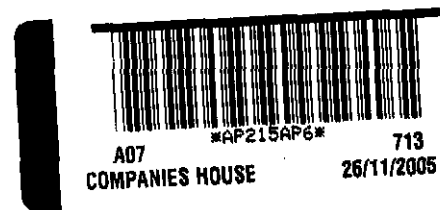


# PORTSMOUTH WATER LIMITED

## REPORT & ACCOUNTS 2005



COMPANY NUMBER: 2536455

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# FINANCIAL HIGHLIGHTS

	<b>2005</b> <b>£000</b>	2004 £000
Turnover	<b>31,273</b>	30,698
Operating profit	<b>10,421</b>	10,139
Profit before taxation	<b>8,740</b>	7,844
Profit after taxation	<b>6,041</b>	5,556
Capital expenditure	<b>9,469</b>	10,078

# BOARD OF DIRECTORS

## EXECUTIVE

### NICHOLAS JOHN ROADNIGHT

F.C.A.<sup>3</sup>

#### Managing Director

Joined in 1978. Previously with Thornton Baker.

### 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.

### ANDREW RICHARD NEVE

B.Sc., C.Eng., M.I.C.E., M.C.I.W.E.M., M.I.Mgt.

#### Technical Director

Joined in 1981. Previously with Thames Water.

### NEVILLE SMITH

B.A., A.C.M.A.

#### Finance Director

Joined in 1998. Previously with Smiths Industries and GEC.

## NON-EXECUTIVE

### TERENCE MICHAEL LAZENBY

FR.Eng.<sup>123</sup>

#### Independent Non-Executive Chairman Chairman of the Audit, Remuneration and Nomination Committees

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.<sup>123</sup>

#### Independent Non-Executive Director

Previously held senior executive positions with Scapa Group plc, Sellotape Group and SmithKline Beecham Consumer Brands.

### RAYMOND JOHN TENNANT

B.A., F.C.C.A., C.P.F.A.<sup>123</sup>

#### Independent Non-Executive Director

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.

<sup>1</sup> Member of the Audit Committee

<sup>2</sup> Member of the Remuneration Committee

<sup>3</sup> Member of the Nomination Committee

# CHAIRMAN'S STATEMENT

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.

It has performed well in the Ofwat measures for efficiency and customer service, being recognised for 2003/04 as the most efficient company and in the top quartile for the overall service performance assessment. The Company expects to maintain this record for 2004/05. The leakage target for 2004/05 was also achieved and water supplies to customers have once again been maintained throughout the year without any restriction.

The most significant event for the Company during the year was the final determination of permitted price limits for the five year period to 2010 published by the Director General of Water Services in December 2004. These limits dictate that Portsmouth Water will be permitted to raise prices in real terms by an average of 0.7% per annum. The Directors decided that an appeal to the Competition Commission would not be in the best interests of the Company. The Board believes the outcome to be challenging but achievable, and will seek to ensure that the level of future efficiencies assumed in the final determination is delivered. The determination ensures that Portsmouth Water's charges will remain the lowest in the industry until at least 2010.

In producing an impressive performance, operating profit rose by 2.8% to £10.4m. (2004 - £10.1m.). This result was helped by income of £0.4m. resulting from the bulk supply to Southern Water Services, which commenced in May 2004 following the completion of a £3.0m. investment. It is most satisfying that the Company has been able to play a part in helping its neighbours to achieve secure water supplies for its customers. Net interest paid was £0.4m. lower than in the previous year, leaving pre-tax profits 11.5% higher at £8.7m. (2004 - £7.8m.).

Cashflow of £4.3m. (2004 - £4.8m.) after interest, tax and capital expenditure was generated during the year, with capital expenditure increasing to £9.4m. (2004 - £8.8m.). In the light of these results,

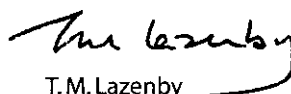
the Board has approved dividends totalling £3.8m. during the year.

Capital investment continued at a high level and once again the programme, aimed at improving water quality and maintaining both infrastructure and other operating assets, was delivered effectively.

The long term management of water resources is a major responsibility for the Company. In order to ensure that restrictions are avoided in the long term, the final determination included funding to undertake the initial planning and environmental investigations for a new winter water storage reservoir at Havant Thicket. A stakeholder group has already been established to ensure that the views of interested parties are reflected in the design and construction of the reservoir. With the bulk supply to Southern Water Services already operational, the planning of this reservoir provides further evidence of the Company's willingness to participate in the wider issues for water resources in the South.

The Company is committed to achieving high standards of health and safety across the organisation. Reportable accidents have fallen from eleven in 2003 to three in 2004. Health and safety is fundamental to the success of the business and the Board will continue to provide leadership in securing further improvements.

The success of the Company is based on the hard work and commitment of its staff and I extend my own and the Board's appreciation to them for their efforts and achievements over the last twelve months, particularly with regard to health and safety and in generating improvements in efficiency. The pricing review has issued a strong challenge to the business which the Directors are determined to meet. I believe that the Company is well positioned to respond to the challenges which lie ahead.



T. M. Lazenby  
CHAIRMAN

# MANAGING DIRECTOR'S REVIEW

Portsmouth Water continues to perform exceptionally well in the UK water industry, delivering a combination of value for money, excellent quality and high levels of service and efficiency.

## Regulation

The 2004 Periodic Review process is now complete and, in December 2004, the Director General of Water Services issued the final determination of price limits for the five year period from 2005 to 2010. The determination provided customers of Portsmouth Water with a real price reduction of 0.7% for 2005/06 (an increase of 2.7% after inflation) and an average annual real price increase of 0.7% for the five year period, considerably less than the average for the industry of 4.2%. This will ensure that customers continue to receive the lowest charges in England and Wales through to at least 2010.

In April the Company published its Monitoring Plan for the five years to 2010, which sets out the commitments Portsmouth Water is making to customers in respect of its service in the light of the final determination of price limits. The monitoring plan provides for:

- Water quality improvements to minimize the risk of cryptosporidium and nitrates in drinking water
- Continued investment in replacing old mains to reduce supply interruptions and leakage
- The initial environmental and planning investigations to enable the development of a winter water storage reservoir at Havant Thicket to meet future demands by the year 2020
- The levels of customer service and water quality to be maintained at those reported for 2003/04

The planned capital investment programme over the 5 years to 2010 amounts to £45m.

The Traffic Management Act 2004 gained Royal Assent in July 2004 and provides for various aspects of traffic management, with certain elements the

subject of consultation by April 2005. The primary aim of the Act is to reduce congestion on the highways by imposing permit charges and overrun charges on utility companies who are required to work on the highway. The Company has serious doubts whether the Act will have any impact on congestion in its area of operation, as its works are generally of short duration, but the effect of the current proposals if implemented would increase costs by approximately £1.2m. Costs arising from the implementation of the Act will give rise to further price increases through the Interim Review mechanism. The Company believes that this legislation would be an unfair burden on customers who will receive no real benefit.

## Operating Efficiency

In the performance tables published by Ofwat for 2003/04, Portsmouth Water was again ranked in the top band for both operating and capital maintenance efficiency. In 2004/05, cost savings amounted to a further 1.7% in real terms and, if depreciation is excluded, the saving was 2.1%. Future costs savings are not expected to be at this level, but the Company is confident that it will achieve the 0.3% real savings assumed by Ofwat in the final determination.

## Water Charges

The average household bill for 2004/05 was £77 (2003/04 - £76). In July 2005, this will increase by 2.7% to £79, but will still be the lowest charge in England and Wales.

## Services to Customers

The Company has continued to provide excellent value to customers in terms of both price and service. Its levels of service to customers are assessed in the highest categories as determined by Ofwat, together with being in the top quartile of water companies in the Overall Performance Assessment.

The Company has provided free domestic leak detection, supply

A MEMBER OF THE CUSTOMER SERVICES TEAM

# MANAGING DIRECTOR'S REVIEW

pipe repairs and free lead communication pipe replacement where customers have replaced their lead pipework. The Company also has an enhanced Guaranteed Standards Scheme providing for automatic payments to customers when standards are not met. During the course of the year, payments have been made predominantly when supply interruptions have exceeded 12 hours. In total £3,650 has been paid to customers.

Water poverty continues to be a national problem and some water customers are likely to face large increases in their overall bills. The Company is continuing to make payments into a Charitable Trust Fund, which aims to provide assistance for customers who have difficulty paying their bills.

## Water Resources

Eighty-five percent of the Company's supply is derived from groundwater sources, with the remaining 15% coming from Gaters Mill, near the tidal limit of the River Itchen, near Southampton. Groundwater levels are therefore critical to maintaining supplies.

The winter of 2004/05 has been particularly dry, with five consecutive months of below average rainfall between November and March. Although groundwater levels have, not surprisingly, been below average this winter, the Company does not anticipate the need for restrictions during the summer of 2005.

A bulk supply facility from Portsmouth Water to Southern Water Services was completed during the year and is now in operation.

Commissioning of two new sources at Lower Upham and Newtown, to replace the Hoe abstraction which was affecting The Moors SSSI at Bishop's Waltham, was nearing completion at the end of the year. The sources are expected to be available for use during the 2005 peak demand period.

During 2004 the Company developed its Water Resources Plan, setting out proposals for meeting customers' demands for the next 25 years. Whilst the Company has adequate supplies for the next 15 years, a twin-track programme of demand management and resource development measures will be needed by 2020 to provide sufficient resources for the following 10 years.

A key element will be the development of the Havant Thicket Winter Water Storage Reservoir, the first major reservoir of this kind in Hampshire. The Company has already set up a stakeholder group with various environmental, planning and community organisations. The group will help to identify the key issues affecting such a major development.

## Leakage and Water Efficiency

The Company recognises the importance of balancing the needs of customers with those of the environment. In the past year, leakage has been contained within the Company's target at 29.7 MI/d.

Overall, the level of leakage has fallen by more than 40% since 1990. This demonstrates the Company's continuing long-term commitment to contain leakage levels.

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.

This year the Company was involved in a joint programme with the Environment Agency, the Royal Horticultural Society and water companies in the South East to encourage B&Q customers to be conservation-minded in their gardens.

The promotion, which provided gardeners with numerous water-saving tips, had added support from BBC TV's Charlie Dimmock.

CONSTRUCTION WORK ON THE  
NEW RESERVOIR AT FARLINGTON

# MANAGING DIRECTOR'S REVIEW

## Water Quality

The Company has again carried out an exhaustive programme of testing to ensure that water of the highest quality is supplied to customers. During the year 17,544 compliance samples, taken from the distribution network, sources and reservoirs, were tested, with 99.95% passing the strict standards set out in the Water Supply (Water Quality) Regulations. The Company continues to achieve one of the highest levels of compliance in England and Wales.

During the course of the year, the Company's water quality investment programme for the next five years was approved by Regulators. A further three membrane filtration plants will be constructed to minimise the risk of cryptosporidium. Nitrate blending facilities will be provided at four sites and a major programme of trunk mains improvements will minimise the risk of discoloured drinking water in the Farlington Zone.

CHEMICAL ANALYSIS  
IN THE LABORATORY

## Capital Investment

Gross capital investment for the year amounted to £9.5m., representing a further significant improvement programme. This included expenditure of £2.1m. at Farlington, where the new reservoir will replace two old reservoirs which were leaking. Eastergate Pumping and Lovedean Booster Stations have been refurbished during the course of the year and new infrastructure costing £1m. will shortly be completed, enabling new sources at Lower Upham and Newtown to be connected into the supply network.

The continuing programme of renewing mains, where structural deterioration and increased burst frequency have resulted from corrosion or ground movement, resulted in expenditure of £3.5m. for the year.

As part of its work on the Periodic Review, the Company has modelled its infrastructure using the UKWIR framework for maintenance planning. The study identified the need for just under 25

kilometres of water mains to be renewed each year through to 2010 and this programme has been confirmed by Regulators in the Ofwat final determination.

A number of other projects undertaken and completed during the year targeted improvements to the Company's assets, both above and below ground.

## Environment

The Company has a long history of good practice in managing its operational sites for the benefit of the environment.

During the course of the year, investigations into the impact of Company abstractions have been completed at the River Itchen and Fishbourne, near Chichester, in support of the Environment Agency's Habitats Regulations Review of Consents. The Company is now participating in the next stage of 'options appraisals', which will identify solutions to ensure 'favourable status' in the future for these key environmental sites.

## Working in the Community

The Company again provided site visits, talks and slide shows to educational groups and other societies during the year. As in previous years, its exhibition was a key feature of the Science Fair held by Portsmouth and South East Hampshire Business and Education Partnership at Portsmouth Dockyard.

The Company continued with its initiative to supply drinking water bottles to infant and junior school children, thereby helping them to maintain hydration during the school day and assisting them to remain alert and attentive during class lessons. 150 of the 185 schools approached have taken up the offer, with over 70,000 bottles distributed.

CHILDREN FROM STAMSHAW JUNIOR SCHOOL  
WITH THEIR WATER BOTTLES



# MANAGING DIRECTOR'S REVIEW

During the year the Company has jointly developed educational facilities at the Staunton Country Park, near Havant. The centre will provide opportunities for local schools to learn more about their local water supplies and the natural water cycle, as well as issues surrounding their natural environment.

## **Health and Safety**

The Company is committed to maintaining high standards of health and safety. It has a health and safety plan which includes a number of initiatives to reinforce the safety message. The number of reportable accidents in 2004 reduced to three from eleven in 2003 and the number of days lost due to accidents reduced from 261 to 147.

## **Employees**

The level of performance achieved by the Company is a testament to the hard work and dedication of its employees. They have once again risen to the challenges presented during the year and I thank them all for their efforts and achievements.



N. J. Roadnight  
MANAGING DIRECTOR

MILLPOND AT FISHBOURNE, WHERE THE COMPANY IS  
INVESTIGATING THE IMPACT OF ABSTRACTION

# FINANCIAL REVIEW

## Financial Results

Turnover for the year was 1.9% higher at £31.3m. (2004 - £30.7m.), reflecting income of £0.4m. from the bulk supply to Southern Water Services, which commenced in May 2004, and the 1.5% overall tariff increase implemented in July 2004.

Operating profit improved by 2.8% to £10.4m. (2004 - £10.1m.), with operating costs rising by 1.4%, mainly as a result of depreciation, as shown below:

	2005 £m	2004 £m	%
Depreciation	5.37	5.16	4.1
Rates	2.11	2.05	2.9
Abstraction Charges	1.54	1.49	3.2
Other Operating Costs	11.83	11.86	(0.2)
	20.85	20.56	1.4

The Company is unable to influence the level of rates and abstraction charges, but the savings in other operating expenditure, which is controllable, were achieved despite a significant increase in electricity prices. In real terms, an overall saving of 1.7% was achieved, assuming inflation of 3.1%.

Interest receivable at £3.5m. (2004 - £2.9m.) mainly arises from a £59.5m. loan to another Group company, South Downs Limited, and reflects both the increased loan and the movement in interest rates in 2004.

Interest payable at £5.2m. (2004 - £5.0m.) includes the indexation of the loan provided by Artesian Finance plc of £2.1m. (2004 - £2.1m.). The interest paid on the capital sum is also impacted by RPI and amounted to £2.6m. (2004 - £2.5m.).

The tax charge for the year of £2.7m. (2004 - £2.3m.) included an increased provision for deferred taxation of £0.3m. (2004 - £0.1m.), giving rise to an overall deferred liability of £9.2m. after discounting.

Dividends declared in the year amounted to £3.8m. (2004 - £4.2m.).

## Capital Expenditure

Gross capital expenditure during the year amounted to £9.5m. compared with £10.1m. the previous year and included £3.5m. of infrastructure renewals (2004 - £3.5m.). Expenditure on non-infrastructure projects included £2.1m. on the construction of a new reservoir at the Farlington Treatment Works and £0.9m. to establish two new water sources to replace a source, for which the licence was surrendered in 2003 as a result of environmental considerations. Capital contributions, which are explained more fully in note 1(c) to the accounts on page 27, amounted to £1.1m. (2004 - £1.0m.).

## Cashflow

Net operating cash flow at £15.7m. (2004 - £15.8m.) reduced principally as a result of an increase in debtors relating to non-tariff basket income. Net interest received was £0.5m. higher, while the net cash outlay for fixed assets was £9.4m. (2004 - £8.8m.).

## Interest Rate and Liquidity Risks

The major financial risks faced by the Company are interest rate and liquidity 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 3.365% on the indexed amount of the loan. The indexed value of the loan at 31 March 2005 was £71.3m.

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

# FINANCIAL REVIEW

the end of the year, £4.5m. (2004 - £4.5m.) of the £15m. facility had been drawn, while the overdraft arrangement remained unutilised.

Details of borrowings are included in notes 15, 16 and 18 to the accounts on pages 33 to 35.

## **Net Debt**

Net debt (excluding the deferred arrangement costs) for the Company at 31 March 2005 was £74.0m. (2004 - £71.7m.). A conventional measure of debt within the water industry is as a percentage of the Regulatory Capital Value (RCV). The net debt to RCV at 31 March 2005 was 78.9% (2004 - 77.7%).

## **Pensions**

The Company continues to account for the Brockhampton Pension Scheme, in which it is a participating employer, in accordance with SSAP 24 and makes the transitional disclosures required by FRS 17. The latest actuarial valuation performed for the purposes of FRS 17 showed a surplus after deferred tax of £11.4m. (2004 - £9.9m.). More detailed information is provided in note 28 to the accounts on pages 39 to 42.

## **Accounting Standards**

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 the Office of Water Services, such that it need only adopt IFRS when non-listed companies are required by statute to do so.



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

Company Number: 2536455

## **Facts and Figures**

Area of Supply	868 km <sup>2</sup>
Population	665,000
Number of Properties Served	294,000
Length of Mains	3,255 km
Average Daily Output	180 Ml

## **Auditors**

GRANT THORNTON UK LLP  
Manor Court  
Barnes Wallis Road  
Segensworth Fareham  
Hampshire PO15 5GT

## **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 sq kilometres.

The Company provides high quality public water supplies to a domestic population of 651,000, 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 2005.

## **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 665,000 domestic and commercial customers in an area of 868 square kilometres in Hampshire and West Sussex through a mains network of 3,255 kilometres.

The Company's Area of Supply is shown on page 12 of this report.

A detailed review of operations for the year is provided in the Chairman's Statement, the Managing Director's Review and the Financial Review on pages 4 to 10.

## **Financial Results and Dividends**

The Company's profit before taxation amounts to £8.740m. (2004 - £7.844m.). After deducting £2.699m. for taxation (2004 - £2.288m.) and £3.781m. for dividends (2004 - £4.194m.), a profit of £2.260m. has been transferred to reserves (2004 - £1.362m.).

The Directors are recommending the payment of a final dividend on the ordinary share capital of £1.567m. (2004 - £2.357m.).

## **Fixed Assets**

Capital expenditure on tangible fixed assets was £9.469m. (2004 - £10.078m.), including £3.457m. on infrastructure renewals (2004 - £3.529m.). Information relating to these and other changes in fixed assets is shown in note 10 to the accounts on page 31.

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 2005, all of whom served throughout the year, are shown on page 3.

Mr. R. L. Sullivan and Mr. R. J. Tennant, who retire by rotation, offer themselves for re-election. They do not have service contracts with the Company.

The interests of the Directors in Group shares are detailed in the Report on Remuneration on page 20.

## **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 2005, the Company's creditor days were 12 (2004 - 9).

## **Substantial Shareholder**

At 31 March 2005, 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

# DIRECTORS' REPORT

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 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 has become increasingly 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 Managing Director's Review on pages 6 and 7.

## **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. During the year the Company also made a donation of £39,000 to a Charitable Trust Fund, which aims to provide assistance for customers who have difficulty paying their bills (2004 - £30,000).

## **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**

On 1 July 2004, the Grant Thornton partnership transferred its business to a limited liability partnership, Grant Thornton UK LLP. Under section 26(5) of the Companies Act 1989, the Directors consented to extend the audit appointment to Grant Thornton UK LLP from 1 July 2004.

Grant Thornton UK LLP offer themselves for reappointment as Auditors in accordance with section 385 of the Companies Act 1985.



**BY ORDER OF THE BOARD**  
**N. SMITH**  
**SECRETARY**  
**HAVANT**  
**24 MAY 2005**

# CORPORATE GOVERNANCE

The Directors are committed to high standards of corporate governance and support the principles set out in the Combined Code, which was revised in 2003 and became effective for the Company from 1 April 2004. 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).

## 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 3, 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
<b>Audit</b>		
T. M. Lazenby (Chairman)	3	3
R. L. Sullivan	3	3
R. J. Tennant	3	2
<b>Remuneration</b>		
T. M. Lazenby (Chairman)	1	1
R. L. Sullivan	1	1
R. J. Tennant	1	1
<b>Full Board</b>		
J. E. Cogley	12	11
T. M. Lazenby	12	12
A. R. Neve	12	12
N. J. Roadnight	12	12
N. Smith	12	12
R. L. Sullivan	12	11
R. J. Tennant	12	11

The Nomination Committee did not meet during the year.



# CORPORATE GOVERNANCE

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.

The Company maintains appropriate Directors' indemnity insurance.

## **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 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 Nomination Committee did not meet during the year.

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

## **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**

The Board has agreed a process for assessing its own performance and that of its committees and individual Directors. Each Director is required to complete a questionnaire, the responses to which are reviewed by the Board as a whole. Action is agreed and taken where necessary.

During the year, the Board carried out a formal review of performance in accordance with this process.

## **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 19 to 21.

## **Accountability and Audit Financial Reporting**

The Board believes that the Annual Report and

# CORPORATE GOVERNANCE

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 Managing Director's Review and the 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 2005 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 a number of key areas, including protection of assets and securing water supplies, finance, water quality, health and safety, information technology and legal matters, which 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 2005 Board meeting, the Directors carried out their annual assessment for the year to 31 March 2005, 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.

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,

# CORPORATE GOVERNANCE

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.

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. T. M. Lazenby (Chairman), Mr. R. L. Sullivan 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.

# REPORT ON REMUNERATION

## Information subject to audit

### Directors' remuneration:

	2005 £000	2004 £000
Total remuneration	501	489
Highest paid Director	139	136

### Remuneration is analysed by Director below:

	Salary/Fees £000	Benefits £000	Total 2005 £000	Total 2004 £000
<b>Executive:</b>				
J. E. Cogley	89	13	102	101
A. R. Neve	89	6	95	93
N. J. Roadnight	126	13	139	136
N. Smith	95	12	107	103
<b>Non-executive:</b>				
T. M. Lazenby (Chairman)	22	-	22	22
R. L. Sullivan	18	-	18	17
R. J. Tennant	18	-	18	17
	457	44	501	489

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  $\frac{2}{3}$  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.

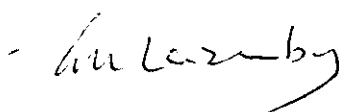
The executive Directors have accrued pension benefits under the Brockhampton Pension Scheme during the year as detailed below:

	Increase in Accrued Pension During Year to 31 March 2005 £000	Transfer Value of Increase £000	Accumulated Accrued Pension at 31 March 2005 £000	Accumulated Accrued Pension at 31 March 2004 £000
J. E. Cogley	1	8	54	51
A. R. Neve	1	14	53	51
N. J. Roadnight	2	27	68	64
N. Smith	2	22	40	37

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. No member of the Scheme has paid contributions during the year.



**BY ORDER OF THE BOARD**  
**T. M. LAZENBY**  
**CHAIRMAN**  
**HAVANT**  
**24 MAY 2005**

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

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.

The Directors are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# AUDITORS' REPORT

## Report of the Independent Auditors to the Members of Portsmouth Water Limited

We have audited the financial statements of Portsmouth Water Limited for the year ended 31 March 2005 which comprise the profit and loss account, the balance sheet, the cash flow statement and notes 1 to 28. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Report on Remuneration that is described as having been audited.

As stated in note 1 on page 27, in view of the licence conditions under which the Company operates as a water supplier, the financial statements and other information contained in the Annual Report are presented as if the Company were subject to the Listing Rules of the Financial Services Authority.

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.

### 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 are set out in the statement of Directors' responsibilities. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom auditing standards.

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 are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 transactions with the Company is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the Combined Code specified for auditors' 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, the Managing Director's Review and the 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 Opinion

We conducted our audit in accordance with United Kingdom Auditing Standards 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. 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 of the state of the Company's affairs as at 31 March 2005 and of its profit for the year then ended and 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.

*Grant Thornton UK LLP*

**GRANT THORNTON UK LLP  
REGISTERED AUDITORS  
CHARTERED ACCOUNTANTS  
PORTSMOUTH  
24 MAY 2005**



# PROFIT AND LOSS ACCOUNT

For the year ended 31 March 2005

	Notes	2005 £000	2004 £000
<b>Turnover</b>	2	<b>31,273</b>	30,698
<b>Cost of sales</b>		<b>(14,429)</b>	(14,071)
<b>Gross profit</b>		<b>16,844</b>	16,627
Net operating expenses	3	<b>(6,423)</b>	(6,488)
<b>Operating profit</b>		<b>10,421</b>	10,139
Loss on sale of fixed assets		<b>(8)</b>	(207)
<b>Profit on ordinary activities before interest</b>		<b>10,413</b>	9,932
Interest receivable	5	<b>3,510</b>	2,863
		<b>13,923</b>	12,795
Interest payable and similar charges	6	<b>(5,183)</b>	(4,951)
<b>Profit on ordinary activities before taxation</b>	7	<b>8,740</b>	7,844
Taxation on profit on ordinary activities	8	<b>(2,699)</b>	(2,288)
<b>Profit on ordinary activities after taxation</b>		<b>6,041</b>	5,556
Dividends	9	<b>(3,781)</b>	(4,194)
<b>Retained profit for the financial year</b>	20	<b>2,260</b>	1,362

There are no recognised gains or losses other than the profit for the year.

The accompanying notes form an integral part of these accounts.

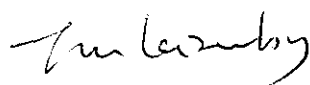
# BALANCE SHEET

As at 31 March 2005

	Notes	2005 £000	2005 £000	2004 £000	2004 £000
<b>Fixed assets</b>					
Tangible assets	10	76,201		73,219	
Investment	11	59,500	135,701	59,500	132,719
<b>Current assets</b>					
Stocks		635		616	
Debtors	12	1,969		1,421	
Investments	13	4		4	
Cash at bank and in hand	14	2,015		2,299	
		4,623		4,340	
<b>Creditors: amounts falling due within one year</b>	15	(19,645)		(21,085)	
<b>Net current liabilities</b>			(15,022)		(16,745)
<b>Total assets less current liabilities</b>			120,679		115,974
<b>Creditors: amounts falling due after more than one year</b>	16		(69,704)		(67,551)
<b>Provisions for liabilities and charges</b>	17		(9,203)		(8,911)
			41,772		39,512
<b>Capital and reserves</b>					
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		35,905		33,645
<b>Equity shareholders' funds</b>	21		41,772		39,512

The accompanying notes form an integral part of these accounts.

The accounts were approved by the Board on 24 May 2005.



T.M. Lazenby  
CHAIRMAN

# CASH FLOW STATEMENT

For the year ended 31 March 2005

	Notes	2005 £000	2005 £000	2004 £000	2004 £000
<b>Net cash inflow from operating activities</b>	22		<b>15,680</b>		15,776
<b>Returns on investments and servicing of finance</b>					
Interest received		<b>3,533</b>		2,862	
Interest paid		<b>(3,038)</b>	<b>495</b>	(2,830)	32
<b>Taxation</b>					
UK corporation tax paid		<b>(981)</b>		(1,071)	
Payments for group relief		<b>(1,501)</b>	<b>(2,482)</b>	(1,235)	(2,306)
<b>Capital expenditure and financial investment</b>					
Purchase of tangible fixed assets		<b>(10,513)</b>		(9,731)	
Sale of tangible fixed assets		<b>20</b>		26	
Capital contributions received		<b>1,087</b>	<b>(9,406)</b>	952	(8,753)
<b>Equity dividends paid</b>			<b>(4,571)</b>		(3,525)
<b>Cash (outflow)/inflow before management of liquid resources and financing</b>			<b>(284)</b>		1,224
<b>Management of liquid resources</b>					
Purchase of short-term deposits			<b>(37)</b>		(63)
<b>Financing</b>					
Repayment of loans			-		(500)
<b>(Decrease)/increase in cash in the year</b>	23		<b>(321)</b>		661

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. The principal accounting policies remain unchanged from the previous year, and 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	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 31. 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) Pensions

The Brockhampton Pension Scheme surplus is such that no contributions are likely to be needed from the

Company in the foreseeable future and no charge is, therefore, made to the profit and loss account. No other economic benefits are currently expected to flow to the Company from recognising any element of the surplus.

In addition, the rules of the scheme preclude any repayment of the overfunding. Therefore, no part of the surplus has been recognised in the balance sheet as an asset. Detailed information regarding the surplus and actuarial position of the scheme is given in note 28 to the accounts on pages 39 to 42.

## (i) Financial instruments

Income and expenditure arising on financial instruments is recognised on the accruals basis, and credited or charged to the profit and loss account in the financial period to which it relates.

Financial assets and liabilities are recorded at cost, with the exception of the index-linked loan.

	2005 £000	2004 £000
<b>2. Turnover</b>		
Unmeasured supplies	20,477	20,198
Measured supplies	8,938	8,933
Bulk supply to Southern Water Services	386	-
Chargeable work	1,472	1,567
	<b>31,273</b>	<b>30,698</b>

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

## 3. Net operating expenses

Administrative expenses	6,622	6,666
Other operating income	(199)	(178)
	<b>6,423</b>	<b>6,488</b>

# NOTES TO THE ACCOUNTS

	2005 £000	2004 £000
<b>4. Directors and employees</b>		
<b>Employment costs:</b>		
Wages and salaries	5,103	5,015
Social security costs	414	409
Pensions management charge	193	193
	<b>5,710</b>	<b>5,617</b>

<b>Average numbers employed during year:</b>	<b>Number</b>	<b>Number</b>
Operations	151	151
Administration	67	67
	<b>218</b>	<b>218</b>

<b>Directors' remuneration:</b>	<b>£000</b>	<b>£000</b>
Total remuneration	501	489
Highest paid Director	139	136

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 19 to 21. The information set out in that Report which is subject to audit forms part of these financial statements.

	2005 £000	2004 £000
<b>5. Interest receivable</b>		
Loan to Group company	3,429	2,798
Interest on short term deposits	62	41
Other interest receivable	19	24
	<b>3,510</b>	<b>2,863</b>

<b>6. Interest payable and similar charges</b>		
£66.5m. loan		
- interest	2,558	2,495
- indexation	2,096	2,063
- amortisation of fees	57	57
- administration expenses	32	32
	<b>4,743</b>	<b>4,647</b>
Other bank loans and overdraft	419	282
Debenture stocks	10	10
Other interest payable	11	12
	<b>5,183</b>	<b>4,951</b>

# NOTES TO THE ACCOUNTS

	2005 £000	2004 £000
<b>7. Profit on ordinary activities before taxation</b>		
Profit on ordinary activities is after charging:		
Depreciation - infrastructure assets	3,312	3,232
- non infrastructure assets	2,060	1,930
Rates	2,112	2,053
Water abstraction charges	1,538	1,491
Auditors' remuneration:		
Audit services - statutory audit	32	32
Non-audit services - Periodic Review reporting	-	24
- other regulatory reporting	10	12
- accountancy	7	-
- taxation	1	1
Hire of plant and machinery	43	31
Other operating leases	333	300
<b>8. Taxation</b>		
<b>Current tax</b>		
United Kingdom corporation tax at 30% (2004 - 30%)	2,407	2,170
Adjustment in respect of prior periods	-	(8)
	2,407	2,162
<b>Deferred tax</b>		
Origination and reversal of timing differences	512	336
Increase in discount	(220)	(210)
	292	126
<b>Tax on profit on ordinary activities</b>	2,699	2,288
<b>Profit on ordinary activities before tax</b>	8,740	7,844
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2004 - 30%)	2,622	2,353
Effect of:		
Expenses not deductible for tax purposes	77	132
Depreciation for the period in excess of capital allowances	497	435
Revenue items charged to capital	(789)	(750)
Adjustments to tax charge in respect of prior periods	-	(8)
<b>Current tax charge for year</b>	2,407	2,162

# NOTES TO THE ACCOUNTS

				2005 £000	2004 £000
<b>9. Dividends</b>					
<b>Equity:</b>					
Ordinary/'A' Ordinary Shares	- interim paid			2,214	1,837
	- final proposed			1,567	2,357
				<b>3,781</b>	4,194
<b>10. Tangible fixed assets</b>					
	Freehold land, buildings & reservoirs	Mains	Pumping plant	Vehicles, mobile plant & office equipment	<b>Total</b>
<b>Cost</b>	£000	£000	£000	£000	<b>£000</b>
At 1 April 2004	36,881	82,496	20,725	7,070	147,172
Additions	2,569	4,742	1,302	856	9,469
Disposals	(40)	(211)	-	(349)	(600)
At 31 March 2005	<b>39,410</b>	<b>87,027</b>	<b>22,027</b>	<b>7,577</b>	<b>156,041</b>
<b>Depreciation</b>					
At 1 April 2004	5,414	45,397	4,654	4,655	60,120
Charge for year	375	3,312	1,006	679	5,372
Disposals during year	(38)	(211)	-	(323)	(572)
At 31 March 2005	<b>5,751</b>	<b>48,498</b>	<b>5,660</b>	<b>5,011</b>	<b>64,920</b>
<b>Net book value</b>					
At 31 March 2005	<b>33,659</b>	<b>38,529</b>	<b>16,367</b>	<b>2,566</b>	<b>91,121</b>
At 31 March 2004	31,467	37,099	16,071	2,415	87,052
<b>Capital contributions</b>					
At 1 April 2004	-	13,833	-	-	13,833
Received during year	-	1,087	-	-	1,087
At 31 March 2005	-	<b>14,920</b>	-	-	<b>14,920</b>
<b>Net book value after deducting capital contributions</b>					
At 31 March 2005	<b>33,659</b>	<b>23,609</b>	<b>16,367</b>	<b>2,566</b>	<b>76,201</b>
At 31 March 2004	31,467	23,266	16,071	2,415	73,219



# NOTES TO THE ACCOUNTS

Loans to Group  
undertakings  
£000

## 11. Fixed asset investment

At 1 April 2004 and 31 March 2005

59,500

2005  
£000

2004  
£000

## 12. Debtors

Trade debtors

1,485

1,001

Amounts owed by Group companies

44

55

Prepayments and accrued income

223

171

Other debtors

217

194

1,969

1,421

All of the above amounts fall due within one year.

## 13. Current asset investment

Unlisted investments: £4,000 (2004 - £4,000).

## 14. Cash at bank and in hand

Of the total amount shown of £2.015m., £1.455m. (2004 - £1.414m.) is held specifically for the payment of the next half yearly loan interest charges.

# NOTES TO THE ACCOUNTS

	2005 £000	2004 £000
<b>15. Creditors: amounts falling due within one year</b>		
3% Perpetual debenture stock	60	60
3½% Perpetual debenture stock	185	185
4% Perpetual debenture stock	39	39
Bank loan	4,500	4,500
Payments received on account	1,171	984
Trade creditors	700	501
Amounts owed to Group companies	675	951
Amounts owed to associated companies	12	-
Corporation tax	453	258
Social security and other taxation	199	186
Other creditors	1,485	2,546
Accruals	453	317
Water rates in advance	4,546	4,601
Proposed dividends	5,167	5,957
	<b>19,645</b>	<b>21,085</b>

The £4.5m. bank loan is part of a 5 year £15m. working capital facility, which is secured upon the assets of the Company and bears interest at London Interbank rates.

	2005 £000	2004 £000
<b>16. Creditors: amounts falling due after more than one year</b>		
<b>In five years or more:</b>		
Bank loan	71,269	69,173
Less: deferred arrangement costs	1,565	1,622
	<b>69,704</b>	<b>67,551</b>

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.

# NOTES TO THE ACCOUNTS

	2005 £000	2004 £000
<b>17. Provisions for liabilities and charges</b>		
<b>Deferred taxation:</b>		
At 1 April 2004	8,911	8,785
Provided during the year in profit and loss account	292	126
At 31 March 2005	9,203	8,911

The total deferred tax balance before the effect of discounting is £14.683m. (2004 - £14.171m.). The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation.

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 £0.431m. (2004 - £0.431m.). At present it is not envisaged that any tax will become payable in the foreseeable future.

## 18. Financial instruments

The Financial Review on page 9 provides an explanation of the objectives and policies for holding financial instruments. The numerical disclosures in this note deal with financial assets and liabilities as defined in FRS 13: Derivatives and Other Financial Instruments. Short term debtors and creditors have been excluded from all disclosures. The fair value of all financial instruments is the same as 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 £1.450m., 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 2005 is detailed below.

	2005 £000	2004 £000
<b>Sterling</b>		
<b>Assets</b>		
Fixed asset investment	59,500	59,500
Current asset investments	4	4
Cash at bank and in hand	2,015	2,299
	61,519	61,803

# NOTES TO THE ACCOUNTS

	<b>Fixed Rate 2005 £000</b>	<b>Fixed Rate 2004 £000</b>	<b>Floating Rate 2005 £000</b>	<b>Floating Rate 2004 £000</b>	<b>Total 2005 £000</b>	<b>Total 2004 £000</b>
<b>Sterling</b>						
<b>Liabilities</b>						
Bank loans and overdraft	<b>69,704</b>	67,551	<b>4,500</b>	4,500	<b>74,204</b>	72,051
Debenture stock	<b>284</b>	284	-	-	<b>284</b>	284
	<b>69,988</b>	67,835	<b>4,500</b>	4,500	<b>74,488</b>	72,335

<b>Fixed rate</b>	<b>Weighted Average Interest Rate % 2005</b>	<b>Weighted Average Interest Rate % 2004</b>	<b>Weighted Average Period for which Rate is Fixed Years 2005</b>	<b>Weighted Average Period for which Rate is Fixed Years 2004</b>
<b>Sterling</b>	<b>3.6</b>	3.6	<b>27</b>	28

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 2005 is detailed below:

	<b>2005 £000</b>	<b>2004 £000</b>
In one year or less	<b>4,784</b>	4,784
In more than five years	<b>69,704</b>	67,551
	<b>74,488</b>	72,335

The Company had undrawn committed borrowing facilities at 31 March 2005, in respect of which all conditions precedent had been met, as follows:

	<b>2005 £000</b>	<b>2004 £000</b>
Expiring in one year or less	<b>2,000</b>	2,000
Expiring in more than two years	<b>10,500</b>	10,500
	<b>12,500</b>	12,500

# NOTES TO THE ACCOUNTS

	2005 £000	2004 £000
<b>19. Called up share capital</b>		
<b>Authorised:</b>		
<b>Equity:</b>		
6,000,000 Ordinary Shares of 10p each	600	600
10,500,000 'A' Ordinary Shares of 10p each	1,050	1,050
	<b>1,650</b>	<b>1,650</b>
<b>Non-equity:</b>		
3,250,000 Redeemable Preference Shares of £1 each	3,250	3,250
	<b>4,900</b>	<b>4,900</b>
<b>Allotted, called up and fully paid:</b>		
<b>Equity:</b>		
4,265,177 Ordinary Shares of 10p each	427	427
6,509,162 'A' Ordinary Shares of 10p each	651	651
	<b>1,078</b>	<b>1,078</b>

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.

	Share Premium £000	Capital Redemption £000	Profit and Loss £000
<b>20. Reserves</b>			
At 1 April 2004	1,539	3,250	33,645
Retained profit for the year	-	-	2,260
At 31 March 2005	<b>1,539</b>	<b>3,250</b>	<b>35,905</b>

# NOTES TO THE ACCOUNTS

	2005 £000	2004 £000
<b>21. Reconciliation of movements in shareholders' funds</b>		
Profit for the financial year	6,041	5,556
Dividends	3,781	4,194
Net increase in shareholders' funds	2,260	1,362
Shareholders' funds at 1 April 2004	39,512	38,150
Shareholders' funds at 31 March 2005	41,772	39,512
<b>22. Reconciliation of operating profit to net cash inflow from operating activities</b>		
Operating profit	10,421	10,139
Depreciation charge	5,372	5,162
(Increase)/decrease in stocks	(116)	27
(Increase)/decrease in debtors	(474)	484
Increase/(decrease) in creditors	477	(36)
Net cash inflow from operating activities	15,680	15,776
<b>23. Reconciliation of net cash flow to movement in net debt</b>		
(Decrease)/increase in cash in the year	(321)	661
Cash outflow from increase in liquid resources	37	63
Cash outflow from decrease in debt	-	500
Change in net debt resulting from cash flows	(284)	1,224
Non cash movement	(2,153)	(2,120)
Movement in net debt in the year	(2,437)	(896)
Net debt at 1 April 2004	(70,032)	(69,136)
Net debt at 31 March 2005	(72,469)	(70,032)

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

# NOTES TO THE ACCOUNTS

	At 1 April 2004 £000	Cash Flow £000	Non cash Movements £000	At 31 March 2005 £000
<b>24. Analysis of changes in net debt</b>				
Cash at bank and in hand	886	(321)	-	<b>565</b>
Debt falling due within one year	(4,784)	-	-	<b>(4,784)</b>
Debt falling due after one year	(67,551)	-	(2,153)	<b>(69,704)</b>
	(72,335)	-	(2,153)	<b>(74,488)</b>
Short term deposits	1,413	37	-	<b>1,450</b>
Current asset equity investments	4	-	-	<b>4</b>
	1,417	37	-	<b>1,454</b>
<b>Total</b>	<b>(70,032)</b>	<b>(284)</b>	<b>(2,153)</b>	<b>(72,469)</b>

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

	<b>2005 £000</b>	2004 £000
<b>25. Capital commitments</b>		
Contracted for but not provided in these financial statements	<b>1,218</b>	2,835

The Company has a further commitment under operating leases relating to computer hardware and associated software of £0.345m. per annum (2004 - £0.345m.) which expire as set out below:

	<b>2005 £000</b>	2004 £000
Within two to five years	<b>345</b>	345

## 26. Contingent liabilities

There were no contingent liabilities at 31 March 2005 or at 31 March 2004.

## 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 undertakings, Portsmouth Water Limited and R. H. Lillywhite Limited, are participating employers 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.

In line with the requirements of FRS 17 : Retirement Benefits, published by the Accounting Standards Board in November 2000, details in respect of the scheme are provided below in accordance with both SSAP 24 : Accounting for Pension Costs and FRS 17. The Company will not be adopting FRS 17 early and therefore the figures in the accounts reflect the SSAP 24 details below:

### SSAP 24

Contributions are determined by qualified actuaries on the basis of periodic investigations. The Company, on the advice of its actuaries, has not made contributions to the scheme since 1 April 1990. The latest actuarial investigation of the scheme was made as at 31 March 2002 and the most significant actuarial assumptions were as follows:

Valuation Method	Projected Unit
Rate of Return on Investments before retirement	7.7% per annum
Rate of Return on Investments after retirement	5.7% per annum
Rate of Increase in Pay	5.55% per annum
Rate of Increase in Pensions in Payment	2.8% per annum
Early Retirement	50% of members in service to retire at the earliest age at which an unreduced pension can be taken and 50% at normal pension age
Valuation of Assets	Valued at 100% of market value

The market value of the scheme's assets at 31 March 2002 was £90.930m. and represented 176% of the value of benefits accrued to members, allowing for expected future increases in earnings and pensions.

The actuarial investigation of the scheme as at 31 March 2002 revealed a surplus of £39.236m. However, as stated in the accounting policy on pensions on page 28, the rules of the scheme preclude any repayment of the overfunding. Consequently, no part of the surplus has been recognised as an asset and a nil pension cost has been charged to the profit and loss account.



# NOTES TO THE ACCOUNTS

## FRS 17

The formal actuarial valuation as at 31 March 2002 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:

	<b>2005</b> % per annum	2004 % per annum	2003 % per annum
Price inflation	<b>2.9</b>	2.9	2.5
Discount rate	<b>5.4</b>	5.5	5.6
Pension increases (RPI)	<b>2.9</b>	2.9	2.5
Salary growth	<b>5.65</b>	5.65	5.25

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:

	<b>2005</b> Expected Return % per annum	<b>2005</b> Fair Value £000	2004 Expected Return % per annum	2004 Fair Value £000	2003 Expected Return % per annum	2003 Fair Value £000
Equities	<b>7.7</b>	<b>61,604</b>	7.9	56,721	7.5	45,247
Bonds	<b>4.7</b>	<b>21,953</b>	4.7	21,037	4.5	13,007
Other	<b>4.7</b>	<b>4,427</b>	4.6	3,300	3.8	7,121
		<b>87,984</b>		81,058		65,375

	<b>2005</b> £000	2004 £000
Total fair value of scheme assets	<b>87,984</b>	81,058
FRS 17 value of scheme liabilities	<b>71,593</b>	66,845
Gross pension asset	<b>16,391</b>	14,213
Related deferred tax liability	<b>4,917</b>	4,264
Net pension asset	<b>11,474</b>	9,949

Under FRS 17, the scheme would be represented on the balance sheet at 31 March 2005 as an asset of £16.391m. (2004 - £14.213m.), which amounts to £11.474m. net of deferred tax (2004 - £9.949m.).

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 2005 actuarial valuation.

# NOTES TO THE ACCOUNTS

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

	<b>2005</b>	<b>2004</b>
	<b>£000</b>	<b>£000</b>
Surplus in scheme at start of year	<b>14,213</b>	7,274
Current service cost	<b>(1,935)</b>	(1,700)
Contributions	<b>1</b>	7
Other finance income	<b>1,875</b>	938
Actuarial gain	<b>2,237</b>	7,694
Surplus in scheme at end of year	<b>16,391</b>	14,213

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

Current service cost (employer's part only)	<b>1,934</b>	1,693
Past service cost	-	-
Total operating charge	<b>1,934</b>	1,693

The following amounts would have been included as net finance income under FRS 17:

Expected return on pension scheme assets	<b>5,545</b>	4,166
Interest on post retirement liabilities	<b>(3,670)</b>	(3,228)
Net return to credit to finance income	<b>1,875</b>	938

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

	<b>2005</b>	<b>2004</b>
	<b>£000</b>	<b>£000</b>
Actual return less expected return on scheme assets	<b>3,565</b>	14,123
Experience gains arising on scheme liabilities	<b>61</b>	207
Loss due to changes in assumptions underlying the FRS 17 value of scheme liabilities	<b>(1,389)</b>	(6,636)
Actuarial gain recognised in the STRGL	<b>2,237</b>	7,694

# NOTES TO THE ACCOUNTS

The history of experience gains and losses is:

	<b>2005</b>	2004	2003
Actual return less expected return on scheme assets (£000)	<b>3,565</b>	14,123	(29,941)
Percentage of scheme's assets	<b>4%</b>	17%	(46%)
Experience gains arising on scheme's liabilities (£000)	<b>61</b>	207	3,571
Percentage of the FRS 17 value of the scheme's liabilities	-	-	6%
Total amount recognised in the STRGL (£000)	<b>2,237</b>	(7,694)	(28,518)
Percentage of the FRS 17 value of the scheme's liabilities	<b>3%</b>	(12%)	(49%)

The Company's net assets, including the FRS 17 balance sheet item disclosed on page 40, would be £53.246m. at 31 March 2005 (2004 - £49.461m.).

# 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 26th day of July 2005, on the following business:

1. To receive and consider the Directors' Report and Accounts for the year ended 31 March 2005 and the Auditors' Report thereon.
2. To re-elect Mr. R. L. Sullivan a Director of the Company.
3. To re-elect Mr. R. J. Tennant a Director of the Company.
4. To re-appoint Grant Thornton UK LLP as Company Auditors and to authorise the Directors to fix their remuneration.

**REGISTERED OFFICE**  
**PO BOX 8**  
**WEST STREET HAVANT**  
**HANTS PO9 1LG**  
**24 MAY 2005**

**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.