Portsmouth Water
150 years of quality service

Portsmouth Water Limited
Annual Report & Accounts
2010

Contents

Highlights

During the past year, Portsmouth Water has again maintained its reputation for supplying high quality drinking water, providing excellent levels of customer service and carrying out its functions in a low cost, efficient manner:

- The Company is again rated in Band A for operating cost efficiency by the industry regulator.
- The Company has continued to perform well in the customer service indicators used by the regulator to assess customer service.
- A high level of compliance with drinking water standards and water supplies maintained without any restrictions.
- The AMP4 capital expenditure programme was completed.
- Awarded a Gold Medal in the RoSPA Occupational Health and Safety Awards.
- The Company met its leakage target for 2009/10.

The key events which will have an impact on Portsmouth Water's performance in the next regulatory period are:

- The industry regulator announced its determination of price limits for the five years to 2015. On average the Company's prices will reduce by 2.1% per annum, excluding inflation.
- The Company's Water Resources Management Plan will be subject to a Public Inquiry in 2010.

	2010
Turnover	**£37.3m**
Operating profit	**£8.3m**
Profit before taxation	**£8.5m**
Net debt	**£84.5m**
Capital expenditure	**£14.1m**

Turnover £m

£37.34m

2007	33.04
2008	33.91
2009	35.40
2010	**37.34**

Operating profit £m

£8.31m

2007	8.84
2008	7.59
2009	6.99
2010	**8.31**

Operating profit before depreciation £m

£16.20m

2007	15.06
2008	14.25
2009	14.67
2010	**16.20**

Operating cashflow £m

£16.60m

2007	16.14
2008	16.00
2009	16.72
2010	**16.60**

Profit before taxation £m

£8.46m

2007	10.72
2008	8.37
2009	5.81
2010	**8.46**

Board of Directors

Executive

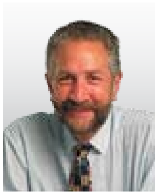
Nicholas John Roadnight
F.C.A. [3]
Managing Director
Joined in 1978. Previously with Thornton Baker. Appointed to the Board in October 1994 and appointed Managing Director in July 1997.

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

Neville Smith
B.A., F.C.M.A.
Finance and Regulation Director
Joined and appointed to the Board in February 1998. Previously with Smiths Industries and GEC.

Non-Executive

Terence Michael Lazenby MBE
FR.Eng. [1,2,3]
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. Previously non-executive director of MTL Instruments Group and Expro International plc, before which he held a number of senior executive positions with British Petroleum.



Robert Leonard Sullivan
B.Sc. [1,2,3]
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
B.A.,F.C.C.A.,C.P.F.A. [1,2,3]
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

It has been an important year for Portsmouth Water and its customers. In November 2009, Ofwat, the economic regulator for the water industry, announced its Final Determination of price limits for the five year period to March 2015 and Defra also advised the Company that it's 25 year Draft Water Resources Management Plan will be subject to a Public Inquiry. These two events will have a major influence on the long term service and security of supplies for customers and the outlook for future performance. In the year the Company has continued to provide its customers with excellent value for money and its water supply charges continue to be the lowest in the industry. It is worth recording that Portsmouth Water scores highly in all the customer service measures used by Ofwat and the Consumer Council for Water. The Company and all of its staff work hard to meet customers' expectations and the results of this are reflected in an exceptionally low level of complaints relative to the rest of the industry. It's approach to health and safety is also recognised by a fifth successive Rospa gold award.

Outlook

In the year to March 2010, the Company produced excellent financial results and maintained its high standards of customer service. Future performance will reflect the outcome of the Price Determination and our response to it. The Final Determination required a price reduction before inflation of 4.8% for 2010/11 and an average reduction of 2.1% each year over the five years. Whilst the Company did not believe this was the appropriate outcome for customers, as bills will be likely to significantly increase after 2015, the Board felt that the Company should focus on delivery of service to customers and that it could continue to meet its financial obligations without referring Ofwat's Determination to the Competition Commission for review.

As a result of the reduced income, a reduction in dividends will be required in the years ahead in part reflecting the lower cost of capital determined by Ofwat. Measures have been taken to address one of the key uncertainties in operating cost by fixing the Company's wholesale electricity price until December 2014 at levels significantly below the current contract price. Electricity costs represent 12% of total operating cost. Tight control of operating costs, whilst maintaining services to customers, will be key objectives in the next five years.

The Company has a strong record of delivery and with adequate financing in place, the Board is confident that the Company will meet its financial obligation to investors until the next price review.

Portsmouth Water's Draft Water Resources Management Plan set out how the Company would meet customers demand for water over the next 25 years. This included a number of measures to overcome rising demand and the impact of climate change, including the construction of a winter storage reservoir at Havant Thicket which was scheduled to be in service by 2022. Preliminary work on the feasibility of options and environmental assessments for the reservoir have already been undertaken. Under new statutory provisions Water Resources Management Plans now have to be approved for publication by the Secretary of State. In the case of Portsmouth Water, along with two other water companies, the Secretary of State has decided that a number of the assumptions used in the draft plan need to be explored at a Public Inquiry. As a result of this development, there is now uncertainty as to the timing of the reservoir. The Company remains committed to the case for the development of the reservoir and is convinced that, together with appropriate demand management measures, it represents the most suitable solution for maintaining the long term security of water supplies given the expected impacts of climate change.

2009/10 Performance

In the year ended March 2010, turnover increased by 5.5% to £37.3m primarily as a result of the tariff increases effective from July 2009. Operating profit rose by 18.9% to £8.3m as a result of the tariff increase but partly offset by an increase in energy costs.

In the light of these results, the Directors are recommending a final dividend of £1.885m, which will be paid in May 2010.

Portsmouth Water has continued to provide high levels of customer service. In the Overall Performance Assessment of Water Companies compiled by Ofwat for 2008/09, the Company was placed fifth out of 22 companies and had the lowest level of complaints in the industry. These standards of performance were maintained in the year to March 2010, although the final Ofwat assessments are not published until later in the year.

Compliance with drinking water standards remains at a high level at 99.98% and water supplies were maintained throughout the year without any restrictions. Groundwater levels are currently at a very high level and no restrictions are anticipated this summer.

Portsmouth Water continues to be regarded as one of the most efficient water companies and again succeeded in being placed in the highest band for operating efficiency by Ofwat.

Capital Expenditure in the year 2010 was £14.1m and included £7.0m on mains renewals. The five year AMP4 programme was completed at approximately £3.4m (6.0%) less than the amount allowed in the 2004 Ofwat Determination, mostly as a result of the effective purchasing on the three membrane filtration plants built in the period.

Health and Safety

The health and safety of employees has the highest priority for the business and in 2009 there were no RIDDOR reportable accidents. The effort and commitment of employees over the last few years was rewarded this year by the Company receiving a Gold Medal from RoSPA. This award is in recognition of achieving five Gold awards and an Industry Sector award in the last five years.

The awards for health and safety and the high level of performance achieved are a testament to the dedication and commitment of the employees and the Board thanks them for their efforts. The 2009 Price Determination has presented the Company with a significant challenge for the next five years, but I am confident that the management and employees can rise to that challenge and maintain services to customers at industry leading levels.

T. M. Lazenby MBE
Chairman

Operating and Financial Review
Our Business

Portsmouth Water provides water to 303,000 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 180 million litres of water through a network of over 3,266 kilometres of underground mains. Water supplied 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 nearly 26% of the total supply, are thought to be the largest group of springs used for public supplies in Europe.

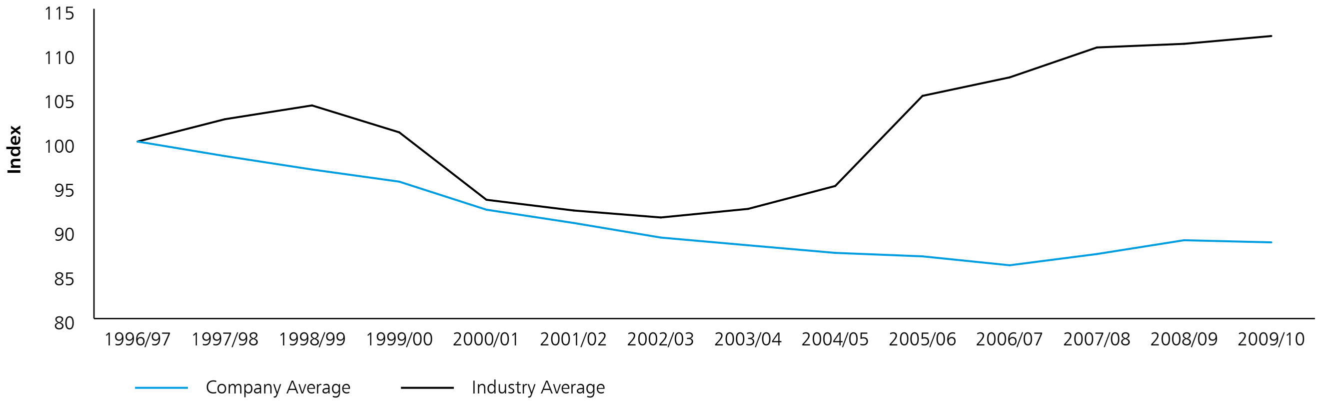
Source	Actual 2009/10 Abstraction (Million Litres)	% of Supply 2009/10	% of Supply 2008/09
Springs at Havant & Bedhampton	17,186	26	29
River Itchen	8,880	13	10
Boreholes, Wells & Adits	40,270	61	61
Totals	**66,336**	**100**	**100**

A map showing the Company's area of supply and the location of its sources and treatment works is shown on page 20.

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, Lovedean, Soberton and Fishbourne. The last three works accounted for approximately 6% of supplies in 2009/10. 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 £89 per household, the equivalent of 24p per day. In real terms, the price of water for household customers has fallen by 11.4% over the last 13 years. This compares with a real increase of 12% 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 November 2009 for the period 2010 to 2015. 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 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

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 2008/09 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 which now has to be approved by the Secretary of State before it can be published. The plan is reviewed annually and enables the Company to balance supplies with forecast demand even at times of dry conditions. A Draft Water Resources Management Plan looking at required resources through to 2035 was published for consultation in April 2008. Representations on the Plan were received from a number of interested parties and, in January 2009, the Company published its response to these representations. In August 2009 the Secretary of State decided that the Plan needed to be subject to a Public Hearing. After reviewing the evidence the Planning Inspector decided that a Public Inquiry was required.

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.

RIGHT
Borehole relining at Walderton Water Treatment Works

FAR RIGHT
Sampling of water being carried out in the Portsmouth area, with HMS Warrior in the background

BELOW
The River Itchen at Gaters Mill, Southampton

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 is measured by a number of key performance indicators (KPI) and these are highlighted in the following section of the Review.

Presentation of RoSPA 2010 Gold Medal Award for Occupational Health and Safety

Operating and Financial Review
Current Development and Performance

Financial Performance

Profit before tax
Turnover for the year increased by 5.5% to £37.3m. This reflected the 4.0% overall tariff increase implemented in July 2009 and £0.5m of income for undertaking a mains diversion. As a result of this operating profit increased by 18.9% to £8.3m as analysed below:

	2009/10 £m	2008/09 £m
Operating profit before depreciation and FRS17 Pension Charge	17.6	16.4
Depreciation (including renewals)	7.9	7.7
FRS17 Pension Charge	1.4	1.7
Total Operating Profit	**8.3**	7.0

Operating costs, excluding depreciation and the FRS17 pension charge rose by £0.7m (3.7%), including an increase in electricity costs of £0.3m which reflected the full year effect from an increase in price as a result of the new electricity contract which took effect from November 2008. The current service cost for the pension scheme reduced by £0.3m to £1.4m following a review by the Actuaries in accordance with FRS 17. The Company did not make any contributions to the scheme.

Interest receivable at £1.4m (2009 - £4.5m) relates mainly to interest received from group companies and is based on Libor plus 1%. A reduction in other finance income of £1.0m represents a fall in the expected return on Pension Fund assets following a review by the actuaries in accordance with FRS 17.

Interest payable at £1.9m (2009 - £7.3m) includes £1.2m negative indexation of the loan provided by Artesian Finance plc (2009 - positive £4.0m). The indexation of the loan for 2010 was based on a fall in RPI for July 2009 of 0.4%, whereas, RPI for July 2008 was +5.0%. Interest on the capital sum amounted to £2.9m (2009 - £3.0m).

As a result of the higher turnover and lower interest costs, profit before tax increased to £8.5m (2009 - £5.8m).

Taxation
The taxation charge at £3.0m was £1.3m higher than last year as result of the higher profit and higher deferred tax, together with the effect of a refund received in the previous year.

Dividends
The dividends paid during the year amounted to £4.663m (2009 - £4.664m). 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 £16.6m (2009 - £16.7m) was unchanged from the previous year despite the increase in operating profit, largely as a result of the mains diversion work undertaken but not billed by the year end. Net cash outlay on fixed assets at £12.4m (2009 - £10.6m) reflected further progress on the mains renewal programme (£7.0m) and completion of the AMP 4 Quality programme. The mains renewal expenditure included replacement of a large raw water main at £0.9m.

Net debt at £84.5m (2009 - £82.9m) increased during the year as a result of the relatively large capital programme. At the year end, net debt to regulatory capital value (RCV) was 77.0% (2009 – 77.4%). The ratio for 2010 reflects the RCV arising from the 2009 final determination.

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 RPI. 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 2010 was £81.4m (2009 - £82.6m).

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. In 2009/10 all of the short term cash was deposited with the Company's Bankers, RBS. Short term liquidity is achieved through a £15m working capital facility and an overdraft arrangement. At the end of the year, £6.0m of this facility had been drawn (2009 - £4.0m),

Operating and Financial Review
Current Development and Performance

while the overdraft arrangement remained unutilised. The £15m facility terminates in March 2011 but the Company has had approval from its Bankers for a three year £10m facility to take effect from April 2011.

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.

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 2009/10 is shown below, and the details of the calculation are shown on page 46.

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 the following of 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 33 to 34 and with UK GAAP.

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 the principal employer, in accordance with FRS17. The latest actuarial valuation carried out for the purposes of FRS17 showed a surplus after deferred tax of £9.8m (2009 - £12.2m).

Key Financial Performance Indicators
Gearing (net debt/regulatory capital value) and cash interest cover are recognised as key indicators for the Company. Performance in 2010 against the target ratios is shown in the table below.

KPI - 1[1]	Target	Performance 2009/10	Performance 2008/09
Gearing - Debt/RCV[2]	<83%	77.0%	77.4%
Cash interest cover[2]	>1.5	1.72	1.66

[1] Each KPI is defined in the Appendix on page 46
[2] Definition of terms is contained in the Appendix on page 46

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 2008/09	Performance 2007/08
To be in the upper quartile of performance for all water companies	Placed equal 5th out of 22 companies	Placed 11th out of 22 companies

The Overall Performance Assessment for 2009/10 will be published by Ofwat after the Report and Accounts have been completed and therefore the performance shown above is for 2008/09.

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 2009/10 and will be reported to Ofwat in the annual regulatory June Return.

DG Service Indicator	Target	Performance 2009/10	Performance 2008/09
DG2 No. of properties at risk of inadequate pressure	≤ 120	66	66
DG3 Unplanned interruptions to supply	≤ 0.3	0.02	0.05
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%	99%
DG8 Bills for metered customers - no. receiving bill based on meter reading	100%	100%	100%
DG9 Telephone contact - no. of calls abandoned - all lines busy	≤ 2.5% ≤ 0.7%	2.9% 0.1%	2.8% 0.4%

The Ofwat assessments for 2009/10 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 2009	Performance 2008
Compliance samples passing standards	99.95%	99.98%	99.97%

The water quality performance indicator relates to the calendar year.

Operating Efficiency
Ofwat publishes a report each year which includes its assessment of the comparative operating efficiency of all water companies in England and Wales using econometric modelling. Companies are put in bands A to E according to their performance for operating efficiency, A being the top band. The latest report published is for the financial year 2008/09, which showed that Portsmouth Water was assessed as the second highest performing company. 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 2008/09
To be ranked in Band A for Operating Efficiency	Operating Efficiency Band A

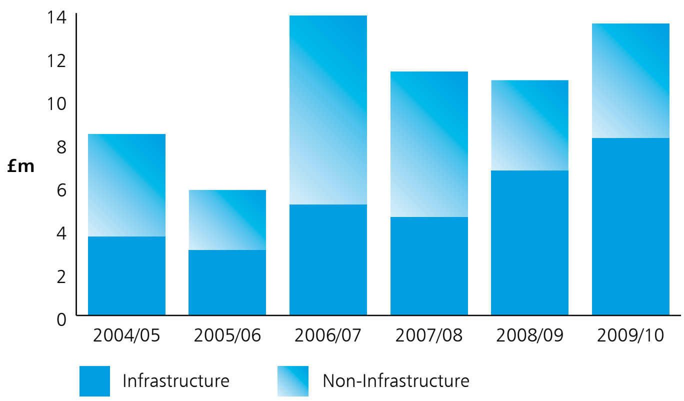
Operating and Financial Review
Current Development and Performance

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 24.5km per year
Water Quality Installation of membrane filtration plants to minimise the risk of cryptosporidium at - River Itchen - Soberton - Fishbourne	 Completed Summer 2007 Completed 2008 Completed 2008
Remedial work on trunk mains in the Company's largest supply area to reduce the risk of discoloured water incidents	Completed Spring 2009
The installation of blending facilities at sources at risk from increasing nitrate levels	Completed 2010
Optional Water Meters It was anticipated that 2,200 domestic customers would wish to switch from an unmeasured to a measured supply	In the 5 years to March 2010, over 23,000 customers had opted to switch, an average of 4,700 per year

Gross capital investment during the year was £14.1m (2009 - £11.8m) and included £7.0m (2009 - £5.2m) on infrastructure renewals. After receiving capital contributions and infrastructure charges of £0.6m, net capital expenditure was £13.5m (2009 - £10.9m). 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:

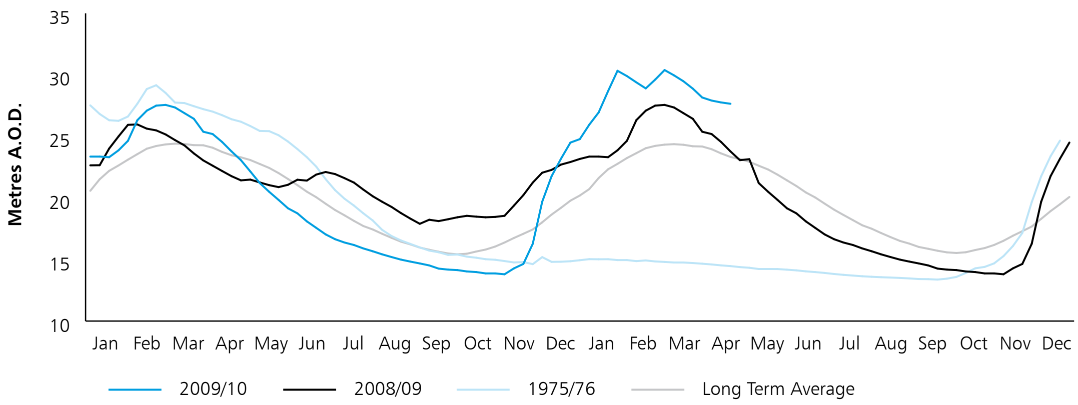
- Mains renewed – 23.7km (2009 – 24.9km) were renewed at a cost of £6.1m. In addition a large raw water main was renewed at a cost of £0.9m.
- Membrane plants - now in service. Limited expenditure during the year
- Nitrate Blending Schemes - was completed in 2010, expenditure in 2009/10 of £1.8m
- Havant Thicket Winter Storage Reservoir – the Company has made good progress with the preparatory work for a winter storage reservoir at Havant Thicket, which should help ensure security of water supplies well into the future. A stakeholder group consisting of interested local bodies and interested parties is well established and we believe that there is strong local support. 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 2009/10 this work resulted in expenditure of £0.5m.

Water Resources - Outlook for 2010
As detailed on page 5, 87% 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

At the end of April 2010, groundwater levels were above the long term average as 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 2010 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
In April 2008, the Company published its Draft Water Resources Management Plan (DWRMP) for Public Consultation. The plan examined the likely key influences on the demand for water from customers and on the Company's ability to meet that demand. The plan also identified the actions required to ensure that the supply/demand balance is met, which included the construction of a winter storage reservoir at Havant Thicket, close to the Company's head office, which would be scheduled to come into service in 2022. As noted above preliminary work on the reservoir including environmental assessments has already begun. Following representation from stakeholders, the Company has revised its plans and informed the Secretary of State of its proposed actions. In August 2009 the Secretary of State announced that certain issues raised in the plan should be subject to a Public Hearing under the auspices of the Planning Inspectorate. After reviewing all the evidence submitted for the Hearing, the Inspector appointed has decided that the evidence should be reviewed in a Public Inquiry, which is more formal and allows challenge to the representations. The Inquiry is unlikely to be held before September 2010.

Until the outcome of the Public Inquiry is known there is uncertainty as to when the Havant Thicket reservoir would be required, and a long delay would likely mean that much of the environmental work carried out to date and held in Fixed Assets would have to be revalidated at a later date. Details of the expenditure to date is shown in note 10 to the accounts on page 37.

Leakage
Leakage for the year was recorded at an average of 28.7Ml/d. The leakage targets were set out in the Company's Business Plan for the last Periodic Review and agreed by Ofwat as part of the Final Determination in 2004.

KPI - 6 Leakage

Target	Performance 2009/10
Average leakage of 29.7Ml/d	Average leakage of 28.7Ml/d

Employees
The Company employs 226 people and believes it recruits and retains the right people 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, 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 the Customer Services department aged under 25 are employed through the Modern Apprenticeship scheme which leads to a minimum NVQ level 2 qualification with many going on to achieve level 3.

Operating and Financial Review
Current Development and Performance

A key part of staff development is the Company involvement with the Institute of Water. The Institute of Water 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 IoW and gain the benefit for both their personal and professional development by attending these events.

One of our employees, Steve Youell, recently won the Continuing Professional Development (CPD) Award for 2010. The CPD award is given to an employee in the water industry who has demonstrated an effective approach to their own personal development.

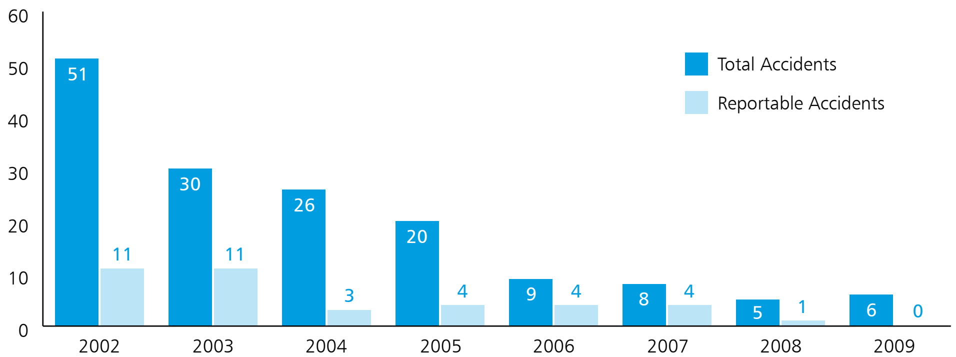
Staff turnover, excluding retirees was 6.8% in the calendar year 2009 (2008 – 7.5%), which compares favourably with the national average which was 7.7% in 2009 (Source CIPD: Annual Survey Report 2009).

Total absence (days per employee per year) was 4.9. This figure compares with 4.1 for last year and is below the average for private companies of the same size at 7.4 (Source: CIPD: Annual Survey Report 2009).

Health and Safety
Health and safety of employees is considered fundamental to the success of the business and the Company is committed to achieving high standards across the organisation. The Company has put health and safety at the top of the agenda and from the Board down has made it a high priority.

Considerable time and resources have continued to be directed into raising the awareness of Health and Safety and the statistical results for the year 2009 show very positive results from these efforts, with no reportable accidents being recorded.

Total Accidents and Reportable Accidents



It is pleasing to report that our efforts have again been recognised externally through the RoSPA Health and Safety Awards ,by the Company being awarded the Gold Medal. This is in recognition of our Health and Safety record over the last five years where we have received five Gold awards and an Industry sector award. This award is again recognition of the efforts of all employees who should feel proud of their achievements in making the Company a safer place.

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.

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 11,800 '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 'Save-a-Flush' 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
In September 2004 Portsmouth Water entered into Educational Partnership with Staunton Country Park. This partnership has seen the creation of a curriculum linked water themed programme, 'Water is Life', suitable for primary school children. The 'Water is Life' programmes cover all aspects of water from its role in the planet, the water cycle as well as the treatment and supply process. A key element of water conservation underpins the whole programme.

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 30p per bottle for every child in local primary, infant and junior schools.

The Water Bottles for Schools offer has gone from strength to strength with 30,000 delivered last year and which has seen nearly 230,000 water bottles through the schools being delivered to our local children.

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 for talks, a community talk 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.

Operating and Financial Review
Corporate Responsibility

The Company's 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.

Hampshire Water Festival
The Company played a key role in organising this festival which was held at Staunton Country Park in July 2009. The event which was attended by 15,000 visitors promoted the efficient use of water in the home.

Portsmouth Water has an active commitment to the conservation of the natural environment, as illustrated by the wildflower meadow above

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.

Performance through the 5 years to 2015
The period from April 2010 to March 2015 is referred to in the Industry as the Asset Management Plan 5 (AMP5)
The Company will continue to focus on service delivery to customers and will aim to remain at the efficiency frontier for operating and capital maintenance expenditure.

Financial performance will be driven by the price limits set by the regulator Ofwat in November 2009, which for the five year period to 2015, are as follows:

	2010/11	2011/12	2012/13	2013/14	2014/15
% (reduction) in bills before inflation	(4.8)	(2.1)	(1.7)	(1.4)	(0.6)

Each year customer bills are adjusted by the previous November's RPI plus the above limit therefore, given that RPI for November 2009 was 0.3%, for 2010/11 charges to customers will reduce by 4.5%.

Energy costs represent over 12% of total costs and given the volatility of prices in recent years is a significant risk to the Company. The current electricity contract terminates in October 2011, but the Company has fixed the wholesale price from this date through to December 2014 at rates considerably less than the current contract and less than that allowed by Ofwat at the 2009 price determination.

Gross capital expenditure in AMP5 will be £40m (2009/10 prices), with mains renewals contributing approximately 50% of the total. This compares to £58m (2009/10 prices) for AMP4.

Presentation of the Energy and Utility Skills Continuing Professional Development Award for 2010 to Steve Youell, a Company Scientist

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.

To ensure water quality standards are maintained, the Company has a fully documented Drinking Water Safety Plan which identifies the potential risks throughout the supply process. Water quality is also 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 five treatment works considered most at risk from cryptosporidium being present in the raw water.

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 23 to 25. In early 2007, the Auditors conducted a special review of the Company's internal control systems. The review did not reveal any significant weaknesses and has recently been updated to reflect system changes. 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.

Havant Head Office and Pumping Station taken in the snow in January 2010

Operating and Financial Review
Risks and Uncertainties

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 Water Framework Directive. Over the next few years the Company will be undertaking a study to identify the impact of its abstraction at key points and to identify solutions where required.

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 conducted an assessment of the risks at each of its sites and included a small amount of expenditure which was allowed in the Final Determination of prices to remedy those sites where there is a risk of damage as a result of flooding.

Regulatory risk relates to decisions taken by Ofwat at the five yearly price review and the potential failure to meet the level of service and capital programme agreed with Ofwat for the AMP 5 period, which could result in Ofwat taking action, including financial penalties. The price review is conducted in an open and transparent manner and the Company actively participates in the process. The performance against the regulatory targets is reviewed on a monthly basis by the Board or the Executive Directors. The annual performance against the targets is discussed on pages 10 to 11.

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 comprising Management and the Trade Unions
- 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

26 May 2010

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	656,000
Number of Properties Served	303,000
Length of Mains	3,266 km
Average Daily Output	180 Ml

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

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

Insurance Brokers
Heath Lambert Group
27-31 Fleet Street
Swindon
Wiltshire SN1 1RG

Area of Supply

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

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

Directors' Report

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 March 2010.

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 656,000 domestic and commercial customers in an area of 868 square kilometres in Hampshire and West Sussex through a mains network of 3,266 kilometres.

The Company's Area of Supply is shown on page 20 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 18.

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 40.

Financial Results and Dividends
The Company's profit before taxation amounts to £8.465m (2009 - £5.814m). After deducting £3.043m for taxation (2009 - £1.683m), a profit of £5.422m has been transferred to reserves (2009 - £4.131m).

The Directors are recommending the payment of a final dividend of £1.885m (2009 - £2.613m).

Fixed Assets
Capital expenditure on tangible fixed assets was £14.054m (2009 - £11.781m), including £6.966m on infrastructure renewals (2009 - £5.186m). Information relating to these and other changes in fixed assets is shown in note 10 to the accounts on page 37.

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 2010, all of whom served throughout the year, are shown on page 3.

Mr J. E. Cogley left service on the 31 August 2009.

Mr. T. M. Lazenby MBE 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 2010, the Company's creditor days were 11 (2009 - 13).

Substantial Shareholder
At 31 March 2010, 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 last four years, been awarded the Gold award in the RoSPA Occupational Health and Safety Awards. In 2010 the Company was awarded the Gold Medal.

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 an active approach to environmental issues and further information is set out in the Operating and Financial Review on pages 5 to 18.

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 has also made donations to a Charitable Trust Fund, which aims to provide assistance for customers who have difficulty paying their bills. A donation of £25,000 was made during the year (2009 - £25,000).

Directors' Report

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

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

In so far as the Directors are aware:

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

By order of the Board

C. Hardyman
Secretary
Havant
26 May 2010

Corporate Governance

The Directors are committed to high standards of corporate governance and support the principles set out in the Combined Code on Corporate Governance. 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).

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 MBE 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)	3	3
T. M. Lazenby MBE	3	3
R. L. Sullivan	3	3
Remuneration		
R. L. Sullivan (Chairman)	3	3
T. M. Lazenby MBE	3	3
R. J. Tennant	3	3
Full Board		
J. E. Cogley[1]	12	3
T. M. Lazenby MBE (Chairman)	12	12
A. R. Neve	12	12
N. J. Roadnight	12	12
N. Smith	12	12
R. L. Sullivan	12	12
R. J. Tennant	12	12

[1] Mr J. E. Cogley left service on the 31 August 2009.

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

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

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

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 26 and 27.

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 significant changes 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 2010 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 on Corporate Governance.

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, while post project appraisal looks at relevant improvement in the internal control procedures. Board approval is required for any project exceeding a quantified expenditure level.

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 2010 Board meeting, the Directors carried out their annual assessment for the year to 31 March 2010, 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 MBE and Mr. R. L. Sullivan.

It meets at least three times during the year. The purpose of the Committee is to ensure the preservation of good financial practices throughout the Company, to monitor that controls are in force to ensure the integrity of those practices, to review the interim and annual financial statements and to provide, by way of timely meetings, a line of communication between the Board and the external auditors.

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

Corporate Governance

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 Operating and Financial Review on pages 5 to 18 along with note 18 to the accounts sets out the Company's financial position; cash flows; liquidity position; borrowing facilities; objectives, policies and processes for managing capital; financial risk management objectives; exposures to credit and liquidity risk.

As highlighted on page 8 the Company meets its day-to-day working capital requirements through a £15m working capital facility that is due for renewal on 31 March 2011.

The Company's financial projections, taking into account expected changes in trading performance show that the Company is forecast to operate within the level of its current facility. The Company has had approval from its Bankers for a three year £10m facility to take effect from April 2011.

Therefore the Directors report that, following the above review, they have a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. Accordingly they continue to adopt the going concern basis of accounting in preparing the accounts.

Report on Remuneration

This report has been prepared in accordance with the requirements of the Companies Act 2006 and the Listing Rules of the Financial Services Authority.

INFORMATION NOT SUBJECT TO AUDIT

Remuneration Committee
The Remuneration Committee met three times 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 MBE 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 include a performance related element. The salary of the executive Directors includes a performance related element, which is based upon the achievement of agreed financial, customer service and personal targets for the whole of the previous year.

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

The service contracts of the executive Directors include notice periods of one year, both by the Company and by the Director. There are no provisions for termination payments, other than payments for the period of notice.

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:	**2010 £000**	2009 £000
Total remuneration	**531**	578
Highest paid Director	**162**	160

Remuneration is analysed by Director below:	Salary/Fees £000	Benefits £000	**Total 2010 £000**	Total 2009 £000
Executive:				
J. E. Cogley	43	9	**52**	114
A. R. Neve	105	12	**117**	111
N. J. Roadnight	144	18	**162**	160
N. Smith	114	15	**129**	122
Non-executive:				
T. M. Lazenby MBE (Chairman)	31	-	**31**	31
R. L. Sullivan	20	-	**20**	20
R. J. Tennant	20	-	**20**	20
	477	54	**531**	578

During the year Mr N. Smith and Mr A. R. Neve received bonus payments of £6,000 and £3,000 respectively. This is included in salary/fees above.
Fees paid in respect of Mr. T. M. Lazenby MBE are paid to Seamab Consultancy Limited.
Benefits comprise company cars and medical insurance.
Mr J. E. Cogley left service on the 31 August 2009.

Long-term incentive schemes
The Company does not operate any long-term performance linked bonus scheme.

Report on Remuneration

Share options

The Company does not operate an Executive Share Option Scheme.

The Directors' beneficial 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
A. R. Neve	30
N. J. Roadnight	55
N. Smith	45

Mr J. E. Cogley left service during the year but continues to have a beneficial holding of 20 shares in South Downs Capital Limited.

Pensions

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

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

The executive Directors have accrued pension benefits under the Brockhampton Pension Scheme, which is a defined benefits scheme, during the year as detailed below:

	Increase in Accrued Pension During Year to 31 March 2010 £000	Transfer Value of Increase £000	Accumulated Accrued Pension at 31 March 2010 £000	Accumulated Accrued Pension at 31 March 2009 £000
J. E. Cogley[1]	1	19	69	68
A. R. Neve	5	124	74	69
N. J. Roadnight	4	91	97	93
N. Smith	5	95	61	56

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

The increase in accrued pension excludes any increase for inflation, although inflation over the year was negative so the full increase in accrued pension has been shown.

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 (excluding inflation) is then reduced by the amount of each member's contribution paid during the year.

[1]Mr J. E. Cogley left service on the 31 August 2009 and therefore his leaving service benefit is his entitled benefit using his actual date of leaving.

By order of the Board

T. M. Lazenby MBE
Chairman
Havant
26 May 2010

Statement of Directors' Responsibilities

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

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

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

The Directors are responsible for:

- keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 2006;
- safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities; and
- under applicable law and regulations, including the Disclosure and Transparency Rules, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the requirements of that law and those regulations. In relation to the latter, the Directors represent that, to the best of their knowledge and belief:
  - the financial statements give a true and fair view of the assets, liabilities, financial position and financial result for the year ended 31 March 2010; and
  - the Directors' Report and information referenced therein, taken together, includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that they face.

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

By order of the Board

C.Hardyman
Secretary
Havant
26 May 2010

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 2010, 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. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

Respective Responsibilities of Directors and Auditors
As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit the financial statements, and the part of the Report on Remuneration to be audited, in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of affairs of the company as at 31 March 2010 and its profit for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters
In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

Under the Listing Rules (because the Company applies the Financial Services Authority Listing Rules as if it were a listed company) we are required to review:

- the Directors' statement in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code on Corporate Governance specified for our review

Nicholas Kelsey
Senior Statutory Auditor

For and on behalf of

Saffery Champness
Chartered Accountants
Statutory Auditors
Lion House
Red Lion Street
London
WC1R 4GB
26 May 2010

Profit and Loss Account
For the year ended 31 March 2010

	Notes	2010 £000	2009 £000
Turnover	2	**37,342**	35,404
Cost of sales		**(20,037)**	(18,961)
Gross profit		**17,305**	16,443
Net operating expenses	3	**(8,993)**	(9,454)
Operating profit		**8,312**	6,989
(Loss) on sale of fixed assets		**(22)**	(37)
Profit on ordinary activities before interest		**8,290**	6,952
Interest receivable	5	**1,405**	4,537
Other finance income	28	**714**	1,676
		10,409	13,165
Interest payable and similar charges	6	**(1,944)**	(7,351)
Profit on ordinary activities before taxation	7	**8,465**	5,814
Taxation on profit on ordinary activities	8	**(3,043)**	(1,683)
Profit for the financial year	20	**5,422**	4,131

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 2010

	Notes	2010 £000	2009 £000
Profit for the financial year		**5,422**	4,131
Actuarial (loss) on pension scheme	28	**(2,636)**	(13,020)
Deferred tax relating to actuarial loss on pension scheme	17	**738**	3,646
Total recognised gains and losses relating to the year		**3,524**	(5,243)

The accompanying notes form an integral part of these accounts.

Balance Sheet
As at 31 March 2010

	Note	**2010 £000**	**2010 £000**	2009 £000	2009 £000
Fixed assets					
Tangible assets	10	**96,030**		90,459	
Investments	11	**59,468**	**155,498**	60,633	151,092
Current assets					
Stocks		**553**		415	
Debtors	12	**4,935**		4,032	
Investments	13	**4**		4	
Cash at bank and in hand	14	**1,931**		2,604	
		7,423		7,055	
Creditors: amounts falling due within one year	15	**(20,547)**		(17,054)	
Net current liabilities			**(13,124)**		(9,999)
Total assets less current liabilities			**142,374**		141,093
Creditors: amounts falling due after more than one year	16		**(80,136)**		(81,263)
Provisions for liabilities	17		**(10,272)**		(9,131)
Net assets excluding pension asset			**51,966**		50,699
Pension asset	28		**9,774**		12,180
Net assets including pension asset			**61,740**		62,879
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		**55,873**		57,012
Shareholders' funds	21		**61,740**		62,879

The accompanying notes form an integral part of these accounts.
The accounts were authorised for issue and approved by the Board on 26 May 2010, and signed on its behalf by;

T. M. Lazenby MBE
Chairman

Company Number: 2536455

Cash Flow Statement
For the year ended 31 March 2010

	Notes	**2010 £000**	**2010 £000**	2009 £000	2009 £000
Net cash inflow from operating activities	22		**16,599**		16,719
Returns on investments and servicing of finance					
Interest received		**1,420**		4,417	
Interest paid		**(3,071)**	**(1,651)**	(3,327)	1,090
Taxation					
UK corporation tax paid		**(965)**		(724)	
Payments for group relief		**(797)**	**(1,762)**	(1,284)	(2,008)
Capital expenditure and financial investment					
Purchase of tangible fixed assets		**(12,925)**		(11,521)	
Sale of tangible fixed assets		**12**		19	
Capital contributions received		**552**	**(12,361)**	890	(10,612)
Equity dividends paid			**(4,663)**		(5,079)
Cash (outflow)/inflow before management of liquid resources and financing			**(3,838)**		110
Management of liquid resources					
(Purchase) of short term deposits			**(55)**		-
Financing					
New loans		**2,000**			-
Loan repayments from Group company		**1,165**	**3,165**		-
(Decrease)/increase in cash in the year	23		**(728)**		110

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) and with the provisions of the Companies Act 2006, 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, which have been applied consistently, 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 37. In accordance with the Companies Act 2006 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 when the timing differences are expected to reverse.

(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 principal employer and its parent company, Brockhampton Holdings Limited, is the participating employer in the Brockhampton Pension Scheme. This scheme is a defined benefit scheme. The assets of the scheme are held in a separate trustee administered fund.

The current service costs are charged to the profit and loss account and included as staff employment costs. The interest cost and expected return on assets are shown as a net amount within other finance income. Actuarial gains and losses are recognised immediately in the Statement of Recognised Gains and Losses.

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 43 and 44.

(i) Financial instruments

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.

Other financial assets consist of short term bank deposits and debtors and are classified as loans and receivables. They are measured at amortised cost.

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 other liabilities and are measured at amortised cost.

Notes to the Accounts

2 Turnover	2010	2009
	£000	£000
Unmeasured supplies	22,671	22,367
Measured supplies	12,740	11,517
Bulk supply to Southern Water Services	518	518
Chargeable work	1,413	1,002
	37,342	35,404

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

3 Net operating expenses	2010	2009
	£000	£000
Administrative expenses	9,233	9,665
Other operating income	(240)	(211)
	8,993	9,454

4 Directors and employees

	2010	2009
Employment costs:	£000	£000
Wages and salaries	6,095	5,946
Social security costs	478	470
Other pension costs (note 28)	1,419	1,718
	7,992	8,134
Transferred to capital schemes	(105)	(108)
Net employment costs	7,887	8,026

	2010	2009
Average numbers employed during year:	Number	Number
Operations	148	144
Administration	78	74
	226	218

	2010	2009
Directors' remuneration:	£000	£000
Total remuneration	531	578
Highest paid Director	162	160

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 26 and 27. The information set out in that Report which is subject to audit forms part of these financial statements.

5 Interest receivable	2010	2009
	£000	£000
Loan to Group company	1,381	4,303
Interest on short term deposits	16	81
Repayment interest	-	138
Other interest receivable	8	15
	1,405	4,537

6 Interest payable and similar charges		2010	2009
		£000	£000
£66.5m. loan	- interest	2,937	2,956
	- indexation	(1,184)	3,967
	- amortisation of fees	57	57
	- administration expenses	25	22
		1,835	7,002
Other bank loans and overdraft		94	312
Debenture stocks		10	10
Other interest payable		5	27
		1,944	7,351

Notes to the Accounts

7 Profit on ordinary activities before taxation		**2010 £000**	2009 £000
Profit on ordinary activities is after charging:			
Depreciation	- infrastructure assets	**4,561**	4,420
	- non infrastructure assets	**3,329**	3,264
Rates		**2,475**	2,360
Water abstraction charges		**1,804**	1,865
Auditors' remuneration:			
Audit services	- statutory audit	**29**	28
Non-audit services	- regulatory reporting	**23**	33
	- taxation	**3**	1
	- general advice	**5**	3
Fees in respect of the Brockhampton Pension Scheme			
	- statutory audit*	**2**	2
Hire of plant and machinery		**10**	10
Other operating leases		**340**	345

* These fees are not paid by Portsmouth Water Limited.

8 Taxation	**2010 £000**	2009 £000
Current tax		
United Kingdom corporation tax at 28% (2009 - 28%)	**2,102**	1,430
Adjustment in respect of prior periods	**(3)**	(522)
	2,099	908
Deferred tax		
Origination and reversal of timing differences	**1,192**	644
(Increase)/decrease in discount	**(51)**	143
Difference between pension cost charge and pension cost relief	**(197)**	(12)
	944	775
Tax on profit on ordinary activities	**3,043**	1,683

The adjustment in respect of prior periods for the year 2009 relates to a tax refund received following a change in the tax treatment of infrastructure renewals expenditure.

The tax charge for the year is lower (2009 - lower) than the standard rate of corporation tax in the UK of 28% (2009 - 28%). The difference is explained as follows:

	2010 £000	2009 £000
Profit on ordinary activities before tax	**8,465**	5,814
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2009 - 28%)	**2,370**	1,628
Effect of:		
Expenses not deductible for tax purposes	**19**	23
Capital allowances for the period in excess of depreciation	**(608)**	(447)
Revenue items charged to capital	**124**	214
Difference between pension cost charge and pension cost relief	**197**	12
Adjustments to tax charge in respect of prior periods	**(3)**	(522)
Current tax charge for year	**2,099**	908

9 Dividends	**2010 £000**	2009 £000
Equity: Ordinary/'A' Ordinary		
Interim paid	**2,050**	2,576
Final paid	**2,613**	2,088
	4,663	4,664

The Directors are proposing the payment of a final dividend of £1.885m for the year ended 31 March 2010. 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 2009	43,535	109,379	33,781	11,862	198,557
Additions	2,015	8,762	1,924	1,353	14,054
Disposals	-	(279)	-	(486)	(765)
At 31 March 2010	**45,550**	**117,862**	**35,705**	**12,729**	**211,846**
Depreciation					
At 1 April 2009	7,233	63,028	11,562	7,497	89,320
Charge for year	413	4,561	1,747	1,169	7,890
Disposals during year	-	(279)	-	(445)	(724)
At 31 March 2010	**7,646**	**67,310**	**13,309**	**8,221**	**96,486**
Net book value					
At 31 March 2010	**37,904**	**50,552**	**22,396**	**4,508**	**115,360**
At 31 March 2009	36,302	46,351	22,219	4,365	109,237
Capital contributions					
At 1 April 2009	-	18,778	-	-	18,778
Received during year	-	552	-	-	552
At 31 March 2010	**-**	**19,330**	**-**	**-**	**19,330**
Net book value after deducting capital contributions					
At 31 March 2010	**37,904**	**31,222**	**22,396**	**4,508**	**96,030**
At 31 March 2009	36,302	27,573	22,219	4,365	90,459

Included within freehold land, buildings and reservoirs at cost above is an amount of £2.208m relating to a capital project involving the design and construction of a winter storage reservoir at Havant Thicket. Costs incurred to date are in respect of initial design, planning application and environmental impact studies. No depreciation has been provided to date on this expenditure. The current position with this project is reported within the Operating and Financial Review on page 12.

11 Fixed asset investments	Loans to Group undertakings £000
At 1 April 2009	**60,633**
Repayments	**(1,165)**
At 31 March 2010	**59,468**

Notes to the Accounts

12 Debtors

	2010	2009
	£000	£000
Trade debtors	**1,912**	1,133
Amounts owed by Group companies	**23**	26
Prepayments and accrued income	**2,771**	2,749
Other debtors	**229**	124
	4,935	4,032

All of the above amounts fall due within one year.

As at 31 March 2010, trade debtors had a carrying value of £4.100m (2009 - £3.175m) before provision for bad debt. Trade debtors in arrears are provided for in full, but only an element of current debt is provided for. The amount of the provision was £2.188m as at 31 March 2010 (2009 - £2.042m).

The ageing of these debtors was as follows:

	2010	2009
	£000	£000
Up to 12 months	**2,182**	1,393
Over 12 months	**1,918**	1,782
	4,100	3,175

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:

	2010	2009
	£000	£000
At 1 April 2009	**2,042**	1,794
Provision for bad debt required in the year	**630**	589
Debt written off in the year as uncollectable	**(484)**	(341)
At 31 March 2010	**2,188**	2,042

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 (2009 - £4,000).

14 Cash at bank and in hand

Of the total amount shown of £1.931m, £1.518m (2009 - £1.464m) is held specifically for the payment of the next half yearly loan interest charges.

15 Creditors: amounts falling due within one year

	2010	2009
	£000	£000
3% Perpetual debenture stock	**60**	60
3½% Perpetual debenture stock	**185**	185
4% Perpetual debenture stock	**39**	39
Bank loan	**6,000**	4,000
Payments received on account	**1,502**	972
Trade creditors	**1,050**	920
Amounts owed to Group companies	**2,078**	2,600
Corporation tax	**742**	-
Social security and other taxation	**209**	215
Other creditors	**3,083**	2,431
Accruals	**422**	574
Water rates in advance	**5,177**	5,058
	20,547	17,054

The £6.0m. 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	2010 £000	2009 £000
In five years or more:		
Bank loan	**81,416**	82,600
Less: deferred arrangement costs	**1,280**	1,337
	80,136	81,263

The thirty year £66.5m. index-linked loan was issued on 26 June 2002, is repayable on 30 September 2032, and is secured upon the assets of the Company. The capital value of the loan is adjusted by the change in the Retail Prices Index from year to year. The fees associated with the loan issue of £1.722m. are amortised over the life of the loan. The 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 amount at 3.635% per annum.

17 Provisions for liabilities	2010 £000	2009 £000
Deferred taxation:		
At 1 April 2009	**9,131**	8,344
Provided during the year in profit and loss account	**1,141**	787
At 31 March 2010	**10,272**	9,131

The total deferred tax balance before the effect of discounting is £11.261m. (2009 - £10.069m.). The amount provided for deferred taxation represents timing differences caused by the excess of tax allowances over depreciation.

	2010 £000	2009 £000
Deferred tax excluding that relating to pension asset:		
Accelerated capital allowances	**10,272**	9,131
Pension asset (note 28)	**3,801**	4,736
Total provision for deferred tax	**14,073**	13,867
At 1 April 2009	**13,867**	16,738
Deferred tax charge in profit and loss account (note 8)	**944**	775
Deferred tax charged to the statement of total recognised gains and losses	**(738)**	(3,646)
At 31 March 2010	**14,073**	13,867

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. (2009 - £0.694m.). 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 £1.515m., 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 2010 is detailed below:

Sterling	**2010 £000**	**2009 £000**
Assets		
Fixed asset investment	**59,468**	60,633
Current asset investments	**4**	4
Cash at bank and in hand	**1,931**	2,604
	61,403	63,241

Sterling	**Fixed Rate 2010 £000**	Fixed Rate 2009 £000	**Floating Rate 2010 £000**	Floating Rate 2009 £000	**Total 2010 £000**	Total 2009 £000
Liabilities						
Bank loans and overdraft	**80,136**	81,263	**6,000**	4,000	**86,136**	85,263
Debenture stock	**284**	284	**-**	-	**284**	284
	80,420	81,547	**6,000**	4,000	**86,420**	85,547

Fixed rate	**Weighted Average Interest Rate % 2010**	Weighted Average Interest Rate % 2009	**Weighted Average Period for which Rate is Fixed Years 2010**	Weighted Average Period for which Rate is Fixed Years 2009
Sterling	**3.6**	3.6	**22**	23

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 2010 is detailed below:

	2010 £000	2009 £000
In one year or less	**6,284**	4,284
In more than five years	**80,136**	81,263
	86,420	85,547

The Company had undrawn committed borrowing facilities at 31 March 2010, in respect of which all conditions precedent had been met, as follows:

	2010 £000	2009 £000
Expiring in one year or less	**9,000**	2,000
Expiring between one and two years	**-**	11,000
Expiring in more than two years	**2,000**	-
	11,000	13,000

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

Notes to the Accounts

19 Called up share capital	2010 £000	2009 £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 2009	1,539	3,250	57,012
Profit for the financial year	-	-	5,422
Dividends	-	-	(4,663)
Actuarial (loss) on pension scheme	-	-	(2,636)
Movement on deferred tax relating to pension scheme	-	-	738
At 31 March 2010	**1,539**	**3,250**	**55,873**

21 Reconciliation of movements in shareholders' funds	2010 £000	2009 £000
Profit for the financial year	**5,422**	4,131
Dividends	**(4,663)**	(4,664)
	759	(533)
Actuarial (loss) on pension scheme	**(2,636)**	(13,020)
Movement on deferred tax relating to pension scheme	**738**	3,646
Net (reduction) to shareholders' funds	**(1,139)**	(9,907)
Opening shareholders' funds	**62,879**	72,786
Closing shareholders' funds	**61,740**	62,879

22 Reconciliation of operating profit to net cash inflow from operating activities	2010 £000	2009 £000
Operating profit	**8,312**	6,989
Other pension costs	**1,419**	1,718
Depreciation charge	**7,890**	7,684
Loss on disposal of asset	**7**	-
(Increase)/decrease in stocks	**(138)**	53
(Increase)/decrease in debtors	**(1,046)**	110
Increase in creditors	**155**	165
Net cash inflow from operating activities	**16,599**	16,719

Notes to the Accounts

23 Reconciliation of net cash flow to movement in net debt

	2010 £000	2009 £000
(Decrease)/increase in cash in the year	**(728)**	110
Cash outflow from increase in liquid resources	**55**	-
Cash (inflow) from (increase) in debt	**(2,000)**	-
Change in net debt resulting from cash flows	**(2,673)**	110
Non cash movement	**1,127**	(4,024)
Movement in net debt in the year	**(1,546)**	(3,914)
Net debt at 1 April 2009	**(82,939)**	(79,025)
Net debt at 31 March 2010	**(84,485)**	(82,939)

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

24 Analysis of changes in net debt

	At 1 April 2009 £000	Cash Flow £000	Non cash Movements £000	**At 31 March 2010 £000**
Cash at bank and in hand	1,144	(728)	-	**416**
Debt falling due within one year	(4,284)	(2,000)	-	**(6,284)**
Debt falling due after one year	(81,263)	-	1,127	**(80,136)**
	(85,547)	(2,000)	1,127	**(86,420)**
Short term deposits	1,460	55	-	**1,515**
Current asset equity investments	4	-	-	**4**
	1,464	55	-	**1,519**
	(82,939)	(2,673)	1,127	**(84,485)**

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

25 Capital commitments

	2010 £000	2009 £000
Contracted for but not provided in these financial statements	**1,054**	4,609

The Company has a further commitment under operating leases relating to computer hardware and associated software of £0.339m. per annum (2009 - £0.339m.) which expire as set out below:

	2010 £000	2009 £000
Within two to five years	**339**	339

26 Contingent liabilities

There were no reportable contingent liabilities at 31 March 2010 or at 31 March 2009.

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

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

The formal actuarial valuation as at 31 March 2008 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:

	2010 % per annum	2009 % per annum	2008 % per annum
Price inflation	**3.7**	3.2	3.7
Discount rate	**5.5**	6.9	6.7
Pension increases (RPI)	**3.7**	3.2	3.7
Salary growth	**5.95**	5.45	6.45

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 28.7 years (2009 - 28.6 years). Allowance is made for future improvements in life expectancy.

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

	2010 Expected Return % per annum	**2010 Fair Value £000**	2009 Expected Return % per annum	2009 Fair Value £000	2008 Expected Return % per annum	2008 Fair Value £000
Equities	**7.8**	**74,538**	8.0	53,382	7.7	66,777
Bonds	**4.3**	**37,784**	4.2	29,017	4.5	33,139
Other	**2.0**	**1,521**	1.9	4,325	3.9	7,780
	6.6	**113,843**	6.4	86,724	6.4	107,696

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

	2010 £000	2009 £000
Total fair value of scheme assets	**113,843**	86,724
FRS 17 value of scheme liabilities	**100,268**	69,808
Gross pension asset	**13,575**	16,916
Related deferred tax liability	**3,801**	4,736
Net pension asset	**9,774**	12,180

Under FRS 17, the scheme is represented on the balance sheet at 31 March 2010 as an asset of £13.575m (2009 - £16.916m), which amounts to £9.774m net of deferred tax (2009 - £12.180m).

The Company remained on a contribution holiday until 31 March 2010 and it has agreed to begin paying contributions from 1 April 2010 at a rate of 12.4% of earnings. Based upon current earnings this would result in Company contributions of £0.735m per annum. Members pay contributions at a rate of 5% of earnings.

Notes to the Accounts

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

	2010 £000	2009 £000
Opening scheme liabilities	**69,808**	77,718
Employer's part of current service cost	**1,419**	1,718
Interest cost	**4,762**	5,175
Contributions by scheme participants	**284**	277
Benefits paid	**(3,306)**	(2,968)
Actuarial loss/(gain)	**27,301**	(12,112)
Closing scheme liabilities	**100,268**	69,808

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

	2010 £000	2009 £000
Opening fair value of scheme assets	**86,724**	107,696
Expected return on assets	**5,476**	6,851
Contributions by scheme participants	**284**	277
Benefits paid	**(3,306)**	(2,968)
Actuarial gain/(loss)	**24,665**	(25,132)
Closing fair value of scheme assets	**113,843**	86,724

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

	2010 £000	2009 £000
Current service cost (employer's part only)	**1,419**	1,718
Past service cost	**-**	-
Total operating charge	**1,419**	1,718

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

	2010 £000	2009 £000
Expected return on pension scheme assets	**5,476**	6,851
Interest on post retirement liabilities	**(4,762)**	(5,175)
Net return	**714**	1,676
Total (expense) recognised in the profit and loss account	**(705)**	(42)

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

	2010 £000	2009 £000
Actual return less expected return on scheme assets	**24,665**	(25,132)
Experience gains arising on scheme liabilities	**-**	4,722
(Loss)/gain due to changes in assumptions underlying the FRS 17 value of scheme liabilities	**(27,301)**	7,390
Actuarial (loss) recognised in the STRGL	**(2,636)**	(13,020)

The actual return on plan assets was a gain of £30.141m in the year to 31 March 2010 (2009 - loss of £18.281m).

The history of experience gains and losses is:

	2010	2009	2008	2007	2006
Present value of scheme liabilities (£000)	**(100,268)**	(69,808)	(77,718)	(86,882)	(84,086)
Total fair value of scheme assets (£000)	**113,843**	86,724	107,696	108,711	104,899
Surplus (£000)	**13,575**	16,916	29,978	21,829	20,813
Actual return less expected return on scheme assets (£000)	**24,665**	(25,132)	(5,382)	(535)	13,587
Percentage of scheme's assets	**22%**	(29)%	(5)%	0%	13%
Experience gains arising on scheme's liabilities (£000)	**-**	4,722	-	-	65
Percentage of the FRS 17 value of the scheme's liabilities	**-**	7%	-	-	-
Total amount recognised in the STRGL (£000)	**(2,636)**	(13,020)	7,602	(519)	4,527
Percentage of the FRS 17 value of the scheme's liabilities	**3%**	19%	10%	0%	5%

The cumulative amount recognised in the STRGL as at 31 March 2010 was a loss of £22.633m (2009 - loss of £19.997m).

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 23rd day of July 2010, on the following business:

1. To receive and consider the Directors' Report and Accounts for the year ended 31 March 2010 and the Auditors' Report thereon.

2. To re-elect Mr. T. M. Lazenby MBE 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
26 May 2010

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

a) Gearing - Debt/RCV	**2010 £000**	2009 £000
(i) Debt		
Bank loan (note 16)	**81,416**	82,600
Bank loan (note 15)	**6,000**	4,000
Debenture stock (note 15)	**284**	284
Cash at bank and in hand	**(1,931)**	(2,604)
	85,769	84,280

For the purposes of this ratio, debt excludes the deferred arrangement costs of £1.280m (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 2009

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.

	2010 £000	2009 £000
Regulatory capital value indexed to 31 March	**111,417**	108,896
(iii) Gearing - Debt/RCV ratio (i) ÷ (ii)	**77.0%**	77.4%

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 32 and is calculated as follows:

	2010 £000	2009 £000
Net cash flow from operating activities	**16,599**	16,719
Interest received, excluding amounts for inter-company loan	**23**	125
Taxation, excluding payments for group relief	**(965)**	(724)
Capital expenditure	**(12,361)**	(10,612)
New borrowings	**2,000**	-
	5,296	5,508
(ii) Interest paid	**3,071**	3,327
(iii) Cash interest cover ratio (i) ÷ (ii)	**1.72**	1.66

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 2009/10 have been supplied to Ofwat, but will not be confirmed in the Ofwat document until later in 2010.