


Portsmouth Water Limited
Annual Report and Accounts 2008

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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 2007
- Significant progress achieved in the AMP4 capital expenditure programme
- The RoSPA Gold award for occupational health and safety was achieved for the third successive year

	2008
Turnover	£33 9m
Operating profit	£7 6m
Profit before taxation	£8 4m
Net debt	£79 0m
Capital expenditure	£12 0m

Board of Directors

Executive

Nicholas John Roadnight

FCA³

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

BSc, CEng, MICE, MC IWEM

Customer Services Director

Joined in 1978. Previously with Anglian Water. Appointed to the Board in June 1997.

Andrew Richard Neve

BSc, CEng, MICE, MC IWEM, MCM

Technical Director

Joined in 1981. Previously with Thames Water. Appointed to the Board in June 1997.

Neville Smith

BA, FCMA

Finance Director

Joined and appointed to the Board in February 1998. Previously with Smiths Industries and GEC.

Non-Executive

Terence Michael Lazenby

FR Eng¹²³

Independent Non-Executive Chairman

Chairman of the Nomination Committee

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 and Expro International plc. Previously held a number of senior executive positions with British Petroleum.

Robert Leonard Sullivan

BSc, CDir¹²³

Independent Non-Executive Director

Chairman of the Remuneration Committee

Joined in June 2002. Previously held senior executive positions with Scapa Group plc, Sellotape Group and SmithKline Beecham.

Raymond John Tennant

BA, FCCA, CPFA¹²³

Independent Non-Executive Director

Chairman of the Audit Committee

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

I am pleased to report that the performance of Portsmouth Water has continued to progress strongly. The Company was recognised as economically the most efficient water company in the UK and in terms of customer service, was placed fourth out of twenty two companies in the Overall Performance Assessment by the Water Industry regulator Ofwat. It also has the lowest level of complaints (measured by complaints per 1,000 customers) in the industry.

That the Company has been able to achieve such high standards of performance is due to the commitment of employees and I would like to thank everyone for their hard work and dedication. The Company will continue to provide the support and training required to develop its people and create continued improvements in all activities. Technology is being used to generate efficient working. In the last year we completed a project to equip a section of the workforce with mobile communications and work scheduling which has provided a more responsive service for our customers and has reduced travelling time and the costs of transport. During this year we developed a facility to recycle excavated material. This will help the environment by reducing the material put into landfill, save the energy currently used to produce new aggregate material and reduce costs.

The financial results for the year ended 31 March 2008 show a reduction in operating profit of £1.2m (14%) to £7.6m (2007 - £8.8m). The previous year's results included a one-off credit of £1.1m to the FRS 17 pension charge following a change to the rules of the pension scheme which resulted in a lower liability for the scheme. Revenue from the bulk supply to Southern Water was down £0.4m as the facility was not used in the year, whilst in the previous year it was used continuously. A reduction in the tax charge to £0.2m (2007 - £2.6m) as a result of the impact of the abolition of industrial building allowances, and other changes to capital allowances and corporation tax rates in respect of the deferred tax resulted in a profit after tax of £8.2m (2007 - £8.1m).

In the light of these results the Directors are recommending a final dividend of £2.1m, which will be paid in May 2008.

Significant progress was achieved with the Company's capital programme established at the last periodic review. Gross capital investment for the year amounted to £12.0m (2007 - £14.8m), which included £4.8m on infrastructure renewals. A new membrane water treatment plant was commissioned at the River Itchen Treatment Works in June 2007, and two similar plants will be commissioned in the summer of 2008. The total cost of these plants will be £11.4m.

The number of customers wishing to switch from an unmeasured to a measured supply through a water meter in the year was 70% above the level assumed by the regulator at the last price review and in the three years since the price review, the total number of customers switching is almost double the assumed amount. The regulatory framework allows a Company to seek an interim determination of its prices where the financial impact of an increased number of customers switching to a metered supply is deemed to be above a materiality threshold. At the current level of switching, the impact of the Company's cashflow is very close to the materiality limit, but at this stage the Company does not intend to seek an interim determination of prices, which would add to customers' bills.

In December 2007, the Company published a Strategic Direction Statement which outlined how it will meet the challenges it faces over the next 25 years. The challenges include climate change, an increasing demand for water and a reduction in our ability to abstract water due to legislation aimed at protecting key habitat sites within the Company's area. In 2007 we conducted research to seek the views of our customers on their satisfaction with the service we provided and their willingness to pay for improvements. These views were reflected in the Strategic Direction Statement. Key elements of the strategy are:

- Whilst setting ourselves new leakage targets, we will urge Government to help us manage demand by requiring all new households to meet water efficiency standards.
- We will implement a Metering Programme to meter 85% of all properties by 2035 which will ensure that most households pay for water by volume with new tariffs to limit excessive use.
- We will develop key new resources including Havant Thicket Winter Storage Reservoir to optimize our use of the surplus winter water from Havant & Bedhampton Springs.
- We will continue to renew both our underground and above ground assets to minimise interruptions to supply and help reduce leakage.

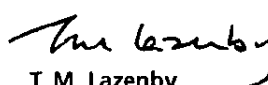
The Strategic Direction Statement was the first element in the process of developing the Company's Business Plan for the period 2010-2015 which the regulator Ofwat will use as the basis for setting new prices from 2010. This process, known as the Periodic Review, will conclude in November 2009 and is consuming a great deal of management and staff time. The information required for the review has increased in complexity and volume since the last review in 2004 and the Company is acquiring more staff and outside help to cope with the workload.

Ofwat have recently published the second part of its review of competition, which will inform the review being undertaken by Defra. In the paper Ofwat recommend that contestable markets are opened up to competition where it will benefit customers.

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 need to use water wisely and efficiently. The Company sponsored the Primary School Science Fair which is promoted by the Portsmouth and South East Hampshire Business and Education partnership and played an active part in the Water Festivals of Hampshire and West Sussex. It also has a partnership with the Sir George Staunton Country Park promoting education and the importance of water.

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 third consecutive year.

This report highlights the excellent achievements of the Company and its employees and I am confident that it will continue to maintain high standards of customer service and performance in the future.


T M Lazenby
Chairman

Operating and Financial Review

Our Business

Portsmouth Water provides water to 299,000 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 178 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 2007/08 Abstraction (Million Litres)	% of Supply 2007/08	% of Supply 2006/07
Springs at Havant & Bedhampton	20,003	30	31
River Itchen	8,567	13	9
Boreholes, Wells & Adits	38,665	57	60
Totals	67,235	100	100

A map showing the Company's area of supply and the location of its sources and treatment works is shown on page 21.

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 £85 per household, the equivalent of 23p per day. In real terms, the price of water for household customers has fallen by 13% over the last 11 years. This compares with a real increase of 10.6% 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 Water Services Regulation Authority (Ofwat) for setting prices and to ensure value for customers, 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 17 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 2006/07 Report - published by Ofwat), and this has benefited customers through lower bills over many years, as shown on page 5.

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.

LEFT Mainlaying work being carried out by the Company's contractor

FAR LEFT Hydrant flushing, carried out in order to maintain water quality

BELOW Detecting possible leaks on the Company's network

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

Presentation to winning students for the Company's 150th Anniversary Artwork Competition by Pamela Taylor, Chief Executive of Water UK and Nick Roadnight, Managing Director of Portsmouth Water

Operating and Financial Review

Current Development and Performance

Financial Performance

Profit before tax

Turnover for the year increased by 2.6% to £33.9m. This reflected the 5.37% overall tariff increase implemented in July 2007, which was partially offset by a reduction of £0.4m of income from the bulk supply to Southern Water and £0.5m in income from new connections, and other non-tariff work. The income from the bulk supply was very high in 2006/07 as the extent of the drought conditions in 2006 meant that it was operating for most of that year.

Operating costs, excluding depreciation and the FRS17 pension charge rose by £0.6m (3.7%). This was largely due to salary pay awards and electricity price increases. The current service cost for the pension scheme was increased by £1.2m to £2.3m. This was as a result of a one-off credit to the charge in 2006/07 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.

There was a loss on disposal of fixed assets of £0.2m compared to a profit of £0.9m in 2006/07 when the Company sold three properties.

Interest receivable at £4.3m (2007 - £3.6m) relates mainly to interest received from group companies and is based on Libor plus 1%.

An increase in other finance income of £0.2m represents an increase in the expected return on Pension Fund assets.

Interest payable at £6.2m (2007 - £5.3m) includes a £2.9m indexation of the loan provided by Artesian Finance plc (2007 - £2.4m). Interest on the capital sum amounted to £2.8m (2007 - £2.7m). Total borrowing was higher during the year as a result of the level and timing of the capital expenditure programme and interest on short term borrowing was £0.3m higher.

As a result primarily of the increased pension charge and lower income from property sales, profit before tax reduced to £8.4m (2007 - £10.7m).

Taxation

The taxation charge was £2.4m lower due to a reduction in deferred tax which was the result of the effect of the removal of industrial buildings allowances and changes to corporation tax and capital allowance rates.

Dividends

The dividends paid during the year amounted to £4.209m (2007 - £4.471m). In 2006/07 a special dividend of £0.3m was paid which represented an element of the profit on the sale of property. 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 £16.0m (2007 - £16.1m) reduced marginally as a result of a reduction in trade creditors. Net cash outlay on fixed assets at £12.2m (2007 - £11.8m) reflected a large outlay on the construction of the three membrane plants and further progress on the mains renewal programme.

Net debt at £79.0m (2007 - £73.6m) increased during the year as a result of the indexation of the £66.5m Index Linked Loan and the relatively high capital programme. At the year end, net debt to regulatory capital value was 72.3% (2007 - 71.3%).

Interest Rate, Liquidity, Capital and Credit Risk

The major financial risks faced by the Company are interest rate, liquidity, capital 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 2008 was £78.6m (2007 - £75.7m).

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, £4.0m of this facility had been drawn (2007 - £1.5m), while the overdraft arrangement remained unutilised.

The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern, so it can provide returns for shareholders and benefit to customers.

Operating and Financial Review

Current Development and Performance

The capital structure is set at a level which provides an appropriate risk profile to ensure the Company can obtain finance at competitive levels. As is common in the water industry the Company monitors capital in the ratio of debt to Regulatory Capital Value (RCV). RCV is a measure of the Company's asset value used in the setting of prices in the water industry. The level of RCV is published by the regulator (Ofwat) on an annual basis. The ratio achieved for 2007/08 is shown below, and the details of the calculation are shown on page 47.

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 34 to 35 and with UK GAAP. There was a change in accounting policy in respect of unbilled measured income as at the year end date, which is described more fully on page 35 of the accounts.

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 £21.6m (2007 - £15.3m).

Key Financial Performance Indicators

Gearing (net debt/regulatory capital value) and cash interest cover are recognised as key indicators for the Company. Performance in 2008 against the target ratios is shown in the table below.

KPI - 1 ¹	Target	Performance 2007/08	Performance 2006/07
Gearing - Debt/RCV ²	<83%	72.3%	71.3%
Cash interest cover ²	>2.2	2.53	2.75

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 2006/07
To be in the upper quartile of performance for all water companies	Placed 4th out of 22 companies

The Overall Performance Assessment for 2007/08 will be published by Ofwat after the Report and Accounts have been completed and therefore the performance shown above is for 2006/07.

Operating and Financial Review

Current Development and Performance

KPI - 3 DG Service Indicators

The DG service indicators data shown below is as recorded by the Company for 2007/08 and will be reported to Ofwat in the annual regulatory June Return

DG Service Indicator	Target	Performance 2007/08	Performance 2006/07
DG2 No. of properties at risk of inadequate pressure	≤ 120	66	90
DG3 Unplanned interruptions to supply	≤ 0.3	0.14	0.23
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%	4.2%	6.2%
- all lines busy	≤ 0.7%	0.3%	Nil

In all categories Ofwat assessed the Company as having good performance for 2006/07. The Ofwat assessments for 2007/08 will not be published until September, but the results recorded by the Company meet the criteria for being assessed as good.

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 2007	Performance 2006
Compliance samples passing standards	99.90%	99.97%	99.96%

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 2006/07, which showed that Portsmouth Water was assessed as the top performing company and in the top bands for both operating and capital maintenance expenditure. 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 2006/07
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

Operating and Financial Review

Current Development and Performance

Capital Investment

The Company made good progress with the five year capital programme agreed with the Regulator for the period 2005 to 2010. Details of progress are shown in the table below

Capital Programme Agreed	Outcome
Infrastructure Assets Renewal of 25km of mains each year	Since April 2005, the Company has renewed an average of 24.6km per year
Water Quality Installation of membrane filtration plants to minimise the risk of cryptosporidium at <ul style="list-style-type: none"> - River Itchen - Soberton - Fishbourne 	Completed Summer 2007 Will be completed in late Spring 2008 Will be completed in late Spring 2008
Remedial work on trunk mains in the Company's largest supply area to reduce the risk of discoloured water incidents	A small amount of work still to be carried out, but will be complete by the end of 2008
The installation of blending facilities at sources at risk from increasing nitrate levels	Will be completed in 2009
Optional Water Meters It was anticipated that 2,200 domestic customers would wish to switch from an unmeasured to a measured supply	In the 3 years to March 2008, over 13,000 customers had opted to switch, an average of 4,300 per year

Gross capital investment during the year was £12.0m (2007 - £14.8m) and included £4.8m (2007 - £4.1m) on infrastructure renewals. After receiving capital contributions and infrastructure charges of £0.8m, net capital expenditure was £11.2m (2007 - £13.9m). The chart below shows the level of net capital investment over a six year period in outturn prices.

Net Capital Expenditure

The major elements of expenditure in the year related to

- Mains renewed - 27km (2007 - 26.0km) were renewed at a cost of £4.8m. The programme allowed for at the last Determination is now close to being met.
- Membrane plants - work is nearing completion at two sites. The expenditure during the year was £4.0m and the full cost of the two plants will be £6.9m.
- Havant Thicket Winter Storage Reservoir - the Company has started planning for a winter storage reservoir, which should help ensure security of water supplies well into the future. In order to obtain planning permission for this scheme, considerable environmental studies and public consultation has to be undertaken, which requires a range of design options and impact assessments. In 2007/08 this work resulted in expenditure of £0.6m.

Water Resources - Outlook for 2008

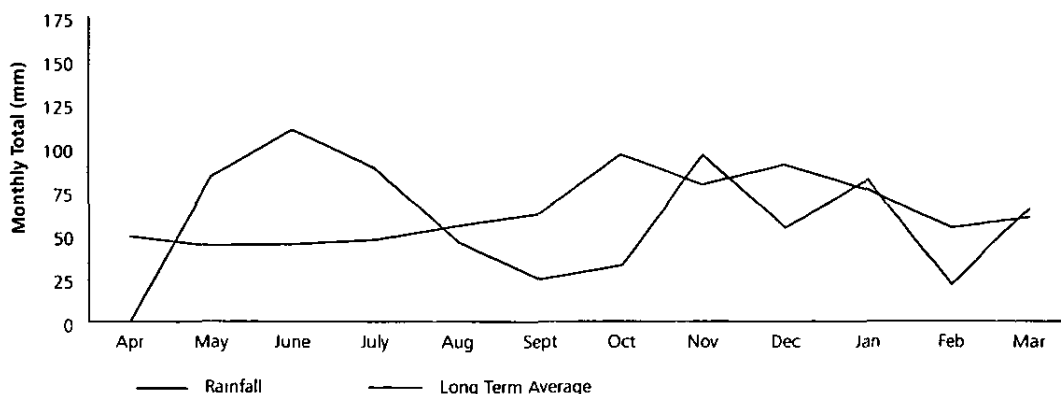
As detailed on page 5, nearly 90% of water supplied to customers is from groundwater springs, boreholes and wells which abstract from the underground chalk of the South Downs. Groundwater levels are therefore critical to maintaining supplies to customers. The Company has for many years monitored the groundwater level at Idsworth Well, Rowlands Castle, which is unaffected by abstraction and is representative of groundwater conditions in the South Downs chalk.

Operating and Financial Review

Current Development and Performance

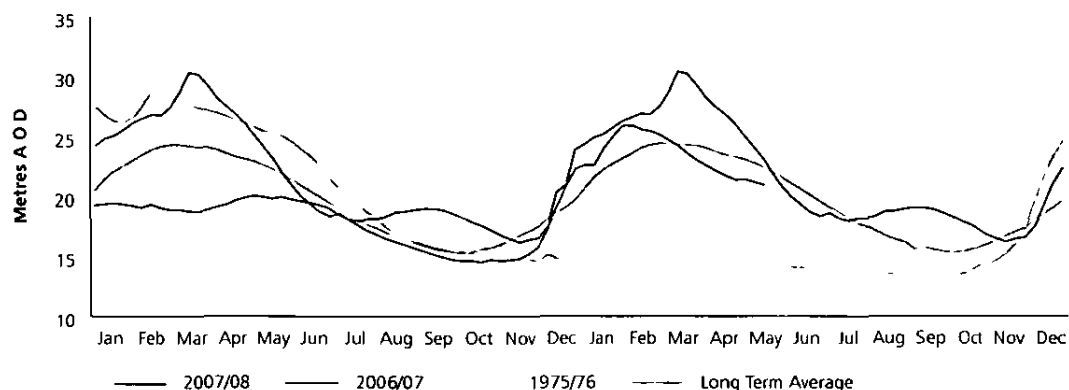
The rainfall for the year 2007/08 is as shown in the chart below

Rainfall at Havant 2007/08



Despite the rainfall in the winter of 2008 being less than the long term average, the groundwater of the South Downs chalk, as measured at Idsworth Well, received recharge during the winter and, by May, was close to 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.

Idsworth Well



Water resources are therefore expected to be sufficient to meet peak demands in the summer of 2008 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 has recently published its Draft Water Resources Management Plan for public consultation. The plan examines the likely key influences on the demand for water from customers and on the Company's ability to meet that demand. 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 domestic households in the Company's area of supply will grow from 281,600 in 2007 to over 348,000 by 2035 (Source - Experian)
- There will be a rise in average year per capita consumption from 160 litres/head/day in 2007 to 174 litres/head/day in 2035. 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 2015. To address this shortfall, the Company has developed a twin track approach of demand management and additional sources of supply consisting of:

Operating and Financial Review

Current Development and Performance

- The development of a Farlington Washwater Recovery Plant in the AMP5 period by 2011/12
- Initiating a Leakage Savings Programme which will reduce leakage levels from the current target of 29.7 Ml/d to a new target of 26.7 Ml/d by 2014/15
- Instigating a promotional Water Efficiency Programme which will include sending cistern devices to all customers starting in 2010/11. The programme will be repeated on a five-yearly basis as the devices only have a short life expectancy
- Beginning a 25 year programme of compulsory metering for all domestic households, where practicable, beginning in 2010/11. The Company plans a targeted programme which will minimise the overall costs of meter installation
- Developing additional boreholes at Lavant and Brickkiln Water Treatment Works within the currently licensed abstraction limits by 2014/15
- Promoting a programme of retrofit fitting of dual flush devices in toilets from 2015/16
- Continuing the development of Havant Thicket Winter Storage Reservoir for completion by 2021

Leakage

Leakage for the year was recorded at an average of 29.6 Ml/d, which was within the leakage target of 29.7 Ml/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.

KPI - 6 Leakage

Target

Average leakage of 29.7 Ml/d

Performance 2007/08

Average leakage of 29.6 Ml/d

Employees

The Company employs 222 people and believes it recruits and retains the right people which is key to the successful performance of the business.

The Company is firmly committed to the development of its employees and that they should all have opportunities to reach their full potential and, as a result, a number during the year have undertaken Degrees, HNC's and NVQ's, along with associated professional qualifications.

In line with this objective the Company fully supports the principle of Modern Apprenticeships, for example, all new employees within Customer Services aged under 25 are employed through the Modern Apprenticeship scheme which leads to a minimum NVQ level 2 qualification.

A key part of staff development is the Company involvement with the Institution of Water Officers (IWO). The IWO is a professional body whose purpose is to promote the advancement of knowledge within the water industry. To this end, Area and National Committees organise meetings, seminars, technical visits and conferences, as well as a variety of social events. These activities provide a shop window for the latest technological developments in the industry and a forum for the discussion of major topics. The Company encourages its staff to belong to the IWO and gain the benefit for both their personal and professional development by attending these events.

Staff turnover, excluding retirees was 8.1% in 2008 (2007: 8.2%), which compares favourably with the national average which was 15.5% in 2006 (Source – EEF Absence and Rehabilitation Survey 2007).

Total absence (days per employee per year) has remained at just under 4.5. The figure of 4.48 compares with 4.38 for last year and is below the average for private companies of the same size at 7.2 (Source: CIPD Annual Survey Report 2007).

Health and Safety

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 been 5 years since the Company embarked on a mission to improve its health and safety culture and therefore the record in this area. To achieve the initial step change the Company put health and safety at the top of the agenda and from the Board down has made it a high priority.

Last year saw the Company implement a number of campaigns and initiatives, aimed at increasing staff awareness of health and safety issues. These included vibration and audio assessments, poster campaigns, tool box talks along with training in safety awareness and manual handling.

The graph below portrays a positive picture in respect of the improvement in the Company's health and safety performance, notably a fall in total accidents to a third of what they were in 2003. The improvement since 2003 reinforces the Company's decision to revitalise health and safety and the commitment of time and resources into that area.

Operating and Financial Review

Current Development and Performance

Total Accidents

The efforts of all employees were rewarded in March 2008, when the Company received a Gold Award for occupational health and safety from RoSPA for the third consecutive 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 18.

Prosecution

In early 2007, an incident occurred at the River Itchen Treatment Works which resulted in polyaluminium chloride being distributed into a tributary of the River Itchen. None of the chemical reached the main river but some fish died. In 2007/08 the Company received a fine of £10,000. The Company has taken action to avoid this happening in the future.

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 10,000 'Save-a-Flush' bags were issued to customers during the year.

Measured Customers

All new properties are charged on the basis of a metered supply and 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.

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

The Company's education partnership with Staunton Country Park has continued to grow. As well as providing the 'Water Is Life' themed education programme for local schools a 'Water is Life Trail' for visitors to the park was launched. The water trail is designed to help educate children and parents visiting the Park about the importance of water as a resource and encourage them to be more water efficient. The trail takes the form of a walk within the park searching for water information boards which help to answer simple questions.

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.

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 we have offered a drinking water bottle at the subsidised cost of 15p per bottle for every child in a local primary, infant and junior school.

Operating and Financial Review

Corporate Responsibility

The Water Bottles for Schools offer has gone from strength to strength with over 20,000 delivered last year and which has seen nearly 160,000 water bottles being delivered through the schools to our local children over the last five years

Community Talks

Employees continue to give community talks to local schools, colleges, clubs and groups such as Age Concern, Rotary and the Women's Institute. To cope with the increasing demand a community talk a team has been set up with volunteers from the Company,

Festivals and Fairs

The Company, once again, sponsored the Primary Schools Science Fair which is promoted by the Portsmouth and South East Hampshire Business and Education partnership. The three-day event held within the historic Dockyard utilising the HMS Warrior and Action Stations to house the exhibitor's stands saw over 1,200 children from local schools visiting the exhibits.

The Company demonstrations this year included water treatment and how different filters work, the sampling process and finished off with a short session on the need for all of us to conserve water.

The Company also played an active part in the Water Festivals of Hampshire and West Sussex. This involved a tour of the River Itchen Treatment works, a week of water experiments for visitors at Staunton Country Park and a stand at Arundel promoting water efficiency.

ABOVE Filtration experiment during Sir George Staunton Country Park Science Week

FAR LEFT 'Water is Life Trail' Board at Sir George Staunton Country Park

LEFT Visitor completing the 'Water is Life Trail' at Sir George Staunton Country Park

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 2008/09 will be £14.3m (2008 - £12.0m), and will include £2.9m for blending facilities to deal with nitrates. Expenditure will reduce to £8.4m in 2009/10.

Energy costs represent almost 10% of total operating costs. The current electricity contract comes to an end in October 2008, and there remains great uncertainty as to the movement of prices and the impact on the business.

As a result of these factors, the Company anticipates that debt will rise from the March 2008 level of £79.0m to £85.0m in 2009 before falling to £84.7m 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 77.7%.

LEFT Official opening of the River Itchen Works Membrane Filtration Plant by Dr Richard Sturt, Chairman of the Consumer Council for Water Southern
BELOW The River Itchen Works Membrane Filtration Plant

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 three treatment works considered most at risk from cryptosporidium being present in the raw water and will commission additional plants at two more works by the summer of 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 24 to 26. In early 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. The EA have made their decisions on the changes they require in the abstraction of water by both Portsmouth Water and Southern Water who also have an abstraction upstream of the Portsmouth facility. The full implication of this decision has yet to be assessed but could result in some of the measures required to address the potential supply/demand imbalance in 2020 identified on pages 12 and 13 being brought forward.

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 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 Desmoulin's 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 has announced its conclusions on these licences and the Company believes the required changes will have little impact on its ability to match supply and demand.

The flooding in various parts of the UK during the summer of 2007 has prompted several national reports. Whilst the Company was not affected in 2007, it has put in hand a thorough review of company response and contingency plans together with a fresh look at the vulnerability of key assets.

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 10 to 11.

Operating and Financial Review

Risks and Uncertainties

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

Company Secretary Christopher Hardyman ACIS

Facts and Figures

Area of Supply	868 km ²
Population	662,000
Number of Properties Served	299,000
Length of Mains	3,278 km
Average Daily Output	178 MI

Auditors

Saffery Champness
Lion House
Red Lion Street
London WC1R 4GB

Bankers

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

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 644,000, 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 2008

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 662,000 domestic and commercial customers in an area of 868 square kilometres in Hampshire and West Sussex through a mains network of 3,278 kilometres

The Company's Area of Supply is shown on page 21 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 4 to 19

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 Operating and Financial Review on page 8 and in note 18 to the accounts on page 41

Financial Results and Dividends

The Company's profit before taxation amounts to £8 369m (2007 - £10 721m) After deducting £0 147m for taxation (2007 - £2 596m), a profit of £8 222m has been transferred to reserves (2007 - £8 125m)

The Directors are recommending the payment of a final dividend of £2 088m (2007 - special £0 147m - final £1 640m)

Fixed Assets

Capital expenditure on tangible fixed assets was £12 033m (2007 - £14 823m), including £4 775m on infrastructure renewals (2007 - £4 117m) Information relating to these and other changes in fixed assets is shown in note 10 to the accounts on page 38

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 2008, 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 27

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 2008, the Company's creditor days were 10 (2007 - 28)

Substantial Shareholder

At 31 March 2008, Portsmouth Water Holdings Limited owned the entire voting capital of the Company

Regulatory Accounts

A set of accounts for regulatory purposes is required by the Water Services Regulation Authority These accounts relate solely to the regulated water supply business and copies may be obtained on request from the Registered Office

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 third 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 5 to 19

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 again not necessary to make any donations this year (2007 - nil)

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

C Hardyman

Secretary

Havant

30 May 2008

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 did not, for the current year, include a performance related element. From April 2008 it is intended that their remuneration will include a performance related element, which will be based upon the achievement of agreed financial and customer service targets (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
Audit		
R J Tennant (Chairman)	4	4
T M Lazenby	4	4
R L Sullivan	4	4
Remuneration		
R L Sullivan (Chairman)	1	1
T M Lazenby	1	1
R J Tennant	1	1
Full Board		
J E Cogley	11	11
T M Lazenby (Chairman)	11	11
A R Neve	11	11
N J Roadnight	11	11
N Smith	11	11
R L Sullivan	11	11
R J Tennant	11	11

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.

Corporate Governance

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

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 27 and 28.

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 2008 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 2008 Board meeting, the Directors carried out their annual assessment for the year to 31 March 2008, including consideration of events since the year end.

Audit Committee and Auditors

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

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 continues 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

Corporate Governance

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 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, as reported in the accounts, did not include a performance related element. From April 2008 it is intended that their salary will include a performance related element, which will be based upon the achievement of agreed financial and customer service targets.

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	2008 £000	2007 £000
Total remuneration	558	531
Highest paid Director	153	147

Remuneration is analysed by Director below	Salary/Fees £000	Benefits £000	Total 2008 £000	Total 2007 £000
Executive				
J E Cogley	99	11	110	106
A R Neve	99	8	107	102
N J Roadnight	139	14	153	147
N Smith	104	14	118	114
Non-executive				
T M Lazenby (Chairman)	30	-	30	24
R L Sullivan	20	-	20	19
R J Tennant	20	-	20	19
	511	47	558	531

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.

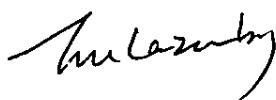
The executive Directors have accrued pension benefits under the Brockhampton Pension Scheme during the year as detailed below.

	Increase in Accrued Pension During Year to 31 March 2008 £000	Transfer Value of Increase £000	Accumulated Accrued Pension at 31 March 2008 £000	Accumulated Accrued Pension at 31 March 2007 £000
J E Cogley	2	27	64	60
A R Neve	2	28	64	60
N J Roadnight	3	40	86	80
N Smith	2	25	52	48

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

30 May 2008

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 2008, 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 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 2008 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 2008.



Saffery Champness

Chartered Accountants
Registered Auditors
Lion House
Red Lion Street
London
WC1R 4GB
30 May 2008

Profit and Loss Account

For the year ended 31 March 2008

	Notes	2008 £000	2007 £000
			(restated)
Turnover	2	33,906	33,042
Cost of sales		(17,078)	(16,406)
Gross profit		16,828	16,636
Net operating expenses	3	(9,243)	(7,794)
Operating profit		7,585	8,842
(Loss)/profit on sale of fixed assets		(183)	912
Profit on ordinary activities before interest		7,402	9,754
Interest receivable	5	4,331	3,612
Other finance income	28	2,851	2,688
		14,584	16,054
Interest payable and similar charges	6	(6,215)	(5,333)
Profit on ordinary activities before taxation	7	8,369	10,721
Taxation on profit on ordinary activities	8	(147)	(2,596)
Profit for the financial year	20	8,222	8,125

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 2008

	Notes	2008 £000	2007 £000
			(restated)
Profit for the financial year		8,222	8,125
Actuarial gain/(loss) on pension scheme	28	7,602	(519)
Deferred tax relating to actuarial (gain)/loss on pension scheme	17	(2,129)	155
Effect of change to corporation tax rate on pension asset		(292)	-
Total recognised gains and losses relating to the year		13,403	7,761

The accompanying notes form an integral part of these accounts

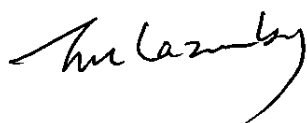
Balance Sheet

As at 31 March 2008

	Note	2008 £000	2008 £000	2007 £000 (restated)	2007 £000 (restated)
Fixed assets					
Tangible assets	10	87,308		82,903	
Investments	11	60,478	147,786	59,940	142,843
Current assets					
Stocks		468		462	
Debtors	12	4,049		3,720	
Investments	13	4		4	
Cash at bank and in hand	14	2,494		2,460	
		7,015		6,646	
Creditors amounts falling due within one year	15	(18,016)		(17,330)	
Net current liabilities			(11,001)		(10,684)
Total assets less current liabilities			136,785		132,159
Creditors amounts falling due after more than one year	16		(77,239)		(74,282)
Provisions for liabilities	17		(8,344)		(9,565)
Net assets excluding pension asset			51,202		48,312
Pension asset	28		21,584		15,280
Net assets including pension asset			72,786		63,592
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		66,919		57,725
Shareholders' funds	21		72,786		63,592

The accompanying notes form an integral part of these accounts

The accounts were authorised for issue and approved by the Board on 30 May 2008, and signed on its behalf by,



T M Lazenby
Chairman

Cash Flow Statement

For the year ended 31 March 2008

	Notes	2008 £000	2008 £000	2007 £000	2007 £000
Net cash inflow from operating activities	22		15,996		16,136
Returns on investments and servicing of finance					
Interest received		3,780		3,156	
Interest paid		(3,257)	523	(2,869)	287
Taxation					
UK corporation tax paid		(687)		(1,124)	
Payments for group relief		(1,223)	(1,910)	(1,133)	(2,257)
Capital expenditure and financial investment					
Purchase of tangible fixed assets		(12,914)		(12,748)	
Sale of tangible fixed assets		32		1,167	
Capital contributions received		753	(12,129)	945	(10,636)
Equity dividends paid			(4,946)		(4,579)
Cash (outflow) before management of liquid resources and financing			(2,466)		(1,049)
Management of liquid resources					
(Purchase) of short term deposits			(60)		(50)
Financing					
New loans			2,500		1,500
(Decrease)/increase in cash in the year	23		(26)		401

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 United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) which have been applied consistently, 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, together with an estimation of amounts unbilled at the year end, for measured water customers. Unmeasured income bills are based on the rateable value of properties. Measured income arises from customers who have meters fitted at their premises and amounts billed, therefore, are based on actual water consumption. The estimation of the amounts unbilled at the year end uses a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

(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 38. 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.

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. 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. 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.

Change in accounting policy

The Company has, for the first time, included a debtor for unbilled measured income as at the year end date in these financial statements, as more fully explained in note 1(a) above. This represents a change in accounting policy and comparative figures have been restated accordingly.

The effect of this change in accounting policy was to,

- (i) Increase turnover by £0 329m (2007 - £0 226m)
- (ii) Increase profits after taxation by £0 231m (2007 - £0 159m)
- (iii) Increase accrued income in the balance sheet by £2 273m (2007 - £1 944m)
- (iv) Increase net assets after provision for tax in the balance sheet by £1 591m (2007 - £1 361m)

Notes to the Accounts

2 Turnover	2008	2007
	£000	£000
		(restated)
Unmeasured supplies	21,546	20,720
Measured supplies	10,636	9,716
Bulk supply to Southern Water Services	530	940
Chargeable work	1,194	1,666
	33,906	33,042

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

3 Net operating expenses	2008	2007
	£000	£000
Administrative expenses	9,506	7,955
Other operating income	(263)	(161)
	9,243	7,794

4 Directors and employees	2008	2007
	£000	£000
Employment costs		
Wages and salaries	5,593	5,484
Social security costs	448	435
Other pension costs (note 28)	2,304	1,153
	8,345	7,072
Transferred to capital schemes	(67)	(106)
Net employment costs	8,278	6,966

Average numbers employed during year	2008	2007
	Number	Number
Operations	143	154
Administration	73	71
	216	225

Directors' remuneration	2008	2007
	£000	£000
Total remuneration	558	531
Highest paid Director	153	147

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 27 and 28. The information set out in that Report which is subject to audit forms part of these financial statements.

5 Interest receivable	2008	2007
	£000	£000
Loan to Group company	4,223	3,532
Interest on short term deposits	78	61
Other interest receivable	30	19
	4,331	3,612

6 Interest payable and similar charges	2008	2007
	£000	£000
£66.5m loan		
- interest	2,827	2,725
- indexation	2,900	2,404
- amortisation of fees	57	57
- administration expenses	22	22
	5,806	5,208
Other bank loans and overdraft	384	105
Debenture stocks	10	10
Other interest payable	15	10
	6,215	5,333

Notes to the Accounts

7 Profit on ordinary activities before taxation	2008	2007
	£000	£000
Profit on ordinary activities is after charging		
Depreciation		
- infrastructure assets	3,633	3,527
- non infrastructure assets	3,027	2,694
Rates	2,267	2,214
Water abstraction charges	1,718	1,668
Auditors' remuneration		
Audit services	27	28
- statutory audit		
Non-audit services	16	17
- regulatory reporting		
- reporting on internal controls	-	13
- taxation	3	1
- general advice	2	-
Fees in respect of the Brockhampton Pension Scheme		
- statutory audit*	2	2
Hire of plant and machinery	51	41
Other operating leases	345	345

* These fees are not paid by Portsmouth Water Limited

8 Taxation	2008	2007
	£000	£000
		(restated)
Current tax		
United Kingdom corporation tax at 30% (2007 - 30%)	1,951	2,005
Adjustment in respect of prior periods	(7)	21
	1,944	2,026
Deferred tax		
Origination and reversal of timing differences	915	664
(Increase) in discount	(141)	(554)
Effect of removal of industrial buildings allowances	(1,403)	-
Effect of changes to corporation tax and capital allowance rates	(592)	-
Difference between pension cost charge and pension cost relief	153	460
Effect of change to corporation tax rate on pension asset	(729)	-
	(1,797)	570
Tax on profit on ordinary activities	147	2,596

The tax charge for the year is lower (2007 - lower) than the standard rate of corporation tax in the UK of 30%. The difference is explained as follows

	2008	2007
	£000	£000
		(restated)
Profit on ordinary activities before tax	8,369	10,721
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2007 - 30%)	2,511	3,216
Effect of		
Expenses not deductible for tax purposes	69	12
Capital allowances for the period in excess of depreciation	(671)	477
Revenue items charged to capital	206	(966)
Rolled over chargeable gains	-	(274)
Difference between pension cost charge and pension cost relief	(164)	(460)
Adjustments to tax charge in respect of prior periods	(7)	21
Current tax charge for year	1,944	2,026

9 Dividends	2008	2007
	£000	£000
Equity Ordinary/'A' Ordinary		
Interim paid	2,422	2,715
Final paid	1,640	1,418
Special paid	147	338
	4,209	4,471

The Directors are proposing the payment of a final dividend of £2.088m for the year ended 31 March 2008. This dividend has not been accounted for within the current year financial statements, as it has 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 2007	41,922	96,965	27,660	9,768	176,315
Additions	827	5,300	4,703	1,203	12,033
Disposals	(231)	(226)	-	(120)	(577)
At 31 March 2008	42,518	102,039	32,363	10,851	187,771
Depreciation					
At 1 April 2007	6,482	55,447	8,071	6,277	76,277
Charge for year	394	3,633	1,716	917	6,660
Disposals during year	(39)	(226)	-	(97)	(362)
At 31 March 2008	6,837	58,854	9,787	7,097	82,575
Net book value					
At 31 March 2008	35,681	43,185	22,576	3,754	105,196
At 31 March 2007	35,440	41,518	19,589	3,491	100,038
Capital contributions					
At 1 April 2007	-	17,135	-	-	17,135
Received during year	-	753	-	-	753
At 31 March 2008	-	17,888	-	-	17,888
Net book value after deducting capital contributions					
At 31 March 2008	35,681	25,297	22,576	3,754	87,308
At 31 March 2007	35,440	24,383	19,589	3,491	82,903

11 Fixed asset investments

	Loans to Group undertakings £000
At 1 April 2007	59,940
Additions	538
At 31 March 2008	60,478

Notes to the Accounts

12 Debtors	2008	2007
	£000	£000
		(restated)
Trade debtors	1,064	1,095
Amounts owed by Group companies	66	51
Prepayments and accrued income	2,811	2,187
Other debtors	108	387
	4,049	3,720

All of the above amounts fall due within one year

As at 31 March 2008, trade debtors with a carrying value of £2 573m (2007 - £2 196m) were impaired and provided for. Aged debtors are provided for in full, but only an element of current debt is provided for. The amount of the provision was £1 794m as at 31 March 2008 (2007 - £1 607m).

The ageing of these debtors was as follows

	2008	2007
	£000	£000
Up to 12 months	976	750
Over 12 months	1,597	1,446
	2,573	2,196

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

Movements on the provision for bad debt are as follows

	2008	2007
	£000	£000
At 1 April 2007	1,607	1,466
Provision for bad debt required in the year	396	352
Debt written off in the year as uncollectable	(209)	(211)
At 31 March 2008	1,794	1,607

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

13 Current asset investments

Unlisted investments £4,000 (2007 - £4,000)

14 Cash at bank and in hand

Of the total amount shown of £2 494m, £1 463m (2007 - £1 408m) is held specifically for the payment of the next half yearly loan interest charges.

15 Creditors amounts falling due within one year	2008	2007
	£000	£000
		(restated)
3% Perpetual debenture stock	60	60
3½% Perpetual debenture stock	185	185
4% Perpetual debenture stock	39	39
Bank loan	4,000	1,500
Payments received on account	1,273	1,390
Trade creditors	714	2,143
Amounts owed to Group companies	3,015	3,646
Corporation tax	995	1,061
Social security and other taxation	208	201
Other creditors	2,203	1,967
Accruals	463	403
Water rates in advance	4,861	4,735
	18,016	17,330

The £4 0m 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.

Notes to the Accounts

16 Creditors amounts falling due after more than one year	2008	2007
	£000	£000
In five years or more		
Bank loan	78,633	75,733
Less deferred arrangement costs	1,394	1,451
	77,239	74,282

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	2008	2007
	£000	£000
Deferred taxation		
At 1 April 2007	9,565	9,455
Provided during the year in profit and loss account	(1,221)	110
At 31 March 2008	8,344	9,565

The total deferred tax balance before the effect of discounting is £9.426m (2007 - £15.512m). The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation.

	2008	2007
	£000	£000
Deferred tax excluding that relating to pension asset		
Accelerated capital allowances	8,344	9,565
Pension asset (note 28)	8,394	6,549
Total provision for deferred tax	16,738	16,114
At 1 April 2007	16,114	15,699
Deferred tax charge in profit and loss account (note 8)	(1,797)	570
Deferred tax charged to the statement of total recognised gains and losses	2,421	(155)
At 31 March 2008	16,738	16,114

The 2007 Finance Act reduced the corporation tax rate from 30% to 28% with effect from 1 April 2008. The deferred tax balances have therefore been re-measured resulting in a credit to the profit and loss account of £0.992m.

The abolition of Industrial Buildings Allowances (IBA's) was announced in the 2007 Budget and as a consequence timing differences in respect of IBA's are no longer recognised. This has resulted in a credit to the profit and loss account of £1.403m.

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 £0.694m (2007 - £0.781m). 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 8 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 £1.460m, 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 2008 is detailed below.

Sterling	2008 £000	2007 £000
Assets		
Fixed asset investment	60,478	59,940
Current asset investments	4	4
Cash at bank and in hand	2,494	2,460
	62,976	62,404

Sterling	Fixed Rate 2008 £000	Fixed Rate 2007 £000	Floating Rate 2008 £000	Floating Rate 2007 £000	Total 2008 £000	Total 2007 £000
Liabilities						
Bank loans and overdraft	77,239	74,282	4,000	1,500	81,239	75,782
Debenture stock	284	284	-	-	284	284
	77,523	74,566	4,000	1,500	81,523	76,066

Fixed rate	Weighted Average Interest Rate %	Weighted Average Interest Rate %	Weighted Average Period for which Rate is Fixed Years	Weighted Average Period for which Rate is Fixed Years
	2008	2007	2008	2007
Sterling	3.6	3.6	24	25

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 2008 is detailed below.

	2008 £000	2007 £000
In one year or less	4,284	1,784
In more than five years	77,239	74,282
	81,523	76,066

The Company had undrawn committed borrowing facilities at 31 March 2008, in respect of which all conditions precedent had been met, as follows:

	2008 £000	2007 £000
Expiring in one year or less	2,000	2,000
Expiring in more than two years	11,000	13,500
	13,000	15,500

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

Notes to the Accounts

19 Called up share capital	2008	2007
	£000	£000
Authorised Equity		
6,000,000 Ordinary Shares of 10p each	600	600
10,500,000 'A' Ordinary Shares of 10p each	1,050	1,050
	1,650	1,650
Non-equity		
3,250,000 Redeemable Preference Shares of £1 each	3,250	3,250
	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 2007 as previously reported	1,539	3,250	56,364
Prior year adjustment - unbilled measured income	-	-	1,361
At 1 April 2007 restated	1,539	3,250	57,725
Profit for the financial year	-	-	8,222
Dividends	-	-	(4,209)
Actuarial gain on pension scheme	-	-	7,602
Movement on deferred tax relating to pension scheme	-	-	(2,129)
Effect of change to corporation tax rate on pension asset	-	-	(292)
At 31 March 2008	1,539	3,250	66,919

21 Reconciliation of movements in shareholders' funds	2008	2007
	£000	£000
Profit for the financial year	8,222	8,125
Dividends	(4,209)	(4,471)
	4,013	3,654
Actuarial gain/(loss) on pension scheme	7,602	(519)
Movement on deferred tax relating to pension scheme	(2,129)	155
Effect of change to corporation tax rate on pension asset	(292)	-
Net addition to shareholders' funds	9,194	3,290
Opening shareholders' funds as previously reported	62,231	59,100
Prior year adjustment - unbilled measured income	1,361	1,202
Opening shareholders' funds restated	63,592	60,302
Closing shareholders' funds	72,786	63,592

22 Reconciliation of operating profit to net cash inflow from operating activities	2008	2007
	£000	£000
Operating profit	7,585	8,842
Other pension costs	2,304	1,153
Depreciation charge	6,660	6,221
(Increase)/decrease in stocks	(6)	132
(Increase) in debtors	(316)	(571)
(Decrease)/increase in creditors	(231)	359
Net cash inflow from operating activities	15,996	16,136

Notes to the Accounts

23 Reconciliation of net cash flow to movement in net debt	2008	2007
	£000	£000
(Decrease)/increase in cash in the year	(26)	401
Cash outflow from increase in liquid resources	60	50
Cash (inflow) from (increase) in debt	(2,500)	(1,500)
Change in net debt resulting from cash flows	(2,466)	(1,049)
Non cash movement	(2,957)	(2,461)
Movement in net debt in the year	(5,423)	(3,510)
Net debt at 1 April 2007	(73,602)	(70,092)
Net debt at 31 March 2008	(79,025)	(73,602)

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	Cash	Non cash	At
	1 April 2007	Flow	Movements	31 March 2008
	£000	£000	£000	£000
Cash at bank and in hand	1,060	(26)	-	1,034
Debt falling due within one year	(1,784)	(2,500)	-	(4,284)
Debt falling due after one year	(74,282)	-	(2,957)	(77,239)
	(76,066)	(2,500)	(2,957)	(81,523)
Short term deposits	1,400	60	-	1,460
Current asset equity investments	4	-	-	4
	1,404	60	-	1,464
	(73,602)	(2,466)	(2,957)	(79,025)

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

25 Capital commitments	2008	2007
	£000	£000
Contracted for but not provided in these financial statements	3,158	5,532

The Company has a further commitment under operating leases relating to computer hardware and associated software of £0 345m per annum (2007 - £0 345m) which expire as set out below

	2008	2007
	£000	£000
Within one year	345	-
Within two to five years	-	345

26 Contingent liabilities

There were no reportable contingent liabilities at 31 March 2008 or at 31 March 2007

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:

	2008 % per annum	2007 % per annum	2006 % per annum
Price inflation	3.7	3.2	3.0
Discount rate	6.7	5.2	4.9
Pension increases (RPI)	3.7	3.2	3.0
Salary growth	6.45	5.95	5.75

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 26.8 years (2007 - 26.7 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:

	2008 Expected Return % per annum	2008 Fair Value £000	2007 Expected Return % per annum	2007 Fair Value £000	2006 Expected Return % per annum	2006 Fair Value £000
Equities	7.7	66,777	7.8	76,283	7.4	77,020
Bonds	4.5	33,139	4.5	27,670	4.2	23,583
Other	3.9	7,780	5.4	4,758	4.5	4,296
	6.4	107,696	6.9	108,711	6.6	104,899

The expected return on assets is derived by taking the weighted average of the long-term expected return on each of the asset classes:

	2008 £000	2007 £000
Total fair value of scheme assets	107,696	108,711
FRS 17 value of scheme liabilities	77,718	86,882
Gross pension asset	29,978	21,829
Related deferred tax liability	8,394	6,549
Net pension asset	21,584	15,280

Under FRS 17, the scheme is represented on the balance sheet at 31 March 2008 as an asset of £29,978m (2007 - £21,829m), which amounts to £21,584m net of deferred tax (2007 - £15,280m).

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 and at the full rate since 1 October 2007).

Notes to the Accounts

The FRS 17 value of scheme liabilities moved over the period as follows

	2008 £000	2007 £000
Opening scheme liabilities	86,882	84,086
Employer's part of current service cost	2,304	2,275
Interest cost	4,500	4,116
Contributions by scheme participants	177	51
Benefits paid	(3,161)	(2,508)
Past service credit	-	(1,122)
Actuarial gain	(12,984)	(16)
Closing scheme liabilities	77,718	86,882

The FRS 17 value of scheme assets moved over the period as follows

	2008 £000	2007 £000
Opening fair value of scheme assets	108,711	104,899
Expected return on assets	7,351	6,804
Contributions by scheme participants	177	51
Benefits paid	(3,161)	(2,508)
Actuarial loss	(5,382)	(535)
Closing fair value of scheme assets	107,696	108,711

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

	2008 £000	2007 £000
Current service cost (employer's part only)	2,304	2,275
Past service credit	-	(1,122)
Total operating charge	2,304	1,153

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

	2008 £000	2007 £000
Expected return on pension scheme assets	7,351	6,804
Interest on post retirement liabilities	(4,500)	(4,116)
Net return	2,851	2,688
Total credit recognised in the profit and loss account	547	1,535

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

	2008 £000	2007 £000
Actual return less expected return on scheme assets	(5,382)	(535)
Experience gains arising on scheme liabilities	-	-
Gain due to changes in assumptions underlying the FRS 17 value of scheme liabilities	12,984	16
Actuarial gain/(loss) recognised in the STRGL	7,602	(519)

The actual return on plan assets was £1 969m in the year to 31 March 2008 (2007 - £6 269m)

The history of experience gains and losses is

	2008	2007	2006	2005	2004
Present value of scheme liabilities (£000)	(77,718)	(86,882)	(84,086)	(71,593)	(66,845)
Total fair value of scheme assets (£000)	107,696	108,711	104,899	87,984	81,058
Surplus (£000)	29,978	21,829	20,813	16,391	14,213
Actual return less expected return on scheme assets (£000)	(5,382)	(535)	13,587	3,565	14,123
Percentage of scheme's assets	(5)%	0%	13%	4%	17%
Experience gains arising on scheme's liabilities (£000)	-	-	65	61	207
Percentage of the FRS 17 value of the scheme's liabilities	-	-	-	-	-
Total amount recognised in the STRGL (£000)	7,602	(519)	4,527	2,237	7,694
Percentage of the FRS 17 value of the scheme's liabilities	10%	0%	5%	3%	12%

The cumulative amount recognised in the STRGL as at 31 March 2008 was a loss of £6 977m (2007 - loss of £14 579m)

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

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 Friday, the 25th day of July 2008, on the following business

- 1 To receive and consider the Directors' Report and Accounts for the year ended 31 March 2008 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 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
30 May 2008

By order of the Board
C Hardyman
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	2008	2007
a) Gearing - Debt/RCV	£000	£000
(i) Debt		
Bank loan (note 16)	78,633	75,733
Bank loan (note 15)	4,000	1,500
Debenture stock (note 15)	284	284
Cash at bank and in hand	(2,494)	(2,460)
	80,423	75,057

For the purposes of this ratio, debt excludes the deferred arrangement costs of £1 394m (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.

	2008	2007
	£000	£000
Regulatory capital value indexed to 31 March	111,172	105,341
(iii) Gearing - Debt/RCV ratio (i) – (ii)	72.3%	71.3%

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 33 and is calculated as follows

	2008	2007
	£000	£000
Net cash flow from operating activities	15,996	16,136
Interest received	3,780	3,156
Taxation	(1,910)	(2,257)
Capital expenditure	(12,129)	(10,636)
New borrowings	2,500	1,500
	8,237	7,899
(ii) Interest paid	3,257	2,869
(iii) Cash interest cover ratio (i) – (ii)	2.53	2.75

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 2007/08 have been supplied to Ofwat, but will not be confirmed in the Ofwat document until later in 2008.