed rate borrowings in the form of perpetual debentures and an index linked loan These instruments are classified as financial liabilities and are measured at amortised cost There are also variable rate loans which are measured at fair value

Notes to the Accounts

2 Turnover	2007 £000	2006 £000
Unmeasured supplies	**20,720**	20,808
Measured supplies	**9,490**	8,943
Bulk supply to Southern Water Services	**940**	751
Chargeable work	**1,666**	1,631
	32,816	32,133

Turnover is wholly attributable to water supply and related activities in the United Kingdom

3 Net operating expenses	2007 £000	2006 £000
Administrative expenses	**7,955**	8,968
Other operating income	**(161)**	(200)
	7,794	8,768

4 Directors and employees

Employment costs	2007 £000	2006 £000
Wages and salaries	**5,484**	5,300
Social security costs	**435**	429
Pensions management charge	**-**	201
Other pension costs (note 28)	**1,153**	2,147
	7,072	8,077
Transferred to capital schemes	**(106)**	(122)
Net employment costs	**6,966**	7,955

Average numbers employed during year	2007 Number	2006 Number
Operations	**154**	153
Administration	**71**	68
	225	221

Directors' remuneration	2007 £000	2006 £000
Total remuneration	**531**	516
Highest paid Director	**147**	143

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 28 and 29 The information set out in that Report which is subject to audit forms part of these financial statements

5 Interest receivable	2007 £000	2006 £000
Loan to Group company	**3,532**	3,468
Interest on short term deposits	**61**	63
Other interest receivable	**19**	42
	3,612	3,573

6 Interest payable and similar charges		2007 £000	2006 £000
£66 5m loan	- interest	**2,725**	2,643
	- indexation	**2,404**	2,060
	- amortisation of fees	**57**	57
	- administration expenses	**22**	27
		5,208	4,787
Other bank loans and overdraft		**105**	269
Debenture stocks		**10**	10
Other interest payable		**10**	10
		5,333	5,076

Notes to the Accounts

7 Profit on ordinary activities before taxation

		2007 £000	2006 £000
Profit on ordinary activities is after charging			
Depreciation	- infrastructure assets	**3,527**	3,842
	- non infrastructure assets	**2,694**	2,440
Rates		**2,214**	2,158
Water abstraction charges		**1,668**	1,606
Auditors' remuneration			
Audit services	- statutory audit	**28**	33
Non-audit services	- regulatory reporting	**17**	16
	- reporting on internal controls	**13**	-
	- taxation	**1**	2
Fees in respect of the Brockhampton Pension Scheme			
	- statutory audit*	**2**	4
Hire of plant and machinery		**41**	61
Other operating leases		**345**	345

* These fees are not paid by Portsmouth Water Limited

8 Taxation

	2007 £000	2006 £000
Current tax		
United Kingdom corporation tax at 30% (2006 - 30%)	**1,938**	2,512
Adjustment in respect of prior periods	**21**	(28)
	1,959	2,484
Deferred tax		
Origination and reversal of timing differences	**664**	165
(Increase)/decrease in discount	**(554)**	87
Difference between pension cost charge and pension cost relief	**460**	(31)
	570	221
Tax on profit on ordinary activities	**2,529**	2,705

The tax charge for the year is lower (2006 - higher) than the standard rate of corporation tax in the UK of 30% The difference is explained as follows

	2007 £000	2006 £000
Profit on ordinary activities before tax	**10,495**	7,578
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2006 - 30%)	**3,149**	2,273
Effect of		
Expenses not deductible for tax purposes	**12**	76
Depreciation for the period in excess of capital allowances	**477**	845
Revenue items charged to capital	**(966)**	(713)
Rolled over chargeable gains	**(274)**	-
Difference between pension cost charge and pension cost relief	**(460)**	31
Adjustments to tax charge in respect of prior periods	**21**	(28)
Current tax charge for year	**1,959**	2,484

9 Dividends

	2007 £000	2006 £000
Equity Ordinary/'A' Ordinary		
Interims paid	**2,715**	2,188
Final paid	**1,418**	1,567
Special paid	**338**	-
	4,471	3,755

The Directors are proposing the payment of a special dividend of £0 143m and a final dividend of £1 644m for the year ended 31 March 2007 These dividends have not been accounted for within the current year financial statements, as they have yet to be approved

Notes to the Accounts

10 Tangible fixed assets	Freehold land, buildings & reservoirs £000	Mains £000	Pumping plant £000	Vehicles, mobile plant & office equipment £000	**Total £000**
Cost					
At 1 April 2006	40,471	91,105	22,763	8,414	162,753
Additions	1,637	6,077	5,565	1,544	14,823
Disposals	(186)	(217)	(668)	(190)	(1,261)
At 31 March 2007	**41,922**	**96,965**	**27,660**	**9,768**	**176,315**
Depreciation					
At 1 April 2006	6,128	52,137	6,979	5,618	70,862
Charge for year	383	3,527	1,473	838	6,221
Disposals during year	(29)	(217)	(381)	(179)	(806)
At 31 March 2007	**6,482**	**55,447**	**8,071**	**6,277**	**76,277**
Net book value					
At 31 March 2007	**35,440**	**41,518**	**19,589**	**3,491**	**100,038**
At 31 March 2006	34,343	38,968	15,784	2,796	91,891
Capital contributions					
At 1 April 2006	-	16,190	-	-	16,190
Received during year	-	945	-	-	945
At 31 March 2007	**-**	**17,135**	**-**	**-**	**17,135**
Net book value after deducting capital contributions					
At 31 March 2007	**35,440**	**24,383**	**19,589**	**3,491**	**82,903**
At 31 March 2006	34,343	22,778	15,784	2,796	75,701

11 Fixed asset investments	Loans to Group undertakings £000
At 1 April 2006	**59,500**
Addition	**440**
At 31 March 2007	**59,940**

12 Debtors	**2007 £000**	2006 £000
Trade debtors	**1,095**	930
Amounts owed by Group companies	**51**	51
Prepayments and accrued income	**243**	225
Other debtors	**387**	209
	1,776	1,415

All of the above amounts fall due within one year

13 Current asset investments

Unlisted investments £4,000 (2006 - £4,000)

14 Cash at bank and in hand

Of the total amount shown of £2 460m, £1 408m (2006 - £1 355m) is held specifically for the payment of the next half yearly loan interest charges

Notes to the Accounts

15 Creditors amounts falling due within one year	2007 £000	2006 £000
3% Perpetual debenture stock	**60**	60
3½% Perpetual debenture stock	**185**	185
4% Perpetual debenture stock	**39**	39
Bank loan	**1,500**	-
Payments received on account	**1,390**	1,494
Trade creditors	**2,143**	698
Amounts owed to Group companies	**3,646**	3,777
Corporation tax	**478**	752
Social security and other taxation	**201**	198
Other creditors	**1,967**	1,178
Accruals	**403**	337
Water rates in advance	**4,735**	4,698
	16,747	13,416

The £1 5m bank loan is part of a five year £15m working capital facility, which is secured upon the assets of the Company and bears interest at London Interbank rates

16 Creditors amounts falling due after more than one year	2007 £000	2006 £000
In five years or more		
Bank loan	**75,733**	73,329
Less deferred arrangement costs	**1,451**	1,508
	74,282	71,821

The thirty year £66 5m index-linked loan was issued on 26 June 2002 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 amount owing on the loan is stated net of the unamortised issue fees

The loan interest is calculated by adjusting the value of the loan by the Retail Prices Index and then charging interest on this inflated amount at 3 635% per annum

17 Provisions for liabilities	2007 £000	2006 £000
Deferred taxation		
At 1 April 2006	**9,455**	9,203
Provided during the year in profit and loss account	**110**	252
At 31 March 2007	**9,565**	9,455

The total deferred tax balance before the effect of discounting is £15 512m (2006 - £14 847m) The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation

	2007 £000	2006 £000
Deferred tax excluding that relating to pension asset		
Accelerated capital allowances	**9,565**	9,455
Pension asset (note 28)	**6,549**	6,244
Total provision for deferred tax	**16,114**	15,699
At 1 April 2006	**15,699**	14,120
Deferred tax charge in profit and loss account (note 8)	**570**	221
Deferred tax charged to the statement of total recognised gains and losses	**(155)**	1,358
At 31 March 2007	**16,114**	15,699

No provision has been made for deferred tax on gains recognised on the sale of properties where potentially taxable gains have been rolled over into replacement assets Such tax would become payable only if the property were sold without it being possible to claim rollover relief The total amount unprovided for is £0 781m (2006 - £0 431m) At present it is not envisaged that any tax will become payable in the foreseeable future

Notes to the Accounts

18 Financial instruments

The Financial Review on page 10 provides an explanation of the objectives and policies for holding financial instruments The numerical disclosures in this note deal with financial assets and liabilities Short term debtors and creditors have been excluded from all disclosures The fair value of all financial instruments is not materially different to the book value

Financial assets

The financial assets of the Company are detailed below The fixed asset investment earns interest based on London Interbank rates Cash at bank and in hand includes a sterling cash deposit of £1 400m , which is placed on the money market at a six monthly rate and is held specifically for the payment of the next half yearly loan interest charges The remaining cash balances on bank accounts receive interest at commercial rates

Financial liabilities

The Company has no foreign currency contracts The interest rate profile of its financial liabilities at 31 March 2007 is detailed below

Sterling	**2007 £000**	**2006 £000**
Assets		
Fixed asset investment	**59,940**	59,500
Current asset investments	**4**	4
Cash at bank and in hand	**2,460**	2,009
	62,404	61,513

Sterling	**Fixed Rate 2007 £000**	Fixed Rate 2006 £000	**Floating Rate 2007 £000**	Floating Rate 2006 £000	**Total 2007 £000**	Total 2006 £000
Liabilities						
Bank loans and overdraft	**74,282**	71,821	**1,500**	-	**75,782**	71,821
Debenture stock	**284**	284	**-**	-	**284**	284
	74,566	72,105	**1,500**	-	**76,066**	72,105

Fixed rate	**Weighted Average Interest Rate % 2007**	Weighted Average Interest Rate % 2006	**Weighted Average Period for which Rate is Fixed Years 2007**	Weighted Average Period for which Rate is Fixed Years 2006
Sterling	**3 6**	3 6	**25**	26

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 2007 is detailed below

	2007 £000	2006 £000
In one year or less	**1,784**	284
In more than five years	**74,282**	71,821
	76,066	72,105

The Company had undrawn committed borrowing facilities at 31 March 2007, in respect of which all conditions precedent had been met, as follows

	2007 £000	2006 £000
Expiring in one year or less	**2,000**	2,000
Expiring in more than two years	**13,500**	15,000
	15,500	17,000

Notes to the Accounts

19 Called up share capital	2007 £000	2006 £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
	4,900	4,900
Allotted, called up and fully paid		
Equity		
4,265,177 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 shares 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' Ordinary 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

20 Reserves	Share Premium £000	Capital Redemption £000	Profit and Loss £000
At 1 April 2006	1,539	3,250	53,233
Profit for the financial year	-	-	7,966
Dividends	-	-	(4,471)
Actuarial loss on pension scheme	-	-	(519)
Movement on deferred tax relating to pension scheme	-	-	155
At 31 March 2007	**1,539**	**3,250**	**56,364**

21 Reconciliation of movements in shareholders' funds	2007 £000	2006 £000
Profit for the financial year	**7,966**	4,873
Dividends	**(4,471)**	(3,755)
	3,495	1,118
Actuarial (loss)/gain on pension scheme	**(519)**	4,527
Movement on deferred tax relating to pension scheme	**155**	(1,358)
Net addition to shareholders' funds	**3,131**	4,287
Opening shareholders' funds	**59,100**	54,813
Closing shareholders' funds	**62,231**	59,100

22 Reconciliation of operating profit to net cash inflow from operating activities	2007 £000	2006 £000
Operating profit	**8,616**	7,049
Other pension costs	**1,153**	2,147
Depreciation charge	**6,221**	6,282
Decrease in stocks	**132**	41
(Increase)/decrease in debtors	**(345)**	552
Increase in creditors	**359**	351
Net cash inflow from operating activities	**16,136**	16,422

Notes to the Accounts

23 Reconciliation of net cash flow to movement in net debt	2007	2006
	£000	£000
Increase in cash in the year	**401**	94
Cash outflow/(inflow) from increase/(decrease) in liquid resources	**50**	(100)
Cash (inflow)/outflow from (increase)/decrease in debt	**(1,500)**	4,500
Change in net debt resulting from cash flows	**(1,049)**	4,494
Non cash movement	**(2,461)**	(2,117)
Movement in net debt in the year	**(3,510)**	2,377
Net debt at 1 April 2006	**(70,092)**	(72,469)
Net debt at 31 March 2007	**(73,602)**	(70,092)

The Company includes as liquid resources term deposits of less than one year and current asset equity investments

24 Analysis of changes in net debt	At 1 April 2006 £000	Cash Flow £000	Non cash Movements £000	**At 31 March 2007 £000**
Cash at bank and in hand	659	401	-	**1,060**
Debt falling due within one year	(284)	(1,500)	-	**(1,784)**
Debt falling due after one year	(71,821)	-	(2,461)	**(74,282)**
	(72,105)	(1,500)	(2,461)	**(76,066)**
Short term deposits	1,350	50	-	**1,400**
Current asset equity investments	4	-	-	**4**
	1,354	50	-	**1,404**
	(70,092)	(1,049)	(2,461)	**(73,602)**

The non cash movement relates to the annual indexation of the loan and the amortisation of the issue fees

25 Capital commitments	2007	2006
	£000	£000
Contracted for but not provided in these financial statements	**5,532**	12,209

The Company has a further commitment under operating leases relating to computer hardware and associated software of £0 345m per annum (2006 - £0 345m) which expire as set out below

	2007	2006
	£000	£000
Within two to five years	**345**	345

26 Contingent liabilities

There were no reportable contingent liabilities at 31 March 2007 or at 31 March 2006

27 Ultimate parent undertaking

Portsmouth Water Limited is a wholly-owned subsidiary of Portsmouth Water Holdings Limited and has, therefore, taken advantage of the exemption under FRS 8 Related Party Disclosures not to provide information on related party transactions with other undertakings within the Group The ultimate parent undertaking is South Downs Capital Limited and is the largest and smallest company for which Group accounts are prepared Copies of these accounts can be obtained on request from the Registered Office

Notes to the Accounts

28 Pensions

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

The formal actuarial valuation as at 31 March 2005 was updated to the accounting date by an independent qualified actuary in accordance with FRS 17 As required by FRS 17, the value of the defined benefit liabilities has been measured using the projected unit method

The key FRS 17 assumptions used for the scheme were as follows

	2007 % per annum	2006 % per annum	2005 % per annum
Price inflation	**3 2**	3 0	2 9
Discount rate	**5 2**	4 9	5 4
Pension increases (RPI)	**3 2**	3 0	2 9
Salary growth	**5 95**	5 75	5 65

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 26 7 years (2006 - 26 6 years) Allowance is made for future improvements in life expectancy

The fair value of assets in the scheme, a breakdown of the assets into the main asset classes, the present value of the FRS 17 liabilities and the surplus of assets over the FRS 17 liabilities (which equals the gross pension asset) are set out below

	2007 Expected Return % per annum	**2007 Fair Value £000**	2006 Expected Return % per annum	2006 Fair Value £000	2005 Expected Return % per annum	2005 Fair Value £000
Equities	**7 8**	**76,283**	7 4	77,020	7 7	61,604
Bonds	**4 5**	**27,670**	4 2	23,583	4 7	21,953
Other	**5 4**	**4,758**	4 5	4,296	4 7	4,427
		108,711		104,899		87,984

	2007 £000	2006 £000
Total fair value of scheme assets	**108,711**	104,899
FRS 17 value of scheme liabilities	**86,882**	84,086
Gross pension asset	**21,829**	20,813
Related deferred tax liability	**6,549**	6,244
Net pension asset	**15,280**	14,569

Under FRS 17, the scheme is represented on the balance sheet at 31 March 2007 as an asset of £21 829m (2006 - £20 813m), which amounts to £15 280m net of deferred tax (2006 - £14 569m)

The Company remains on a contribution holiday at the present time This position will be revisited in the light of the results of the 31 March 2008 actuarial valuation Members were also on a contribution holiday until 1 October 2006 but have now restarted the payment of contributions (at a reduced rate for the first year)

Notes to the Accounts

The post retirement surplus under FRS 17 moved over the period as follows

	2007 £000	2006 £000
Surplus in scheme at start of year	**20,813**	16,391
Current service cost	**(2,326)**	(2,148)
Contributions	**51**	1
Other finance income	**2,688**	2,042
Past service credit	**1,122**	-
Actuarial (loss)/gain	**(519)**	4,527
Surplus in scheme at end of year	**21,829**	20,813

The following amounts have been included within operating profit under FRS 17

	2007 £000	2006 £000
Current service cost (employer's part only)	**2,275**	2,147
Past service cost	**(1,122)**	-
Total operating charge	**1,153**	2,147

The following amounts have been included as other finance income under FRS 17

	2007 £000	2006 £000
Expected return on pension scheme assets	**6,804**	5,897
Interest on post retirement liabilities	**(4,116)**	(3,855)
Net return	**2,688**	2,042

The following amounts have been recognised within the statement of total recognised gains and losses (STRGL) under FRS 17

	2007 £000	2006 £000
Actual return less expected return on scheme assets	**(535)**	13,587
Experience gains arising on scheme liabilities	**-**	65
Gain/(loss) due to changes in assumptions underlying the FRS 17 value of scheme liabilities	**16**	(9,125)
Actuarial (loss)/gain recognised in the STRGL	**(519)**	4,527

The history of experience gains and losses is

	2007	2006	2005	2004	2003
Actual return less expected return on scheme assets (£000)	**(535)**	13,587	3,565	14,123	(29,941)
Percentage of scheme's assets	**0%**	13%	4%	17%	(46%)
Experience gains arising on scheme's liabilities (£000)	**-**	65	61	207	3,571
Percentage of the FRS 17 value of the scheme's liabilities	**-**	-	-	-	6%
Total amount recognised in the STRGL (£000)	**(519)**	4,527	2,237	(7,694)	(28,518)
Percentage of the FRS 17 value of the scheme's liabilities	**0%**	5%	3%	(12%)	(49%)

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 00 am on Tuesday, the 24th day of July 2007, on the following business

1 To receive and consider the Directors' Report and Accounts for the year ended 31 March 2007 and the Auditor's Report thereon

2 To re-elect Mr T M Lazenby a Director of the Company

3 To re-elect Mr A R Neve a Director of the Company

4 To reappoint Saffery Champness as Company Auditors and to authorise the Directors to fix their remuneration

Registered Office
PO Box 8
West Street Havant
Hants PO9 1LG
25 May 2007

By order of the board
N Smith
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 - Key Performance Indicators

KPI - 1	2007	2006
a) Gearing - Debt/RCV	**£000**	£000
(i) Debt		
Bank loan (note 16)	**75,733**	73,329
Bank loan (note 15)	**1,500**	-
Debenture stock (note 15)	**284**	284
Cash at bank and in hand	**(2,460)**	(2,009)
	75,057	71,604

For the purposes of this ratio, debt excludes the deferred arrangement costs of £1 451m (note 16) and the current asset investment of £0 004m (note 13)

(ii) Regulatory Capital Value (RCV)

Value established by Ofwat in Final Determination in 2004

One of the elements considered by Ofwat in assessing revenues required by the Company is a return on the capital investment in the business The value of the capital base of each company for the purposes of setting price limits is the RCV The RCV is widely used by the investment community as a proxy for the market value of the regulated business For Portsmouth Water the RCV is a key element of its bond covenants

	2007	2006
	£000	£000
Regulatory capital value indexed to 31 March	**105,341**	95,831
(iii) Gearing - Debt/RCV ratio (i) – (ii)	**71 3%**	74 7%

b) Cash interest cover

This ratio represents the number of times cashflow of the business covers interest payments

(i) Cashflow before interest paid is derived from the cashflow statement on page 34 and is calculated as follows

	2007	2006
	£000	£000
Net cash flow from operating activities	**16,136**	16,422
Interest received	**3,156**	3,575
Taxation	**(2,257)**	(2,216)
Capital expenditure	**(10,636)**	(6,108)
New/(repayment of) borrowings	**1,500**	(4,500)
	7,899	7,173
(ii) Interest paid	**2,869**	2,959
(iii) Cash interest cover ratio (i) – (ii)	**2 75**	2 42

KPI - 2 and 3 Customer Service Measures

Indicators are based on information supplied to Ofwat and confirmed in the Ofwat publication 'Levels of Service for the Water Industry in England and Wales Report'

KPI - 4 Water Quality

This indicator is based on figures reported to the DWI

KPI - 5 Efficiency

The results for this indicator are provided by Ofwat in its publication 'Water and Sewerage Unit Costs and Efficiency'

KPI - 6 Leakage

This indicator is based on figures supplied to Ofwat and confirmed in its report 'Security of Supply, Leakage and the Efficient Use of Water' The figures for 2006/07 have been supplied to Ofwat, but will not be confirmed in the Ofwat document until later in 2007