Portsmouth Water Limited
Annual Report & Accounts 2016

Delivering excellence
for our customers,
our people and our
environment

Company Number: 2536455

Portsmouth Water At a Glance

We are an independent company unique in the industry as we are majority owned by a Trust on behalf of our employees

158

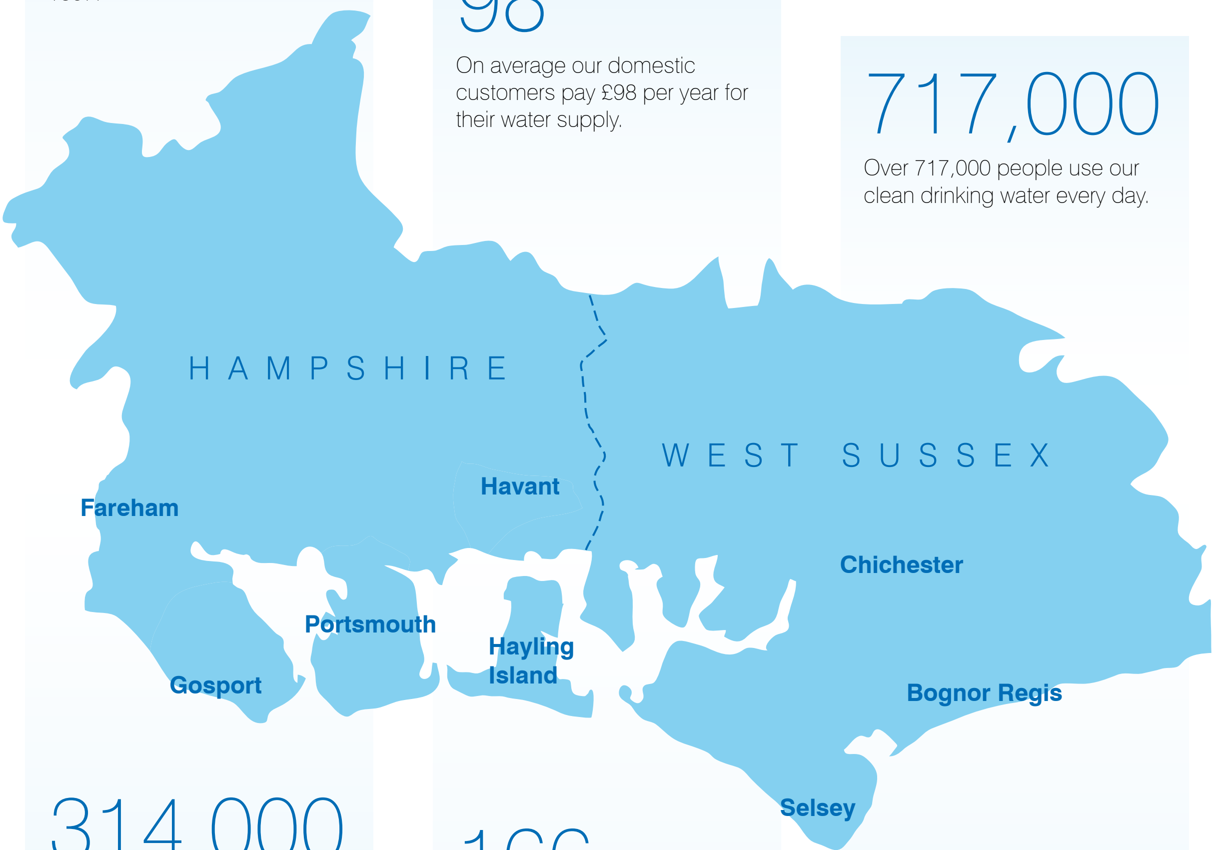
We are proud to have served the local community since 1857.

98

On average our domestic customers pay £98 per year for their water supply.

717,000

Over 717,000 people use our clean drinking water every day.



314,000

We provide clean drinking water to 314,000 homes and businesses in our area.

166

We serve the cities and towns of Portsmouth, Chichester, Fareham, Gosport, Havant and Bognor Regis. On average, each day we supply approximately 166 million litres of water.

3,300

Our area of supply has a network of over 3,300 kilometres of underground mains.

We provide drinking water only. We do not provide sewerage services; this is normally provided by Southern Water.

Highlights

- > At just £98 our average household bill continues to be the lowest in England and Wales
- > Number one ranked for customer service across the industry for the second successive year
- > The Water Quality Team were successfully accredited ISO17025
- > RoSPA Presidents Award winner for the second successive year
- > No reportable health & safety accidents

Turnover

£39.8m

Cash generated from operations

£13.7m

Operating profit

£8.2m

Capital expenditure

£9.3m

2014 results have not been restated for FRS 102

Contents

Registered Office

PO Box 8
West Street
Havant
Hampshire
PO9 1LG

Chairman's Statement

Mike Kirk
Chairman
27 May 2016

We are extremely pleased to be ranked top of the industry in customer services for the second successive year

I have great pleasure in presenting the Annual Report and Accounts for what has been another busy and eventful year. We have completed the first year of the current Regulatory Period and are on track for a positive performance against our Outcomes. We have also invested significant efforts in the preparation for the Non-Household Market Competition in 2017, including our decision to dispose of our Non-Household retail business on 1 April 2017 to Castle Water. At the same time we have continued to deliver excellent customer service, the lowest household bills in the industry and a strong financial performance.

Our Customers

We are extremely pleased to be ranked top of the industry wide survey for customer service for the second successive year. The Ofwat independent Service Incentive Mechanism quarterly survey ranked the Company number one for overall service and for both billing and operational matters. The number of complaints that we receive per 10,000 customers fell to 8.6. This compares to the industry average for 2014/15 of 28.0, and the lowest for that year of 10.2.

Extensive customer research was undertaken as part of our proposal to introduce a "Social Tariff" to support customers who find it difficult to pay. We are pleased to announce that our customers overwhelmingly supported a Social Tariff which will see a small general increment in customers' bills in order to support those in genuine difficulty. This tariff will be launched in July 2016 and will compliment a range of services we already offer to support those in society that need help.

Maintaining appropriate levels of water quality, in compliance with the requirements of the Drinking Water Inspectorate is a fundamental activity for the business. During the year we began construction on a significant £4.4m investment in two new water quality schemes at our Eastergate and Westergate water treatment works. These two projects will implement Ultra Violet treatment which is highly effective at killing water-borne micro-organisms. This has been implemented to address the risk of cryptosporidium, which can cause sickness if left untreated. The capital spend in 2015/16 was £3.1m and the schemes will be fully commissioned by the summer of 2016.

As I have already noted, water quality is fundamental to our business and so we were disappointed that we did not meet one of the measures relating to our performance in this area - that 99.95% of samples meet the required standards. Our results were actually 99.94%, so the margin of under-performance was a very small 0.01%. In addition it is important to note that this results from a total of 15,190 samples taken at customer taps during the year - with only four of those samples failing and in all cases for issues relating to the customers' pipes and not for the inherent quality of the water supplied. These results were disproportionately impacted by failures to meet the lead standards, as a result of a lead solder joint in the customer supply pipe, in an area that otherwise has no lead pipes supplying or within the property.

During the year we have undertaken extensive work with local developers in order to understand both their experience and expectations of working with us. The results have indicated that the level of service we provide is good and that our communication and quality of work meet their expectations. They also indicated that our services represent good value for money. This is an important customer segment for the business and during 2016/17 we will continue to review and refine how we support developers.

Our People

We were delighted, for the second consecutive year, to receive the President's Award from the Royal Society for the Prevention of Accidents (RoSPA). This recognises 11 consecutive years of winning 10 Gold awards and one Industry Sector award. Health and Safety is our number one priority and we are immensely proud of this achievement.

As part of our programme of continuous improvement, our water quality team achieved ISO 17025 accreditation and Drinking Water Testing Specification for our laboratory. This required significant commitment and skills from both our water quality team and the teams who take water samples from our treatment works and reservoirs. It confirmed the skills and good practice that the Company already had in operation.

Our Environment

We continue to invest in ensuring that we do not have an adverse impact on the environment and to support biodiversity across our sites. We have taken action, with the support of the Environment Agency, to reduce the impact of abstraction in two important rivers in our area of supply. In common with many water companies we are experiencing increasing levels of nitrates in our water sources. This is often impacted by the use of fertilisers and by other agricultural activities. Rather than undertaking expensive treatment for nitrates at our works, we are seeking to reduce them at source by working with farmers. During the year we recruited a dedicated catchment manager who will both work with farmers and undertake detailed analysis of the key areas at risk within our catchment. We expect to invest further in catchment management activities over the 5 year regulatory period and beyond.

Leakage for the year was below the target of 30 Ml/day. There were no restrictions to customer supplies last year, and the current groundwater levels are such that we do not expect any restrictions this summer.

Our Business

From April 2017 the non-household water market will be opened to competition. This will allow business customers to choose who will provide their retail services (this covers customer services, account management, billing, credit control and meter reading). This is commonly referred to as 'retail competition'. There will be no change to the infrastructure that delivers drinking water to customers and Portsmouth Water will continue to supply clean water to the businesses in our area and be responsible for any emergencies.

The Company continues to make good progress to ensure that we meet the necessary compliance and market operating requirements for the opening of retail competition. These preparations remain an area of significant management focus and effort reflecting the importance of this activity.

The Board undertook a strategic review of the business and, in light of the decision by Ofwat to introduce retail competition, a decision was made to seek to exit retail activities for business customers. It was the Board's view that the business did not have the reach or experience to compete in this market on a national scale. Accordingly the Company entered an agreement with Castle Water, a water retailer already operating in Scotland, to dispose of the retail business when the market opens on 1 April 2017. From 1 April 2016 Castle Water has been responsible for management of our non-household customer accounts under an operating agreement.

In December 2015 the UK Treasury announced a proposal to implement retail competition for household customers by 2020. Ofwat is currently undertaking further research and analysis in order to support the Treasury in its final policy decision, which is anticipated in the Autumn of 2016. Portsmouth Water has already indicated it intends to be active in a household retail market should one be established.

Financial results

The financial results for the period show a significant increase in Operating Profit of £1.5m to £8.2m. This was primarily driven by the net movement of:

- A £1m increase in turnover;
- £1.9m reduction in infrastructure renewals expense;
- Accelerated depreciation charges of £0.7m relating to plant and equipment made redundant by the new UV schemes;
- Provision for an ODI failure of £0.3m; and
- Higher staff costs (including pension) of £0.6m

The 2.5% increase in turnover to £39.8m reflected the 2% average tariff increase and 2,300 new properties.

A further one off charge of £0.6m arose as a result of losses on disposal of fixed assets and is presented below operating profit.

Gross capital investment in the year was £9.3m. The Company renewed 11.6km of mains at a cost of £1.8m (2015 - £3.7m). In accordance with FRS 102, this cost is no longer capitalised and is charged to the income statement as an operating cost. A further £1.7m of new mains and enhancements to the network were capitalised along with above ground capital projects totalling £7.6m, of which the two new UV treatment plants were the most significant schemes. The Company also received capital contributions of £1.2m (2015 - £1.3m), towards the cost of new mains serving new developments.

Overall cash generated from operating activities of £13.4m is higher than the prior year (2015 - £11.9m). This was driven by lower infrastructure renewals expensed of 1.9m and resulted in a year end cash balance of £9.2m (2015 - £6.8m). Purchases of fixed assets increased by £3.0m, dividend payments increased by £0.4m, net repayments of loans fell by £2.3m. Overall this resulted in a net increase in cash and cash equivalents in the year of £2.4m which is similar to 2015.

Gearing at the year end of 70.2% was improved slightly on the 2015 gearing of 72.4% as a result of increased cash balances. Cash interest cover 1.96 times (2014 - 1.80 times) and return on regulatory equity 9.3% (2014 - 5.1%), have both improved driven largely by increased operating profit due to lower infrastructure renewals spend in the period. This is expected to reverse in 2016/17.

In response to the principles of Corporate Governance published by Ofwat, the Company has established a Governance Code and this is on our website. The Board believes that it complies with the principles although the structure of the Board does not strictly comply with the Ofwat guidelines. The Ofwat principles suggest that independent Non-Executives should constitute the largest faction of Directors.

The Board of Portsmouth Water consists of three independent Non-Executive Directors (including the Chairman) and three Executive Directors. The Chairman has the casting vote and neither the Managing Director or the Finance and Regulation Director are allowed to vote on the dividend. We believe that this structure is appropriate for a company of our size and satisfies the overall principle that the independent Directors have considerable influence. Ofwat have confirmed that they are satisfied with this position. Details of our compliance with the Ofwat principles is shown in the Corporate Governance section on page 34 of this report.

> We were delighted, for the second consecutive year, to receive the President's Award from RoSPA

Strategic Report

Our Mission

"To supply high quality drinking water whilst providing excellent levels of service for our customers at the lowest price in the country"

Portsmouth Water supplies drinking water to a population of 717,000 over an area of 868km^2.

To achieve our Mission we have developed a number of Outcomes, as part of the Regulatory Business Plan process (see page 7). These summarise our business goals and aspirations over the coming years. We did this by consulting our customers and our stakeholders.

These Outcomes form the backbone of our strategy and are reflected in our Business Plan for the 5 year period from 2015/16 to 2019/20.

The way that these business Outcomes align to our strategy, detailed objectives, KPIs and business risks is set out in more detail on pages 8 and 9.

Our Outcomes:

- **Safe secure and reliable drinking water**
- **A high quality service**
- **Less water lost through leakage**
- **Supporting the community**
- **A health and safety culture**
- **An improved environment supporting biodiversity**

Underpinning the outcomes is an overarching business need for;
A business which is financeable, provides a stable return to shareholders and has ongoing financial resilience.

Delivering excellence for our customers our people and our environment

Strategic Report

What We Do

We use a combination of natural resources, technology and a motivated and committed workforce to supply high quality drinking water whilst providing excellent levels of service for our customers at the lowest price in the country.

Our principal business activity is the supply of drinking water to both domestic (household) and commercial (non-household) customers. The supply of water is a closely regulated industry. We talk about our regulators more on page 27. Portsmouth Water operates as a water supplier under an Instrument of Appointment granted by the Secretary of State for the Environment under the Water Industry Act 1991.

We collect water from the environment, make it safe to drink and distribute it to our customers. Our process is broken down into four main areas and we have explained this further below.

Portsmouth Water provides water to 296,000 homes and 18,000 businesses in an area of 868km^2 extending from Fareham in the East of Hampshire to Littlehampton in West Sussex. Our area of supply covers the major conurbations of Portsmouth, Fareham, Gosport, Bognor Regis, Havant and Chichester. A map showing the area of distribution is set out on page 1.

The Company's water is drawn from the chalk of the South Downs and is abstracted from wells, boreholes springs and the River Itchen. We treat this in 21 treatment works. Further information about our water resources is set out in page 20 under "Our Environment".

Water resources	**Water treatment**	**Treated water distribution and supply**	**Customer services**
Wholesale Service	*Wholesale Service*	*Wholesale Service*	*Retail Service*
We take water from, natural springs, boreholes and rivers. We take care to make sure that we have enough water for you to use but don't damage our environment. We invest in supporting the local environment.	We filter and treat it so that the water is safe to drink. We do lots of checking to make sure that our water meets all of the drinking water standards. We invest in new equipment and technology to do this efficiently and effectively.	We move the water through our underground network of pipes to your tap. We carry on checking the quality until it gets to you. We take care to repair leaks and deal with bursts quickly so that you always have water.	We send out your bill, take payments, read your meter (if you have one) and deal with any other questions or problems that you have. We do our best to make sure that we get things right and say sorry, and put them right, if we don't.

The Regulatory Price Review

The water industry in England and Wales is, currently, a monopoly business. Accordingly the prices that we may charge our customers for water (and related services) are set and regulated by Ofwat, the industry's Economic Regulatory Body. The primary way that Ofwat financially regulates water companies is through a five yearly review commonly known as the "Price Review" ("PR"). Through this process companies set out in their "Business Plan" what they expect to spend on the services that we supply to our customers. This includes elements such as the cost of customer service, investment in capital schemes (fixed assets) and meeting all of the other legal and social obligations. As a result of this process Ofwat sets price limits for each company and this, in turn, determines the bills that customers pay.

The current regulatory period commenced on 1 April 2015 and will run for five years until 31 March 2020. As part of the Price Review, companies set a number of Outcomes which they promised to achieve over the five year PR period. Many of these outcomes have financial rewards and penalties attached to them. These are part of a regulatory mechanism called the Outcomes Delivery Incentive Mechanism ("ODIs").

The Company's Outcomes are set out on page 8. A summary of how they relate to our business strategy can be found on pages 8 to 9 and those with related financial rewards and penalties attached are noted in our table covering KPI's on pages 10 to 11.

Strategic Report

Our Strategy

The Outcomes that we have form the backbone of our strategy. As a business we align our day to day activities closely to these and monitor them using a set of key performance indicators (KPIs). Many of these KPIs also form the basis of rewards and penalties which are part of the quinquennial price review process with Ofwat (the ODIs). We monitor and manage our significant business risks against our ability to achieve the Outcomes. We have summarised how these elements align below;

Outcomes (page 6) — **How we plan to do that**

Our customers

Safe secure and reliable drinking water

High quality service

Support the Community

- A comprehensive testing programme in accordance with Drinking Water Inspectorate requirements
- A dedicated catchment management officer and activities to protect the quality of our water sources
- Investment in schemes to improve water quality and reliability such as new UV treatment plants
- Review of our water resources to determine whether we have sufficient resources for the next 25 years
- Careful monitoring of our mains network, a programme of mains renewals and management of bursts and leakage
- A focus on excellent customer service including a culture of excellence
- Telephone calls are handled locally and in person
- Supporting vulnerable customers through a number of schemes
- Working closely with local schools and actively supporting local education activities

Our people

A Health and Safety Culture

- Driving a culture of health and safety in everything we do
- Ensure the safest possible environment for employees, visitors and the general public
- Risk assessments for employees and public safety on every job we undertake
- Invest in our people by supporting ongoing professional development, education and training

Our environment

Less water lost through leakage

An improved environment supporting biodiversity

- Investment in an ongoing programme of leak detection and repair
- Agree a Biodiversity action plan with stakeholders and complete it by 2020
- Promotion of water efficiency through free advice, water saving devices and community events
- Appointment of a “catchment management officer”
- An active programme to promote meters to our customers

Our business

A business which is financeable, provides a stable return to Shareholders and has ongoing financial resilience

- An effective corporate governance structure
- Operation of effective finance processes and internal controls
- Close monitoring of budget and out-turn performance against KPIs and key ratios (for covenants and rating agencies)
- A stable dividend policy

Key Performance Indicators (pages 10 to 11)

- Water quality standards
- Water quality contacts
- Bursts
- Interruptions to supply
- Service Incentive Mechanism
- Guaranteed Service Standards

- RoSPA accreditation
- Health and Safety "reportable accidents"
- Health and Safety "total accidents"
- Employee absence
- Headcount

- Leakage
- Per capita consumption
- Temporary usage bans

- Operating profit
- Operating profit: Regulatory Capital Value ("RCV")
- Return on Regulatory Equity ("RoRE")
- Cash Interest Cover
- Gearing (Net Debt: RCV)
- Regulatory Rewards and Penalties (ODIs)

Risks (pages 28 to 29)

- Operational
- Water Quality
- Business Continuity
- IT

- Human Resources
- Health and Safety

- Environmental

- Financial
- Regulatory

Strategic Report

How We Measure Success

As a business we focus on a range of operational and financial key performance indicators ('KPIs') to help us assess and monitor our performance. We believe that the KPIs, summarised below, provide a balanced view of how we are performing against both our business Outcomes and our overall long term business vision. These KPIs align closely to our Outcomes and cover the key areas of our business operations and activities. They also cover the range of interests of our different stakeholders. A number of the KPIs are also linked directly to financial rewards and penalties built into the Ofwat regulatory framework through the Outcome Delivery Incentive Mechanism (ODIs').

KPI	Definition
Our customers	
Water quality standards (Mean Zonal Compliance) * (Calendar year)	This is the average of the compliance rates for the 39 standards tested. This is reported to the Drinking Water Inspectorate. This is known as Mean Zonal Compliance.
Water quality contacts * (Calendar year)	A measure of customer contact for taste, odour, discolouration and illness calculated as the number of contacts per 1,000 population.
Bursts *	The number of burst mains calculated in accordance with Ofwat guidance. Defined in number of incidents per annum.
Interruptions to supply *	Average time of supply interruption per property (includes both planned and unplanned interruption).
Service Incentive Mechanism (SIM) * From 2015 this included only domestic customers and the weightings were revised.	An independent Ofwat survey of all companies. A customer experience performance measure with two elements: Qualitative score derived from the customer experience survey and quantitative score based on the number of 'unwanted' calls received, combined with the number of complaints received and the Company's effectiveness at resolving these complaints.
Guaranteed Service Standards	A scheme for our customers which puts in writing the minimum standards we aim to meet. If we fail to meet the standards we pay compensation.
Our people	
RoSPA accreditation*	The Company will apply for its Health and Safety accreditation annually.
Health & Safety Reportable accidents	An absence of more than 7 days as a result of an injury at work and reportable to the HSE.
Health & Safety Total accidents	All accidents including reportable accidents but excluding vehicle accidents.
Employee absence	The number of days absent from work per person.
Headcount	The number of staff employed by the Company.
Our environment	
Leakage *	The total level of leakage, including customer supply pipe leakage, as measured on an average mega litre per day (Ml/d) basis.
Per Capita Consumption *	The weighted average water consumption per customer served calculated from the number of measured and unmeasured households.
Temporary Usage Bans *	Introduction of water restrictions in accordance with the Company's approved drought plan.
Our business	
Operating Profit	Financial measure in accordance with UK accounting standards being turnover less operating costs.
Cash interest cover	The ratio represents the number of times that adjusted cash flow covers interest payment. A detailed calculation is included in Appendix I.
Gearing (Net debt: RCV)#	The ratio of Net Debt (loans and debentures less cash) to RCV. A detailed calculation is included in Appendix I.
Return on Regulatory Equity (RoRE)#	The % return (and adjusted profit based measure on the equity component of RCV). The equity input is derived by applying the inverse of the gearing ratio to RCV. A detailed calculation is included in Appendix I.

** these measures are also subject to rewards and penalties as part of the Ofwat Outcome Delivery Incentive Mechanism*
*** 2015 restated for FRS 102*
 # 2015 restated for the 'midnight adjustment' to RCV

2015/16 Target	Our performance				2015/16 target met?
Financial year	**2015/16**	**2014/15**	**2013/14**	**2012/13**	**pages 12 - 13**
< 99.95% (Calendar year)	99.94%	99.97%	99.97%	99.96%	✗
< 0.429 contacts per 1,000 population (Calendar year)	0.570	0.841	0.430	0.550	✗
< 342 bursts per annum	219	294	226	267	✓
< 5 minutes	3 mins 30 secs	8 mins 44 secs	5 mins 16 secs	3 mins 53 secs	✓
Upper quartile > 80 (Total Score is out of 100)	89.6	82.0	82.8	68.0	✓
< 120 payments	109	139	56	58	✓
Calendar year	**2015**	**2014**	**2013**	**2012**	**pages 14 - 16**
RoSPA awarded	Awarded	Awarded	Awarded	Awarded	✓
0 accidents	0	2	1	1	✓
< 12 accidents	9	6	7	7	✓
< 2.5 days	2.43	New measure - no comparative			✓
266 staff	252	243	237	233	✓
Financial year	**2015/16**	**2014/15**	**2013/14**	**2012/13**	**pages 18 - 21**
< 30.0 Ml/d	28.1Ml/d	28.9Ml/d	29.5Ml/d	34.1Ml/d	✓
< 146.6 l/h/d	143.3 l/h/d	145.5 l/h/d	148.3 l/h/d	148.5 l/h/d	✓
0 bans	0	0	0	0	✓
Financial year	**2015/16**	**2014/15****	**2013/14**	**2012/13**	**pages 22 - 24**
Better than budget	£8.2m	£6.7m	£5.9m	£6.3m	✓
> 1.40	1.96	1.80	1.58	1.80	✓
< 80%	70.2%	72.4%	81.4%	77.9%	✓
> 6.0%	9.3%	5.1%	5.8%	6.1%	✓

Strategic Report

Our Customers

Number 1 ranked for customer service across the industry for the second successive year

Customer Service levels

Customer service is at the heart of everything that we do. In 2011 Ofwat introduced an independent customer satisfaction survey the Service Incentive Mechanism (SIM). This compares the service received by customers of all water companies across England and Wales. The score includes both quantitative and qualitative measures. The quantitative measure looks at the number of unwanted contacts and customer complaint levels and the qualitative measure is based on customer surveys rating the service they received. This measure enables us to compare our customer service against the industry. Ofwat has used the SIM score as a metric for rewards and penalties.

Portsmouth Water's final score for 2015/16 is 89.5. This is an increase compared to the previous year when the Company's final score was 82.0. The number of complaints reduced from last year to 8.6 per 10,000 customers which is expected to be amongst the lowest in the industry. We also saw fewer complaints reach the second stage of the complaints process, and no complaints were investigated by the Consumer Council for Water (CCW).

The improvement in our SIM score is due to our continued focus on customer service levels which we have driven through staff training together with a culture of continuous improvement.

The SIM survey score (the qualitative measure) increased from 4.48 to 4.57 resulting in us remaining 1st in the industry. We recognise that other companies within the industry will continue to make improvements and therefore we continue making enhancements to retain our number one position.

Water prices and affordability

Portsmouth Water's water charges, for household customers, are the lowest in England and Wales. Our average domestic bill is £98 (2015 - £96).

However, despite this commitment to affordable water bills, in recent years we have seen increasing levels of household debt in common with similar trends across the country. Accordingly the Company pays close attention to how we support customers who may be struggling to pay their water bill. We have a number of options available to support these customers which are set out in more detail under our Corporate Responsibility Statement on page 32. We continue to look at ways in which we can further support customer groups with vulnerabilities and, following extensive customer research, we will introduce a new social tariff to be launched in July 2016.

Investment in Water Quality programmes

During the year we have invested in two significant schemes to safeguard water quality at Eastergate and Westergate water treatment works. In recent years we have seen an increase in the risk of poor raw water quality extracted from the aquifer at these sites. This may be due to activity in the catchment area. This has resulted in both increased levels of turbidity (cloudiness due to fine particulate matter) and increased risk of Cryptosporidium. Cryptosporidium can cause sickness if not removed or treated in the water supply.

The Water Safety Plan for both sites describes the need for a Cryptosporidium removal or inactivation process, due to this deterioration in water quality. Funding for this work was included in the Business Plan, with the support of the DWI and Ofwat. Subsequently the DWI issued a notice to Portsmouth Water, the Water Supply Regulations, which requires the Company to mitigate the risk of turbidity and cryptosporidium at both sites, with a compliance date of 31st August 2016.

The solution that we have planned for this particular issue are advanced Ultra Violet (UV) treatment plant. This highly effective treatment will kill 99.99% of micro-organisms in the water without the need to add chemicals. It is a highly effective and reliable technology which we are confident will address the water quality issues at these sites and maintain water quality for our customers and in line with the DWI requirements.

Following the design process, construction on these sites commenced in October 2015 with a total budgeted cost of £4.4m of which £3.1m was incurred during the year. Both UV projects are progressing well with the majority of civil work and building construction at both sites now complete with work on track for completion prior to August 2016.

KPI performance

Set out on pages 10 to 11 are the key performance indicators that we use to manage our business. Disappointingly we have failed to meet two of these measures.

We did not achieve our Water Quality KPI "Mean Zonal Compliance" of 99.95% by a margin of 0.01% points. The mean zonal compliance (MZC), which is the representation of overall drinking water quality in customers' properties is reported to the Drinking Water Inspectorate (DWI) on an annual (calendar) basis. During 2015 calendar year the Company carried out a total of 15,190 determinations in samples taken at customer taps; four of these failed to meet the relevant standard (1 taste, 1 odour & 2 lead). In each case the problem identified was in the customer's internal pipework. The overall result was disproportionately impacted by two sample failures for lead which, in both cases, arose as a result of lead in the customer side supply pipes. In one case this arose as a result of a lead solder joint in the customer's supply pipe. There were no lead pipes supplying or within the property. Whilst we offer customers subsidies towards the cost of replacing lead pipework these are rarely taken up. This KPI results in a financial penalty as part of the Ofwat ODI scheme and as a result allowed revenue will be reduced by £316,000 over the next price review period (2020-2025).

The second KPI that we failed to meet relates to "Water Quality Contacts". This is a measure of the number of times that customers contact us with complaints connected to water taste, odour, discolouration or illness. This is calculated as the number of contacts per 1,000 population served and is reported annually (for the calendar year) to the Drinking Water Inspectorate. We set ourselves a challenging level of less than 0.429/1,000 population. Unfortunately, we reported 398 water quality contacts of this nature which equates to 0.570/1,000 population. Despite this value being above our KPI value this remains significantly below the industry average of 1.7/1,000 population (2014 data). We currently have a number of initiatives in place to further reduce the number of water quality contacts. The current trend shows that levels are falling on average and we will continue to focus on improving this performance.

Strategic Report

Our People

Nearly 40% of all staff have received supported further education during their career here

Developing our people

Our people are critical to the success of our business. We are committed to the development of our employees and believe that they should all have opportunities to reach their full potential. As a result, many employees have undertaken Degrees, HNC's, and NVQ's along with relevant professional qualifications. Nearly 40% of all staff have received supported further education at some point during their employment. We are committed to maintaining an approach of "lifelong learning".

Apprenticeships

We offer Modern Apprenticeships in the field of Mechanical & Electrical, Maintenance and Customer Services for employees under 25. Our Apprenticeships follow an agreed training programme of both on and off-the-job training alongside approved further education to an HNC or NVQ standard. The training programme is conducted by both the Company and the accredited training organisation. They are normally between two and four years. Many staff who have obtained their apprenticeship with the Company have progressed further, both academically and in their career within the Company.

Further Education

A key part of staff development is the Company's involvement with the Institute of Water. The Institute of Water is a professional body promoting knowledge within the water industry, organising meetings, seminars, technical visits and conferences. The Company encourages its staff to belong to the Institute of Water and gain the benefit for both their personal and professional development by attending these events.

The EBP South 'Amazing People' Awards 2015

We celebrated winning an Employee Business Partnership (EBP) 'Amazing People' Award in the category of 'Amazing Business involved in STEM'. The award was presented at the 2015 Amazing People Awards Dinner.

The awards, which are held annually, are a celebration of the time and commitment businesses, schools, colleges and other partners invest in developing innovative programmes that support young people's preparation for adult life and work.

The award was giving to us in recognition of the work we have done with schools and young school leavers in promoting activities relating to STEM (Science, Technology, Engineering and Mathematics) helping them prepare for the world of work. The award was collected by some of the staff volunteers that helped deliver a number of our STEM activities.

Health and Safety

Health and Safety has been a priority within the Company for many years and this focus has driven a very low number of employee accidents with no serious "reportable" accidents in the year. Reportable accidents are those which result in more than 7 days off work.

We continually review our working practices, challenge ourselves and our colleagues to ensure we put safety first. We are proud of our safety record in recent years but we encourage a culture of continuous focus and improvement.

We introduced a new approach to H&S during the year which we called "hearts and minds". Much of our historic approach to H&S has been a top down prescriptive approach. During 2015 we introduced "hearts and minds" with the intention of driving a 'bottom up' engagement with H&S, where our operational staff drive both the culture, appropriate H&S activities and changes.

Number of Accidents in 2015

We measure the number of accidents for a calendar year. We had no reportable accidents during the year. A reportable accident is where an employee is off work for more than 7 days as a result of an injury at work.

There were 9 accidents in the year, an increase of 3 since 2014. The total lost days for the year as a result of accidents was 2 (2014 - 38).

Total and Reportable Accidents

RoSPA 2016 Presidents Award

2016 saw us become the holder of the RoSPA President's Award for Health and Safety for the second successive year. The President's Award, is part of the RoSPA prestigious awards scheme and is given to organisations that have demonstrated excellence in the area of Health and Safety consistently for 10 years or more.

The President's Award acknowledges our achievements in the previous 11 years, of winning ten gold level awards and an Industry Sector award. This is a tremendous achievement and a true testimony of the efforts that everyone in the Company has put in to make Portsmouth Water a safer place to work.

We had no reportable accidents during the year

2016
RoSPA
President's Award

Health and Safety

"Everyone goes home safe at the end of every day."

Strategic Report

Our People

The Water Quality team were successfully accredited ISO 17025

8746

Accredited to ISO/IEC 17025:2005

Laboratory Accreditation

During 2015 the Water Quality team successfully completed the process of obtaining accreditation to ISO 17025 and DWTS (Drinking Water Testing Specification) for their laboratory and sampling activities. This was a requirement bought in by the Drinking Water Inspectorate (DWI) and it was business critical that we obtained accreditation by the end of 2015.

Accreditation is required for both sampling and the laboratory, so it impacts the Water Quality team and also the teams which take our samples from treatment works, reservoirs and customer properties.

Accreditation is awarded by UKAS (United Kingdom Accreditation Service). The initial assessment visit involved 9 full days of auditing during which time the auditors reviewed all our procedures and processes and assessed the staff undertaking the sampling and testing. Now that the laboratory has gained accreditation this will continue to be reviewed on an annual basis.

Gender Diversity

The Company is committed to the principle of gender equality in all aspects of employment including recruitment, promotion and remuneration. The numbers of female and male employees (headcount) at the end of the financial year are shown in the table below;

	2016 Female	2016 Male	2015 Female	2015 Male
Directors	**2**	**4**	1	4
Senior Managers	**2**	**11**	1	13
Other Employees	**80**	**159**	73	156
Total	**84**	**174**	74	173

Strategic Report

Our Environment

An improved environment supporting biodiversity.

Biodiversity & Conservation

The Company has made a commitment, as part of our Outcomes, to support conservation and biodiversity.

As part of this commitment to our environment, we employ an Environment & Biodiversity Specialist to;

- Enable the business to ensure that we are aware of all environmental constraints when we plan new schemes.
- Provide advice to our engineering teams on all aspects of environmental legislation and biodiversity.
- Work with our operational sites, to ensure that we manage the habitats in a way that protects, and where possible, enhances their biodiversity potential.
- Ensure that we have up to date ecological survey information for all our sites so we can protect habitats and species likely to be present.
- Identify and manage projects to protect and enhance biodiversity.
- Liaise with external stakeholders on related issues such as providing 'stepping stones for nature'.

Following the Ofwat price determination we have increased our budget in this area in order to undertake more conservation and biodiversity projects.

During 2015/16 we used a specialist consultant to perform new ecological surveys across 52 of our sites. This has helped us to produce a priority list of biodiversity actions.

During the winter of 2015/16, following consultation with Natural England and our Customer Challenge Group, we completed a number of high priority conservation projects.

- Restoration of chalk grassland on south facing slopes at our Farlington water treatment works by the removal of invasive non-native scrub. This will be an ongoing project for a number of years to ensure any regenerating scrub is removed.
- Replacement of fences and removal of scrub at Nore Hill reservoir (which is no longer in operation) to facilitate sheep grazing. This will help us restore the chalk grassland habitat. The grazing will keep the grass short and inhibit scrub regeneration, which benefits wild flowers such as orchids and butterflies.
- Removal of scrub at the Fort Southwick Reservoir site to restore chalk grassland and provide sheltered bays for butterflies and other insects.
- Working with the National Trust and a local bat specialist, to open up the abandoned underground reservoir at Slindon to establish whether it may be suitable for a bat roost / hibernation site.

In addition the following projects were also completed in 2015/16;

- A river restoration project on the River Ems as part of our National Environment Programme commitments.
- Bat surveys undertaken by a Hants & IOW Wildlife Trust specialist at 5 Portsmouth Water buildings known to house bat roosts and 2 buildings identified as having a high potential for bat roosts.
- Comprehensive botanical surveys at 6 sites to identify priority habitats, provide detailed habitat maps, assess the current site management and make further recommendations.
- Woodland management at our Highwood Reservoir site.
- Removal of historic fly tipped waste from woodland at Itchen and Maindell water treatment works.
- Construction and erection of owl and kestrel boxes at a number of sites.
- Purchase of bat boxes and bird boxes for smaller birds.
- Six volunteer staff conservation working parties undertook a range of projects.

After many years of decline, the British Barn Owl population is now thought to be slowly increasing

A new home for Barn Owls

A pair of Barn Owls took up residence in the nest box in one of our disused buildings raising 3 chicks last summer. Barn Owls nest between March and August and lay small eggs, the female normally does all the incubation and once the eggs have hatched she continues brooding the young for about 3 weeks.

As Barn Owls are a Schedule 1 protected species the National Trust arranged for their licensed expert to check the box and ring the chicks before they fledged. They found 3 healthy chicks in the nest box, two male and one female. The female chick was slightly larger.

On average a wild Barn Owl eats about 4 small mammals per night. Thirty owl pellets were collected from below the nest box. The local Wildlife Trust used these at an environmental education event for youngsters. They dissected the pellets to identify the bones of at least 79 small mammals of 7 different species including; harvest mice, shrews, house mice, wood mice and voles.

There were two birds in the building in February 2016 and we have our fingers crossed that they will stay and nest in our box again. For more information on Barn Owls visit www.barnowltrust.org

Strategic Report

Our Environment

The Company is committed to ensuring a sustainable water supply for its customers now and into the future

Water Resources

The Company is committed to ensuring a sustainable water supply for its customers now and into the future. We work closely with our key stakeholders such as the Environment Agency to ensure that the water we abstract remains within our licence terms and does not damage the environment. During the year we worked with local land owners to help improve the environment including the scheme at the River Ems described on the next page. The Board continues to focus on the risk that growth in populations and climate change could impact on water resources. This risk is discussed further on page 28.

In 2014 the Company published its Water Resources Management Plan (WRMP). The WRMP focuses on the factors that will impact future demand for water including climate change and population growth. It identifies whether the Company will have sufficient water resources over the next 25 years to meet this demand. In its plan the Company is projecting a water resource surplus in the period to 2040. Consequently, the Company has been approached by two neighbouring water companies to provide bulk supplies of water to meet their needs and these have been included in the Plan.

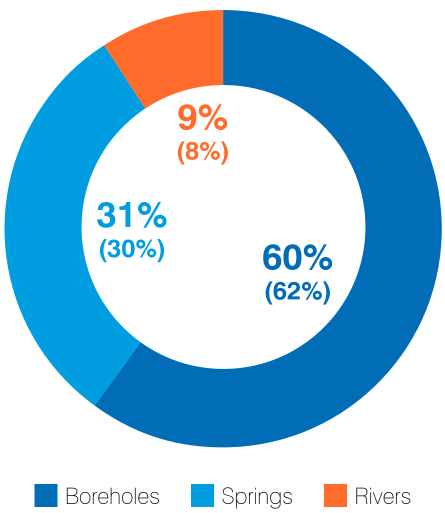
The Water Resources in the South East (WRSE) group, led by the Environment Agency and comprising seven water companies, has been investigating the potential for regional solutions to meeting the water needs of South East England. This may require further schemes, such as the Havant Thicket reservoir, to be commissioned in the Portsmouth Water area in order to provide a long term sustainable water supply to other communities in the South East.

On average, each day the Company supplies approximately 166 million litres of water. The chart below shows the major sources used by the Company during the year.

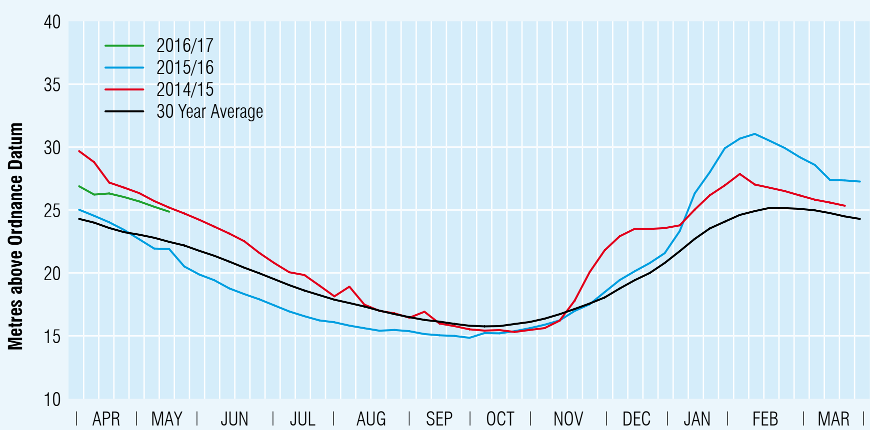
Water Resources - Outlook for 2016

91% (2015 - 92%) of water supplied to customers is from groundwater springs and boreholes 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 levels at Idsworth Well, Rowlands Castle. The Company has not had to impose restrictions on our customers since 1976 and, as a result of the current groundwater level, it is unlikely to do so this year. Groundwater levels at the end of April 2016, were above the long term average as outlined on the graph below, which includes the thirty year long term average at the end of April 2016.

Abstraction Sources 2015/16 (2014/15)



Trends in Groundwater Levels



River Ems Restoration Scheme

As part of the National Environment Programme Portsmouth Water were asked to improve the River Ems for fish and invertebrates. This has been done by a combination of river channel improvements and a variation of an existing abstraction licence.

The river channel at 'Deepsprings' was too wide and straight for a chalk stream. This reduced the ability of the river to remove silt and limited the development of plants such as Water Crowfoot.

In association with the Arun & Rother Rivers Trust, and the Wild Trout Trust, we re-modelled the river bank and created a series of pools and riffles. Fencing has also been provided to prevent cattle from trampling the new river banks.

In addition to our scheme, additional river restoration work has been carried out downstream. This included weir removal, channel improvements and additional fencing. It is anticipated that a greater length of river will now be used by migratory fish such as Sea Trout and Salmon.

To support this restoration a licence variation is currently with the Environment Agency for approval and will provide an increased volume of augmentation water discharged further upstream. This water will flow through the 'Deepsprings' section of river and ensure that the improvements are sustainable under dry conditions.

It is anticipated that a greater length of river will now be used by migratory fish such as Sea Trout and Salmon

Strategic Report

Our Business

The year ended 31 March 2016 was the first year of the current Ofwat regulatory review period. Ofwat's determination for 2015-2020 set our allowed income from customers when we committed to keeping customer bills flat in "real" terms.

Ownership structure

The ownership structure of the business is unique within the industry, with the majority of the shares being owned by an Employee Benefit Trust (EBT) on behalf of the employees. The Board believes that this structure ensures that we are able to take a long-term view on the business without being pressurised to provide unsustainable dividend growth.

We feel that this structure also helps to align the interests of employees and customers in the long-term – with the vast majority of our employees also being customers. Further information on the group structure is set out in page 35.

Financing structure

Since 2001 the Company has largely been a debt financed entity. An index linked fixed interest loan with a base value of £66.5m was drawn in 2002, with inflation risks on the cost of the loan being effectively hedged against regulated revenues which are also linked to the Retail Prices Index (RPI). Interest is charged at a fixed rate of 3.635% on the indexed amount of the loan. The indexed carrying value of the loan at 31 March 2016 was £97.7m (2015 - £96.7m).

Gearing and liquidity

Net debt to regulatory capital value is a key covenant defined by the Company's index linked loan documents. Gearing at 70.2% (2015 - 72.4% restated) improved as a result of improved cash balances. The 2015 position has been restated as a result of an adjustment to RCV by Ofwat at the Final Determination which came into effect on 1 April 2015. This improved the ratio from 80.0% to 72.4%. This remained comfortably within the 86% ceiling imposed by the bond covenants.

As a consequence of this improved cash flow the Company did not utilise any of the £4m committed overdraft or £10m revolving credit facility both with Lloyds Bank. These facilities, are used to manage day to day working capital and the expected working capital peaks driven, primarily, by the profile of spend in connection with significant capital programmes. They are renewable annually and in May 2018, respectively.

The Company has concluded that it has adequate funding to meet both ongoing working capital requirements and the needs of the planned capital investment programme over the 4 remaining years of the current regulatory period.

Interest cover

The interest cover ratio, defined by the covenants associated with Company's index linked loan, of 1.96 times (2015 - 1.80 times) remains comfortably above the 1.4 times covenant required. The improvement reflects improved operating profit due to lower infrastructure renewals spend in the year which is expected to reverse in 2016/17.

Return on regulatory equity (RoRE)

This is the primary ratio used by our equity shareholders and has been revised to reflect the impact of FRS 102 which eliminates 'infrastructure renewals accounting' (see note 30). The improvement from 5.1% to 9.3% reflects the impact of lower infrastructure renewals activity in the year.

New UK GAAP

During the year the Company adopted FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (typically referred to as "new UK GAAP". Detailed information in respect of the adjustments made as a result of this standard are set out in notes 1 and 30 of the financial statements. The most significant impact is as a result of the removal of "infrastructure renewals accounting" previously permitted by FRS 15. This had a net impact on fixed assets of £21.3m at 31 March 2015 of which £0.8m reduced operating profit.

Review of trading performance

Operating Profit

Operating profit at £8.2m shows a significant £1.5m increase on the prior period of £6.7m. This was primarily driven by a £1m increase in turnover and a reduction in infrastructure renewals charged to the income statement of £1.9m. This was offset by a number of one off costs and is discussed further below;

Revenue

The £1m increase in turnover was largely driven by average tariff increases of 2% and 2,300 new properties.

Operating costs

Total operating costs fell by £0.6m which resulted from a number of movements.

During 2015 the infrastructure mains renewals contract was re-tendered and transferred to a new contractor. As a result of this change the Company anticipates significant savings over the 5 year Business Plan period. As is normal in these cases, the change-over of contractor resulted in a slow-down in renewals activity during 2015/16. This, together with the lower cost per kilometre of mains renewed, resulted in a £1.9m reduction of renewals expenditure from £3.7m to £1.8m.

Under the new Ofwat regulatory Outcome Delivery Incentive Mechanism (page 7) we have provided £0.3m in connection with penalties as a result of a failure to meet a water quality metric. This is discussed further on page 13.

Two activities in the period have resulted in additional one off accelerated depreciation charges of £0.7m. In preparation for the implementation of the Company's new end-to-end ERP IT system (in 2016/17) we have undertaken a review of the fixed asset register. In addition the two UV plants developed during the year will result in a number of redundant assets once commissioned, on which depreciation has been accelerated.

Headcount in the business has increased from 246 to 251 reflecting operational requirements, the increased effort required to meet the requirements of the Retail Competition and the development of and preparation for the new IT system. This, together with the annual salary increase of 2.3% and increased pension costs of £0.2m have resulted in increased employee costs of £0.6m.

These have been partially offset by business-wide operational savings.

Interest & other finance income

Interest payable shows an overall reduction of £1.3m which is primarily due to £1.4m lower indexation on the £66.5m index linked loan driven by RPI levels.

Other finance income reflects movements in the net pension scheme position and is set out further in note 25.

Taxation

The tax charge in the period of £0.7m includes a current tax charge of £1.2m and deferred tax credit of £0.5m. The increase in current tax in the period of £0.8m is as a result of higher profit chargeable to corporation tax. This was primarily driven by lower infrastructure renewals spend of £1.8m (2015 - tax deduction of £5.3m) with a tax effected impact of £0.7m. Deferred tax charges reversed primarily as a result of the cumulative reduction of the effective rate of tax from 21% to 18%.

Dividends

The dividends paid during the year totalled £1.2m (2015 - £0.8m). Dividends are paid up to the parent company with part of the payment being used to service interest payments on an inter-company loan of £0.7m (2015 - £0.4m) with the balance being paid as a dividend to the Group's shareholders.

The Company's dividend policy aims to show sustainable growth in real terms and is based on a 1.65% growth rate. The final dividend proposed for the year is £0.6m.

Capital investments

Gross capital investment in the year was £9.3m (2015 - £5.8m).

Mains activity

	2015/16 £m	2014/15 £m
Renewals charged in the income statement	**1.8**	3.7
Enhancements capitalised	**1.7**	2.1
Total mains investment	**3.5**	5.8

During the year the Company renewed 11.6km of mains at a cost of £1.8m (2015 - £3.7m). In accordance with the requirements of FRS 102 this cost is not capitalised and is charged to the income statement as an operating cost. In addition a further 16.8km, £1.7m of new mains and enhancements to the network were capitalised (2015 - £2.1m).

Major capital schemes

As the first year of the 5 year regulatory business cycle the Company began the programme of capital schemes that were agreed in the Business Plan. The most significant schemes related to the new UV treatment plants £3.1m and a further £1.0m related to the replacement of membrane filters.

Capital contributions

The Company receives capital contributions, primarily in connection with new mains for housing developments, which amounted to £1.2m (2015 - £1.3m). In accordance with the requirements of FRS 102 these contributions are deferred and amortised to the Income Statement.

Depreciation charges for the period increased by £1.0m from £5.1m to £6.1m. This was impacted by additional accelerated depreciation charges of £0.7m noted above.

Cash and Cash Flow

Cash generated from operations of £13.7m is higher than the prior year (2015 - £11.9m). This was driven by lower infrastructure renewals expensed of £1.9m. Year on year payments in connection with fixed assets increased by £3.0m, dividend payments increased by £0.4m, net repayments of loans fell by £2.3m. The year end cash balance was £9.2m (2015 - £6.8m).

Pensions

The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest actuarial valuation as at 31 March 2016 was carried out in accordance with FRS 102 and shows a net pension asset (after deferred tax) of £14.6m (2015 - £9.0m). The overall increase in the surplus on actuarial valuation has largely been driven by improvements in AA corporate bonds.

Financial Viability

The Company's financial position is set out in the financial statement on pages 53 to 74, including cash flows, liquidity position, borrowing facilities and loan maturities. The Strategic Report, on pages 6 to 31, also covers aspects such as the overall financial performance and financial risks. Finally the Viability Statement on pages 30 and 31 sets out the factors considered and the conclusions reached by the Board in assessing both the going concern of the business over the period of 12 months from the balance sheet date and the prospects over a longer period of just under 4 years to the end of the current Business Plan.

The Company's current bankers are Lloyds who provide a committed £4m overdraft facility and a £10m revolving credit facility details of which are set out above.

The Company's financial projections, taking into account expected trading expectations, indicate that the Company is forecast to operate comfortably within the levels of our current facilities. Accordingly the Directors have concluded that there is a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. Accordingly they continue to prepare the accounts on a Going Concern basis. Further detailed information in relation to the assessment process undertaken by the Board is set out in the Viability Statement on pages 30 and 31.


Portsmouth
Water

Strategic Report

The Issues That Affect Us

There are many external issues that impact our business. These shape our business decisions, risk profile and strategy. Set out below are the four key issues likely to impact the business over the next 5-10 years.

Regulation

The water industry is highly regulated (see page 27 for further information). The Regulatory environment continues to become more complex and challenging and this increases both the compliance burden and costs of addressing new regulatory requirements. Ofwat is our economic regulator and determines the prices we set for our water bills. We have just completed the first year of the 5 year price review period.

The Environment Agency ('EA') controls the amount of water that we are allowed to take from the Environment. We work closely with the EA in developing our water resources management plan; currently our plan indicates that we have sufficient water capacity to support a resilient supply network. Current proposals in respect of the reform of abstraction licences is an area of significant concern for the business.

The Drinking Water Inspectorate sets the standard for the quality of water that we supply to our customers and sets the standards required. Of late we have seen continuing tightening of the drinking water standard for lead. The majority of lead pipework within the network is in customers' properties and therefore difficult to influence. This continues to result in increasing challenges for the business.

Competition

The Water Act 2014 included the legislative changes which will enable a competitive market for retail water and sewerage services for commercial (non-household) customers. The intention is that a new retail market will begin operating in April 2017. This means that from this date commercial customers will be able to choose their water retailer across England. Portsmouth Water will continue to supply drinking water to all customers (see What We Do on page 7).

The Company has been working towards the opening of this market, which involves significant effort in preparation of systems, processes and data requirements. We remain confident that we will be ready for planned market opening in 2017 and compliant with the key requirement of a "level playing field".

In preparation for market competition the Board closely reviewed the Company's strategy, particularly in light of the cost/benefits involved. As a consequence of this strategic review the Company announced the decision to undertake an arrangement with Castle Water to provide billing and associated services for our business customers, prior to an eventual exit from the non-household retail market.

From 1 April 2016, Castle Water, a specialist business retailer already operating in the Scottish water market, took over billing, call handling and other retail activities for our business customers. Initially this is performed on behalf of Portsmouth Water with a view to Castle Water taking over these customers from April 2017 when the competitive market is expected to open.

In December 2015 the Treasury announced the desire to open household customers to a competitive market. This matter is currently under consideration with a view to a decision being made in late 2016. The Company has already signalled its intention to be fully active in a household retail market should one develop.

Resilience of Supply

The South East of England faces the dual challenges, in both the near and long term, of continued population growth and limited water resources. In terms of water resources, the area as a whole is seen by the EA as one of water stress. Predictions also suggest that this part of the UK may be dis-proportionately impacted in the future by climate change.

As a result of these pressures, the Company continues a focus on balancing supply and demand for water, in order that generations in the future will continue to benefit from a secure supply of clean water at affordable prices.

At present Portsmouth Water is in a positive position of having sufficient water supplies. In the future, this could be utilised for the benefit of the wider South Coast area, by investment in the building of Havant Thicket reservoir. This significant 10 year programme would require a highly collaborative approach between water companies and regulators in order to fund and develop. In the meantime, we continue to invest in schemes to maintain and enhance the resilience of our supply network and to promote water efficiency amongst our customer base.

Affordability

Despite general improvements in economic conditions, the UK continues to see a rise in levels of household debt for lower income families. Across the industry, trends show both increasing levels of overdue and bad debt and greater numbers of applications for reduced tariffs. In addition, both Government and Ofwat have clearly signalled the need for a more proactive and targeted approach to both identify and support those household customers in greatest need of support.

To date, the approach taken by water companies, including Portsmouth Water, has been to work with charities such as The Citizens Advice Bureau, StepChange, Christians Against Poverty, National Debtline and The Money Advice Service and to offer reduced tariffs and other forms of support. For the main part these have relied on the customer to apply for such schemes. However, the future is likely to bring a step change where companies must be both more proactive in identifying customers with affordability issues and better collaboration to support customer groups with vulnerabilities. This is likely to bring significant challenge in terms of how these issues can be addressed practically by water companies and how they will be funded.

Strategic Report

The Issues That Affect Us

Our Stakeholders

Our Customers and our community

Customers are at the centre of our business. Our mission statement describes what our customers expect of us and we are continually reviewing the service we provide and how we can improve it. We supply water to over 296,000 households and 18,000 businesses. This number increases each year as we work with housing developers to ensure they can build and serve significant housing plans for the area.

We are an integral part of the local community; proud of our close ties with the community we serve, having supplied drinking water for almost 160 years.

- Most of our employees are from the local area.
- We have a partnership with a local Country Park, contributing to an education centre which introduces children to the importance of fresh water, how it is delivered and why we must use it wisely. To date, over 10,000 children have visited the centre.
- We have been actively involved in schools and have attended and sponsored local science fairs for many years.
- The Company participates in PUSH, The Partnership for Urban South Hampshire, which seeks to encourage local development in a sustainable manner.

Customer Challenge Group

In 2012 we established our Customer Challenge Group ('CCG'), which includes a range of stakeholders and customers. This is a forum initially established to ensure the Company built a business plan based upon high levels of customer engagement and provided a challenge to the Business Plan submitted to Ofwat. We undertook significant customer research where customers told us their expectations of us as a business and this was the foundation of our Business Plan. It is a key part of the Company's governance in respect of our performance against the Business Plan over the 5 year regulatory cycle.

The Group is chaired by an independent member of the public whose responsibility is to represent the customers and stakeholders to hold us to account on our performance.

Our employees

One of our primary objectives is that our employees return to their families at the end of the day without injury and customers are safe when we are working near their homes or when they are near our sites. The Board of Directors see Health and Safety as a key priority of the business and they ensure:

- The safest possible environment for our employees, visitors and general public.
- Continual review of all our operational practices from a health and safety perspective

We must make sure we provide an attractive remuneration package for our staff. We are located within the South East of England with a relatively dynamic labour market, with low unemployment. We offer an attractive package including life assurance cover and entry to a pension scheme.

Finally we invest in our people, offering all of our staff development opportunities to reach their potential. This includes degrees, NVQs, professional qualifications and relevant courses.

Our investors

Like all businesses we need to generate sufficient profits to provide a fair return to shareholders and meet the interest cost of our borrowings.

The major shareholder in the Company is an Employee Benefit Trust (EBT) which acts on behalf of our employees who receive payments as a result of this shareholding. The EBT has told us that they want to see us maintain the current level of return provided to them and they expect a reasonable small real annual increase in the level of dividends.

Our main source of finance is an index linked loan which has conditions which require a certain specified level of financial performance. The conditions also stipulate that the Company has to take all reasonable steps to maintain an Investment Grade credit rating. This rating demonstrates to lenders that we can meet our interest payments and allows us to secure borrowing at reasonable interest rates.

Our suppliers

Suppliers and the overall supply chain are key to enabling the business to successfully function operationally, financially and environmentally. This supply chain is diverse in nature ranging from the pipe and fittings that supply the water to our Customers, to the pumps and the electricity that powers them and to the chemicals that are used to treat the water. In addition there is a significant range of supplied items and services that enable both the supply of water and the overall functioning of the wider business.

We have always strived to deal with our suppliers on a professional partnership based approach; helping to ensure that we receive quality products and services and that our suppliers feel valued and are paid a fair price. During the year this principle has been cemented with the new mains laying contract which operates on a fully collaborative working basis. This includes common shared goals & behaviours and co-location.

Company collaborative working has been extended to other water companies and has enabled "benchmarking" of some internal operations and an increasing number of joint contracts with suppliers.

The CCG Chairman's Note

I was appointed Chair of the CCG in October 2015. The CCG was established to ensure that customers' views were appropriately reflected in the Business Plan. Since the start of the year the role continues in a monitoring capacity to review both the Company's performance against the Outcomes and the ongoing engagement with customers.

The Company's Board have engaged in an open and transparent manner with the CCG and have provided both quantitative and qualitative information to the CCG. In addition the Company has consulted on and developed a Monitoring Framework, as per Ofwat guidance, to provide greater assurance on published Performance Measures.

Portsmouth Water has a number of touch points with its customers and continues to evolve its plans and approach to customer engagement. The CCG has contributed to this dialogue and will work closely with the company to develop the overall strategy, actions and timetable.

The use of metering will provide significantly greater understanding of the usage patterns of customers and has the potential to improve the utilization and reduce waste. However, at the current time the take-up of metering has been disappointing and the CCG encourages the Company to focus further in this area.

Lakh Jemmett
CCG Chair

Our Regulators

Defra set policy for the water industry. These policies, such as the development of competition for non-household customers and water abstraction reform, are then implemented by individual regulators.

The Water Services Regulation Authority, or Ofwat, is the body responsible for economic regulation of the water and sewerage industry in England and Wales. Ofwat is primarily responsible for setting limits on the prices charged for water and sewerage services, taking into account proposed capital investment schemes and expected operational efficiency gains.

The Drinking Water Inspectorate regulates the public water supply companies in England & Wales. Its remit is to assessing the quality of drinking water England and Wales, taking enforcement action if standards are not being met, and appropriate action when water is unfit for human consumption. It is also responsible for reporting on drinking water quality to the European Union.

The Environment Agency is a non-departmental public body with responsibilities relating to the protection and enhancement of the environment in England. The Environment Agency set the volume of water that we may extract from the environment.

Natural England is the non-departmental public body responsible for ensuring that England's natural environment, is protected and improved. Natural England monitor the way we maintain and operate our sites to ensure we enhance the local environment. We have been complemented for the improvement in the management of our sites by Natural England and in particular the Site of Scientific Special Interest on the River Itchen.

The Consumer Council for Water (CCWater) is the independent voice for all water consumers in England and Wales. It was established to provide consumers with strong representation. It provides free advice to consumers and keep them informed on the issues that affect their water and sewerage services. CCWater monitor the quality of the service we provide to our customers.

Strategic Report

Principal Risks and Uncertainties

Effective risk management is critical to the achievement of our strategic aims and customer Outcomes. As a company risk management is embedded in our day to day activities and use a range of formal and informal processes to keep risk at the heart of what we do.

Risk category	Description	Potential impacts	Nature	Likelihood	Impact
Our customers					
Operational	The significant loss of treatment works or failure of critical parts of the mains network	Failure to supply customers over an extended period.	Operational Reputational Financial		
Water quality	Failure against drinking water quality standards.	Water not fit to drink.	Operational Reputational		
Business continuity	Scenarios for loss of major business elements such as key operational sites, power, telecoms, IT, personnel.	Adverse impact on ability to carry on normal business activities. Potential impact on ability to supply services to customers and ultimately potential impact on business viability.	Operational Reputational Financial		
Our people					
Human resources	Loss or shortage of critical skills, company knowledge or operational capacity. Possible over reliance on key individuals.	Adverse impact on ongoing operational activities. Poor business decision making due to lack of knowledge or experience.	Operational Reputational		
Health & Safety	Failure to maintain appropriate health and safety standards.	Serious injury or death of employee or contractor. Prosecution by HSE.	Reputational		
Our environment					
Environmental	Reduction in water abstraction licences due to EA reform. Climate change and population growth increases demand. Damage to the environment.	Inability to provide a sustainable supply of water to the population. Impact on habitats and biodiversity.	Operational Reputational Financial		
Our business					
Financial	Liquidity, solvency, capital risk and credit risk.	Insufficient funds or facilities to finance capital programme, service debt or for day to day operating cash flow requirements. Breach or financial covenants and or breach of licence conditions for financial viability. Inability to pay dividends. Inability to recover revenue due to increasing bad debt driven by socio economic conditions.	Financial		
	Exposure to increasing costs or other financial loss reduce the financial viability of the Company.	Significant costs, such as power or interest expense, cannot be controlled and result in trading losses. Unexpected events, such as significant claims against the Company result in significant costs.	Financial		
Regulatory	Regulators' actions have an adverse impact on the business. DWI and EA related regulatory impacts are considered under Water Quality and Environmental risks.	Failure to meet customer service standards or Outcomes agreed with Ofwat may result in penalties. Unexpected changes in the Ofwat regulatory approach.	Reputational Financial		
Legal & governance	Failure to meet our legal obligations particularly licence conditions and data protection. Lack of appropriate Governance.	Prosecution or fines as a result of company failure. Significant adverse publicity and loss of reputation.	Reputational Financial		
Competition 'Open Water'	Adverse impact on business performance due to the introduction of competition.	Inability to meet the requirements of the competitive market before or after market opening. Adverse financial impact due to increased compliance costs.	Reputational Financial		
IT	Significant successful cyber-attack on the Company	Loss of critical computer systems result in failure to operate the business as usual.	Operational Reputational Financial		

Likelihood of occurrence
Low Medium High

Impact of occurrence
Negligible Moderate Serious Catastrophic

The table on pages 8 to 9 sets out how the principal risks and uncertainties identified relate to the Company's business objectives and reporting KPIs. We have summarised in the following table an overview of our risk management priorities. This summarises the type of risk, explains the likely impact and summarises the mitigations (plans, controls and actions) in place. It also provides an indication of the likelihood and potential impact of each risk occurring, together with the Board's assessment of the trend (increasing, decreasing or stable). In each category the level of required mitigation and control is determined by the Company's risk tolerance. On an annual basis the Board reviews its tolerance for risk and sets appropriate levels.

Further information on the Board's approach to risk is set out in the Corporate Governance Report on page 39.

Trend	Mitigation/Control
↔	- The supply network has been developed to connect different supply areas, such that in most situations water can be transferred to compensate for a failure at a treatment works or in the network. - A fully documented Emergency Plan which is initiated in the event of a major incident. - Employment of modelling, telemetry and monitoring to assess the resilience of the network.
↔	- A Drinking Water Safety Plan which identifies the potential risks throughout the supply process. - A rigorous sampling regime in accordance with statutory legislation together with 24 hour monitoring and response - We maintain two days storage of treated water in service reservoirs to provide sufficient time for any water quality issues at treatment works to be addressed. - Membrane filtration at five treatment works considered most at risk from cryptosporidium. Ultra violet treatment plants currently being built at two higher risk sites.
↔	- Defined and documented Emergency Plan in place which utilises Drinking Water Safety Plan (DWSP) risk assessments. - Business continuity planning processes. See also IT risk mitigations. - Appropriate insurance cover.
↔	- Investment in a programme of employee development and cross training and collaborative working with other water companies. - Regular succession planning reviews at the Board level and Non-Executive Directors with appropriate, relevant skills mix. - Control procedures and policies in place to ensure that all relevant legislation is complied with. - Appropriate use of contractors and consultants to support the business needs.
↔	- Culture of health and safety awareness and "zero tolerance" policy lead from the Board down including a Health and Safety Committee. - Risk assessment, training and inspections embedded in the business. All incidents reviewed for lessons learned.
↑	- Detailed modelling and studies in order to assess and understand the future balance of supply and demand. - Monitoring and modelling in order to identify the impact of abstraction at certain sites; identification and implementation of mitigating solutions. - Biodiversity surveying and specific schemes to support and enhance biodiversity.
↔	- An appropriate capital structure with a mixture of cash, debt and equity together with appropriate credit facilities. - Effective processes of budgeting for costs and cash flows. This includes close monitoring of headroom against financial covenants and stress testing. - Mitigation of significant costs or claims (see below) - Utilisation of all appropriate means of debt collection, including the use of a dedicated debt recovery section and collection agencies. - Plans for the implementation of a "social tariff" for our financially vulnerable customers.
↔	- An effective system of internal controls together with a process of budgeting and forecasting to manage the underlying cost base. - Energy represents around 9% of operating costs. An energy broker us used in order to manage exposure to power costs and price fluctuations. - Both interest payments and revenue are currently linked to RPI and therefore provide a natural hedge. - The contract for mains renewals activities was recently re-negotiated to manage this significant cost and service. - Comprehensive insurance cover for a range of risks, including damage to property, public and employee liability, fraud and terrorism.
↑	- The 5 year price review is conducted in an open and transparent manner and the Company actively participates in the process. - Performance against regulatory targets is reviewed on a monthly basis by the Board or the Executive Directors. - Close engagement with Ofwat through consultation processes, workshops and industry groupings.
↔	- Corporate Governance code and authorisation framework which is reviewed annually. Monitoring of legal and governance areas. - Appropriate levels of insurance cover such as Public Liability insurance. - Close monitoring of performance against licence conditions through KPIs. A clear data protection policy.
↑	- A transparent Governance process around the Company's strategy for "Open Water". This includes Board sponsorship, an Open Water Steering group and clear managerial responsibility. Strategic decision to exit the Non Household retail market; reduces compliance burden and costs. - Open Water risk register and traffic lights and actions prepared and reviewed monthly at Steering Group and Board level. - External assurance in relation to Open Water progress.
↔	- Third party end to end threat monitoring and alert services are used to promptly identify and respond to cyber threats. - Standard operating procedures such as regular back-ups held off site. Duplicate IT infrastructure held in a secure off site location. - A clear disaster recovery programme in place to enable us to continue working should the systems fail.

Strategic Report

Viability Statement

The Board has assessed the prospects of the Company over a period greater than one year.

Background information

The Company's business model and strategy are central to an understanding of its prospects, further explanation can be found on page 6. As a regulated, capital intensive, utility provider the nature of the Company's activities are long-term and, although subject to some regulatory changes, the business model is generally stable. The Company's current overall strategy, budget and cash flow projections are intrinsically linked to the Ofwat 5 year regulatory review cycle. Consequently, the 5 year regulatory Business Plan (which runs from 1 April 2015 to 31 March 2020) and the related Ofwat Final Determination are the primary drivers for the Company's future prospects. The Final Determination sets out the allowed revenue, operating expenditure, capital expenditure and agreed business Outcomes for the 5 year period. More information in respect of the regulatory regime is set out in pages 25 to 27.

The Board continues to take a conservative approach to the Company's strategy. The business' focus is largely on delivering the agreed regulatory Outcomes within the costs set out in the Ofwat Final Determination. Decisions relating to major capital schemes, water quality, resilience of supply and changes to the business strategy are made with a low tolerance for risk. In particular, the Board has considered the changes in the risk profile of the Company resulting from the introduction of retail competition in the non-household market from 1 April 2017. It has approved a change in business strategy, to dispose of the non-household retail business, in order to manage the business risk in respect of this change.

The assessment process of the Company prospects

The Company's prospects are assessed, primarily, through its budget process and performance against regulatory Outcomes. These are both closely linked to the 5 year financial position set out in the Ofwat Final Determination for the period 2015/16 to 2019/20 which drives the key budget assumptions.

The budget prepared included;

- Detailed budget analysis by department for the forthcoming (2016/17) financial period.
- Five year budget projections to 2019/20 comprising 1 year actuals, 1 year detailed budget and 3 years projections. These are compared against the Final Determination.
- Cash flow projections to 2019/20 (2 year detailed monthly and 3 year annual)
- Projection of key financial ratios including those required for banking covenants and to maintain an investment grade credit rating.

It also has regard to committed funding & liquidity positions and future funding requirements.

This assessment process involves an annual review of the budget (including financial projections through to the end of the current regulatory period) and related objectives, led by the Managing Director and Finance Director, through the Management Board. All Company departmental heads are involved in this review. A key part of this review is a comparison of the projected total operating and capital expenditure ("Totex") against that set out in the Ofwat Final Determination for the 5 year period. The Board participates fully in the annual process by means of the budget review and approval process, setting annual business objectives and the Board strategy day. The annual budget process was completed and approved by the Board during February 2016.

The key business assumptions in the budget related to;

- Increase in RPI (which drives tariffs and costs)
- Levels of capital and renewals spend and related efficiency and cost savings
- Salary increases
- Interest rates and loan indexation rates
- Levels of targeted cost savings

Alongside this, the Company also updates the analysis of significant risks that could prevent the budget and Outcomes from being delivered. The Board performs regular reviews of the principal risks and uncertainties and a formal annual review and a robust assessment was completed and approved in April 2016. Details of the principal risks and uncertainties are set out on pages 28 to 29 and details of the Board risk assessment process are set out on page 39. The purpose of the principal risks table is, primarily, to summarise those matters that could prevent the group from delivering on its strategy. A number of other aspects of the principal risks – because of their nature or potential impact – could also threaten the Company's ability to continue in business in its current form if they were to occur. This was considered as part of the assessment of the Company's viability, as explained further below.

The period of assessment

As set out above the Board conducted the assessment for a period to 31 March 2020; a period of just under 4 years. The Board considers that this period of 4 years to be most appropriate as it aligns to the end of the current Ofwat regulatory period. As set out above the Ofwat Final Determination and Outcomes are significant drivers of the business strategy & performance and accordingly also align to the Company's budgeting period. Whilst the Board considers 4 years to be an appropriate horizon to consider the continuing viability of the Company, they do consider the viability over a longer term beyond this period.

Assessment of viability

Although the budget reflects the Directors' best estimate of the future prospects of the business, they have also stress tested the potential impact on the Company of a number of scenarios. This has been performed by quantifying their financial impact and overlaying this on the financial forecasts. The potential impact has been considered in relation to operating profit, cash flow, liquidity and the key financial ratios needed for banking covenants and the retention of an investment grade credit rating.

These scenarios, which are based on aspects of principal risks and uncertainties set out in pages 28 to 29, represent 'severe but plausible' circumstances that the Company could experience.

The scenarios tested included combinations of the following:

- The loss of a combination of two critical strategic assets resulting in an in year unexpected cost increase of £8m.
- An in year unexpected capital outlay of £10m together with a £12m pension deficit arising.
- An upper limit capital expenditure test.
- Loss of a critical IT system for one month in combination with two different scenarios; i) loss of a significant treatment works; and ii) an in year unexpected capital outlay of £10m together with a £12m pension deficit arising.

In addition the Directors also tested a number of broad sensitivities including increase in interest rates, increase in costs and adverse movements in Retail Price Index.

In each case the availability and effectiveness of mitigating actions that could reasonably be taken to reduce the impact was taken into account. The primary mitigating actions relate to the use of available credit facilities, levels of insurance cover, the ability to defer capital and renewals spend and the discretion not to pay dividends.

The results of this stress testing showed that, due to the stability of the business, the Company would be able to withstand the impact of these scenarios occurring over the period of the financial forecasts by making adjustments to its operating plans within the normal course of business.

Viability statement

Based on their assessment of prospects and viability above, the Directors confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the four year period ending 31 March 2020.

Going concern

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

Directors' Responsibility Statement

We confirm that to the best of our knowledge:

- the accounts, prepared in accordance with the applicable set of accounting standards give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the report and accounts, taken as a whole, provides the information necessary to assess the Company's performance, business model and strategy and is fair, balanced and understandable; and
- the Strategic Report includes a fair review of the development and performance of the business, together with a description of the principal risks and uncertainties.

For and on behalf of the Board

N. Smith
Managing Director

27 May 2016

Corporate Responsibilty Statement

Affordability

In recent years the country has seen increasing levels of household debt. Accordingly the Company pays close attention to how we support customers who may be struggling to pay their water bill. We have a number of options available to support these domestic customers;

We introduced our Arrears Assist Scheme in May 2014. Through this scheme we encourage customers back into making regular payments by matching the payments we receive £ for £. We currently have about 250 customers on this scheme with nearly 100 having completed it. We have found the Arrears Assist Scheme has been successful in encouraging customers to engage with us about payment of their water accounts. It also enables us to better understand our customers' financial situation and the hardships they are facing.

Customers can also apply to be placed on the WaterSure Tariff. This tariff is for metered customers who are in receipt of certain benefits and have a medical condition that requires an individual to use more water or has 3 children under the age of 19 resident in the property. These customers have their measured bills capped at our average bill value. We will be launching a new "social tariff" to support those who find it difficult to afford their water bill, in July 2016.

We also operate a scheme called WaterDirect. Customers who receive certain benefits from the Department of Work and Pensions, and are in arrears on their bills, can request that water bill payments are deducted straight from their benefits.

Finally we have in house Visiting Officers whose role is to engage with hard to reach customers, and agree a repayment plan that fits a customer's financial situation. Our Visiting Officers will also discuss the repayment schemes above, water efficiency tips and may refer the customer to a Money Advice Centre if they believe this to be beneficial for the customer.

Compensation & Customer Charter

We operate a compensation scheme as part of our Customer Charter. This includes the service standards as set out in law, under the Guaranteed Standards Service (GSS) scheme. If we fail to meet any of the standards outlined in the GSS guidelines, customers are entitled to a compensation payment. The GSS standards cover the following areas;

- Making and keeping of appointments with customers
- Responding to account queries
- Responding to complaints
- Dealing with interruptions to the water supply (planned and unplanned)
- Levels of water pressure

Our Company Customer Charter is enhanced beyond the GSS standards. In addition to the GGS standards we will pay compensation if the water meter is not read at least once within a 12 month period. We also increase the compensation payment amounts beyond what is required in the GSS standards.

Energy Use and Carbon Emissions

In common with all water companies energy is a significant operating cost of the business accounting for 9% of operating expenses. The majority of our energy consumption and the associated greenhouse emissions relate to water pumping and treatment activities. Our gross greenhouse emissions for the year was 11,813 tCO_2e (2014/15 - 12,592 tCO_2e).

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

We continue to work proactively to develop sustainable solutions that minimise the impact on the environment and reduce our carbon footprint.

In our Business Plan, over the 5 year period from 2015/16 to 2019/20 we committed "to increase the percentage of energy obtained from renewable resources and, wherever practicable, to reduce electrical consumption delivering a more sustainable water supply service".

We address carbon emissions in a number of different ways;

- Operate solar arrays at 5 of our water treatment works.
- Purchase 100% of our energy from 'Green' energy sources (biomass).
- In June 2015 we completed our Energy Savings Opportunities Scheme (ESOS) in compliance with new legislation.

We will continue to investigate the feasibility of sustainable wind and solar energy projects and other renewable technologies where cost effective. We continue to work towards further reductions in our power consumption including;

- Enhancing telemetry controls monitoring power consumption.
- Targeting investment to optimise pump operation, reduce our base level power requirement and through life monitoring of pump efficiency.

This is the first year we have also participated in National Grid's Demand Side Balancing Reserve (DSBR) where we switch off our pumps during times of peak demand, to assist the Grid in balancing supply and demand in the UK.

Water Efficiency

Since 2010, when we started our Water Efficiency programme, we have distributed over 150,000 free water saving devices to our customers.

The Company continues to promote the benefits of saving water to our customers. We are constantly looking for new ways to encourage water saving. We promote ways to reduce water consumption through our website, free devices, community and school events and this year a team was set up to promote the benefits, financial and environmental, of a customer switching to a water meter.

Working in the Community

We have a long standing tradition of community involvement. Part of this work involves educating our community about the value of clean and safe drinking water and how this is delivered by us. Since 2004 we have had a successful working partnership with Staunton Country Park and for the past

	Units	*2015/16*	*2014/15*	*2013/14*
Electricity used	MWh	21,689	21,438	21,801
Gross greenhouse gas emissions	tCO_2e	11,813	12,592	11,389
Water delivered - Distribution input	Ml	60,880	61,597	62,583
Gross Greenhouse gas emissions per million litres of water delivered	**$KgCO_2$/ML**	**194**	**204**	**182**

20 years we have been sponsoring and contributing to the annual Education Business Partnership STEM Fair (Science, Technology, Engineering and Maths). This event gives hundreds of local school children the opportunity to see where their water comes from and discover the processes that are involved to achieve this.

In 2015 we were approached to take part in an exciting, award-winning event known as TeenTech, which involved a number of lively one-day events to help young teenagers see the wide range of career possibilities in Science, Engineering and Technology. We delivered an exhibition in the "Challenge Zone", where groups of children took part in an interactive activity to build and power their own water supply system. The display model was designed by a volunteer team of our employees.

Supporting Disability in the Workplace

The Company has adopted a policy which complies with the Disability Discrimination Act 1995. Every consideration is given to applications for employment from disabled persons, where the job requirements may be adequately covered by a person with a disability. Employees who become disabled during employment are given continued employment where possible and opportunities for training and career development are provided for all disabled employees.

During the year we came 3rd in the Hants and IOW Work Choice "employer of the year" awards. The work choice awards are for employers who have demonstrated exceptional commitment in creating opportunities and supporting those with disabilities in the workplace.

Catchment Management

The quality of the river, groundwaters and springs, from which we abstract, is largely determined by the way the surrounding land is managed. As a result of this, our approach to building resilience in water supply is to work in partnership with land owners, farmers and other organisations (for example the Environment Agency and Natural England) to reduce diffuse pollution. Improving the water quality in the natural environment is a more sustainable/economic approach than energy and chemical intensive water treatment.

For the 2015-2020 Business Plan period, there are two principal aims to our Catchment Management Strategy. The first is to better understand where and how pollutants originate and what are the best ways to address them.

The second is to continue our 'on the ground' work through the Downs and Harbours Clean Water Partnership. We established the Partnership in 2008 with Natural England and the Environment Agency. It's objective is twofold: to protect and improve the groundwaters, as well protect and enhance the wider water environment across and beyond our area of supply. This includes the western South Downs, Portsmouth, Chichester, and Langstone harbours, and the River Hamble.

The coming year will see the continuation of innovative research projects and field trials of pollution mitigation measures, together with the continued provision of free services and advice to land owners and farmers to reduce the adverse impact of diffuse pollution such as fertilisers and pesticides. This includes one-to-one expert advice in infrastructure improvements, pesticide handling, precision farming and soil management. This will help us deliver water quality improvements 'today' and shape our longer term Catchment Management Strategy through our next regulatory period for 2020-2025.

www.cleanwaterpartnership.co.uk/index.php/

WaterAid

The Company continues to support and promote the charity WaterAid to customers and staff. Over the last 30 years donations from our customers, together with fundraising efforts of our employees have raised nearly £500,000 for WaterAid. It is estimated the average cost is only £15 per person for supplying a safe water supply to a village, combined with sanitation and hygiene education for life.

Nature Conservation & Biodiversity

The Company is committed to ensuring compliance with all environmental legislation and obligations, carefully assessing the impact of its activities, especially construction projects on the environment, to ensure that the impact of such schemes is minimised.

Biodiversity

The Company has a statutory duty to consider conservation and biodiversity as part of our business activity. We operate in an environmentally sensitive area and we are committed to ensuring compliance with all environmental legislation and obligations, carefully assessing the impact of our activities on the environment, to ensure that the impact is minimised.

As part of our wider commitment to improving the environment, we aim to conserve and enhance biodiversity on the 44 operational sites we own. Sites are located in a variety of habitats including chalk down-land, river catchments and coastal margins. Habitat management plans have been agreed for all operational sites.

We own one Site of Special Scientific Interest (SSSI) at the Itchen water treatment works, which we manage in conjunction with Itchen Valley Country Park. Through a Natural England High Level Stewardship agreement we allow cattle grazing of the meadow to maintain the wet grassland habitat.

Key projects completed in 2015/16 have included;

- Chalk grassland restoration projects at three sites.
- A river restoration project on the River Ems.
- Ecology surveys undertaken at 52 sites, with full vegetation habitat mapping at 6 sites.
- Bat surveys at 7 buildings.
- Investigation of an abandoned underground reservoir to assess its suitability for conversion to a bat roost.
- Six staff volunteer conservation working parties.

Further information in relation to our commitment to biodiversity and the environment is set out on pages 18 to 21 "Our Environment".

Governance

Mike Kirk
Chairman
27 May 2016

Chairman's Introduction

We are committed to high standards of corporate governance and take the lead from those set out in the UK Corporate Governance Code and guidance issued by Ofwat. That guidance highlighted Ofwat's principles by which they believe Water Companies should deal with Board Leadership, transparency and governance. In 2014 the Company adopted its own Governance Code which can be found on the Portsmouth Water website.

I am pleased to confirm that we consider that the Company complies with the Ofwat principles in all areas with the exception of Board Composition. Our approach to this area is explained below.

Board Composition

The Ofwat principles suggest that independent Non-Executives should constitute the largest fraction of Directors. We currently consist of three independent Non-Executive Directors (including myself as Chairman) and three Executive Directors. I have the casting vote and therefore believe we still comply with the spirit of the proposal. In addition, discussion and approval of dividends is solely carried out by the Non-Executive Directors as the Executives are Directors of the Ultimate Parent and are prevented, by the Instrument of Appointment, from voting. The Non-Executives carefully considered this issue and believe the structure is appropriate. To increase our number would be an unnecessary expense and we believe it is important to have an Engineering and Finance Executive on the Board. Ofwat have confirmed that they are satisfied with this position.

Board Changes

I am delighted that Helen Orton joined the Board on 12 October 2015 as Finance and Regulation Director. Helen brings to the Board a strong financial background after many years working in a senior audit position at accountants, PricewaterhouseCoopers, coupled with detailed sector knowledge which will help us make the most of the opportunities ahead and to deliver against our Business Plan commitments.

Links

A copy of the FRC 2014 UK Corporate Governance Code can be found at: www.frc.org.uk/our-work/publications/corporate-governance/UK-corporate-governance-code-2014.pdf

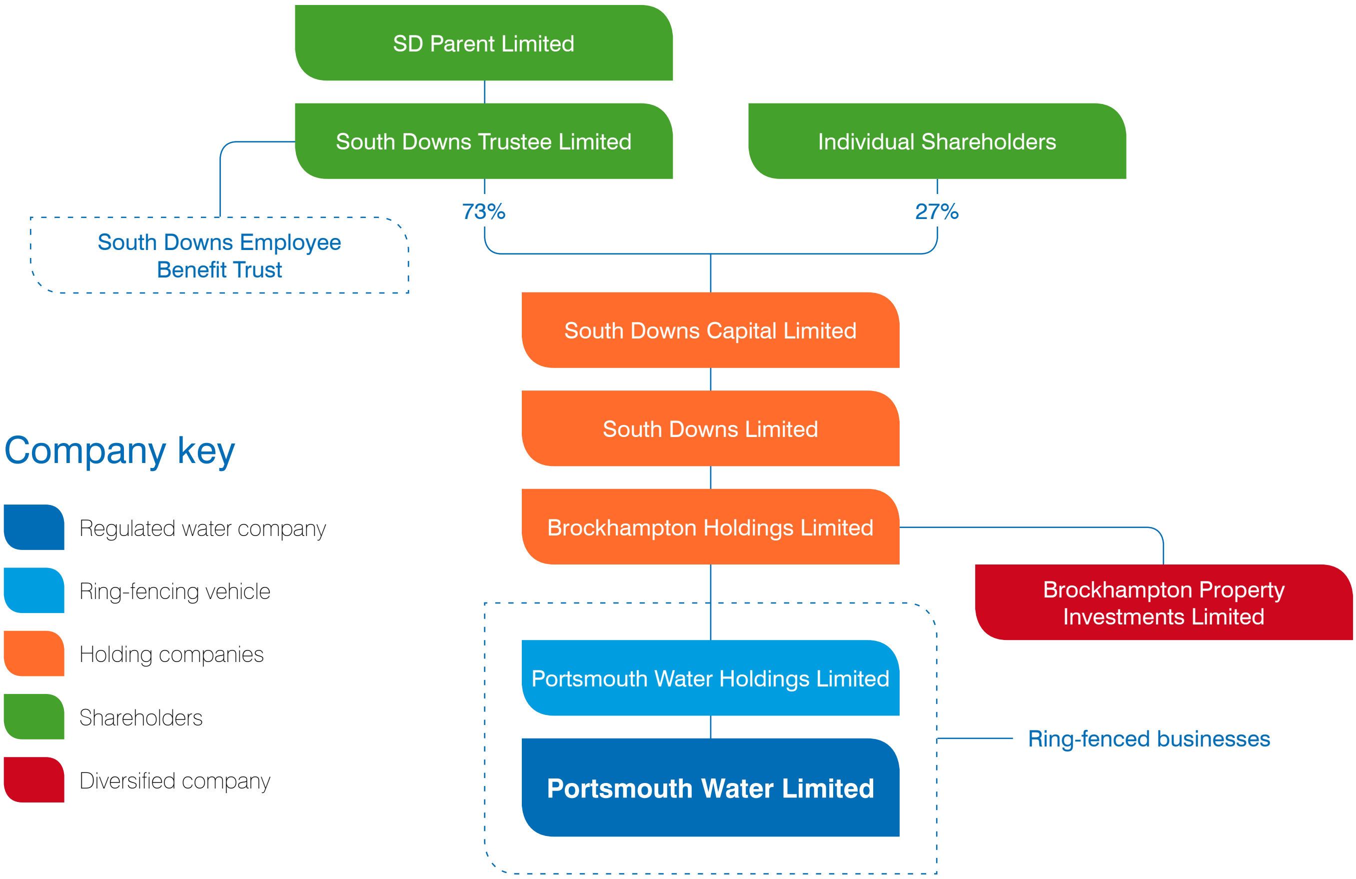
A copy of the Portsmouth Water Governance Code can be found at: www.portsmouthwater.co.uk/wp-content/uploads/2015/02/D67ZBEE-1EAZ-42F6-BE30-3D086D7COZCZ.pdf

Contents

Governance

Ownership Structure

The following chart shows the ownership of the Company and the Group Structure. Unless indicated, all companies are wholly owned by the parent company shown and all companies are domiciled in the UK for tax purposes.



Explanation
Portsmouth Water Limited is the primary trading company in the group and is included within the regulatory ring-fence as established by the Instrument of Appointment. The immediate parent of Portsmouth Water is Portsmouth Water Holdings, a company established in 2002 to protect the interest of Bond holders by exercising control over distributions.

We consider South Downs Capital Limited to be Portsmouth Water's ultimate holding company and ultimate controlling entity. Although the South Downs Employee Benefit Trust, through South Downs Trustee Limited, holds the majority of the equity shares and hence the majority of the voting rights, they are not considered to be in a position to exercise a 'dominant influence' over South Downs Capital Limited and nor can they appoint or remove the majority of the Board. Accordingly consolidated Group Financial Statements are prepared at the level of South Downs Capital Limited.

The corporate vehicle for South Downs Employee Benefit Trust is South Downs Trustee Limited. SD Parent Limited is a dormant company purely set up to hold and protect the shares of South Downs Trustee Limited. As such the financial results reported in the consolidated Group Financial Statements of South Downs Capital Limited would be no different if consolidated Group Financial Statements were prepared at the level of SD Parent Limited.

Financing
Portsmouth Water Limited is financed by way of an RPI indexed linked loan secured upon the assets of the Company. This thirty year £66.5m index-linked loan was issued in June 2002 and is repayable on 30 September 2032. The loan interest is calculated by adjusting the value of the loan by RPI and then charging interest on this amount at 3.635%. The current value of the loan is £97.7m (2015 - £96.7m).

Governance

Board of Directors

Executive Directors

Neville Smith (59)
Managing Director

Appointed to the board
February 1998

Qualifications
B.A., F.C.M.A.

Committee membership
Member of Nomination Committee

Experience
Neville was appointed to the Board of Portsmouth Water as Finance and Regulation Director in 1998. He was also responsible for Customer Service and IT activity. He became Managing Director in 2011 and is also a Director of the ultimate holding company, South Downs Capital Limited and is a Trustee of the Brockhampton Pension Scheme.

Neville is a Fellow of the Chartered Institute of Management Accountants and previously had 15 years' experience in the electronics manufacturing sector in finance positions at GEC, Smiths Industries Aerospace and Roxspur plc.

In 2015 Neville was the South East Area President of the Institute of Water.

Helen Mary Grace Orton (46)
Finance and Regulation Director

Appointed to the board
October 2015

Qualifications
B.Sc., F.C.A.

Experience
A Chartered Accountant and previously a Director with PricewaterhouseCoopers LLP. Helen has a broad range of commercial experience working with a wide range of listed and large companies. She has particular experience working with businesses in the Water Industry and other regulated industries including the development of Regulatory Financial Statements.

Helen joined the Company and was appointed to the Board in October 2015.

Roderic Colquhoun Porteous (59)
Engineering Director

Appointed to the board
May 2012

Qualifications
B.Sc., C.Eng., M.I.C.E.

Experience
Rod has a broad Water Engineering background with extensive operational, engineering design, asset maintenance, capital planning and customer service experience, gained previously with S E Water (SAUR Water Services) and other water companies and consultants including overseas appointments.

He joined Portsmouth Water in 1999 holding Senior Manager positions across a range of functions and appointed to the Board in May 2012.

Non-Executive Directors

Michael Peter Kirk (56)
Independent Non-Executive Chairman

Appointed to the board
November 2012

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

Committee membership
Chairman of the Nomination Committee, Member of Audit Committee, Member of Remuneration Committee

Experience
Mike is a Chemical and Nuclear Engineer, with extensive experience of long-life infrastructure design and project economics. He then moved into investment banking and had extensive experience advising water, power and gas utilities through several periodic reviews. Mike is Chairman of First Wessex, a large Housing Association in Hampshire and Surrey. He is also Deputy Chairman of a large UK Community Volunteering Charity, TCV, and Executive Chairman of a listed speciality Oil & Gas Business.

Heather Virginia Benjamin (58)
Senior Independent Non-Executive Director

Appointed to the board
November 2012

Qualifications
B.A., C.M.I.P.D., F.I.A.C.C.M., F.C.I.P.S., F.I.O.D.

Committee membership
Chair of the Audit Committee, Member of Nomination Committee, Member of Remuneration Committee

Experience
Heather is a procurement specialist. She held the executive role of Chief Procurement Officer at Centrica and has significant experience in managing supply chains, including outsourced partnerships. She has recently been appointed as Independent Director at Cheque and Credit Clearing Company and is also the Chair of Trustees for Walsingham Support, a learning disability organisation. She has combined her passion for music with her board role at Academy of St Martins in the Fields International Orchestra.

Martin Paul Johnson (43)
Independent Non-Executive Director

Appointed to the board
July 2014

Qualifications
M.Sc, C.Eng., F.I.MechE., B.Eng. (Hons), PRINCE2

Committee membership
Chair of the Remuneration Committee, Member of Audit Committee, Member of Nomination Committee

Experience
Martin Johnson is a Mechanical Engineer, a Fellow of the Institute of Mechanical Engineers and a Lean Six Sigma Master Black Belt, with experience in regulation, large capital programmes and customer strategy from BAA and BMI Healthcare. Martin brings board experience from his current role as Chief Executive of Adelie Foods Group and previously as Chief Commercial Officer at BMI Healthcare. Martin started his career as an Engineer in the automotive sector with Ford and BMW.

Governance

Board of Directors

	Board	Audit Committee	Nomination Committee	Remuneration Committee
Number of meetings in the year	**12**	**4**	**0**	**3**
Chairman				
Mike Kirk	12/12	4/4	-	3/3
Independent non-executive directors				
Heather Benjamin	12/12	4/4	-	3/3
Martin Johnson	11/12	3/3	-	3/3
Executive directors				
Neville Smith	12/12	-	-	-
Rod Porteous	12/12	-	-	-
Helen Orton	7/7	-	-	-

How the Board Operates

The Board has a schedule of matters reserved for its decision and delegate more detailed consideration of certain matters to Board Committee.

Information is circulated to the Board in a timely fashion to ensure that all Directors are fully briefed on all issues arising at Board Meetings. They are free to seek any further information considered necessary. Under the guidance of the Chairman, all matters before the Board are discussed openly and presentations and advice are received frequently from senior managers.

All Directors have access to the services of the Company Secretary and may take independent professional advice at the Company's expense in the furtherance of their duties.

Board Effectiveness

The Board consists of three Non-Executive and three Executive Directors. There are no representatives of the Group Majority Shareholder on the Board. We consider that the composition of our Board is appropriate for balancing the needs of customers, the environment and our shareholding, as no single Director or group of Directors can dominate the Board's decision making.

It is considered that the Board and its Committees have the appropriate balance of skills, experience, independence and knowledge to enable them to discharge their duties and responsibilities effectively.

Performance Evaluation

During the year, a formal performance evaluation of the Board, its committees and its Directors was undertaken. Each Director was required to complete a questionnaire, the responses to which were reviewed by the Board as a whole. The Non-Executive Directors also met without the Executives to consider the performance of the Board and its committees, and without the Chairman to appraise his performance. The Executive Directors are subject to a formal appraisal of performance which is reviewed by the Chairman. The Chairman also meets with each Non-Executive Director to review individual performance. The evaluation concluded that the Board and its committees operated effectively, and that each Director demonstrated commitment to the role and performed effectively.

Chairman and Managing Director

The roles of Chairman and Managing Director are separate with a clear division of responsibilities between them.

The Chairman is responsible for leading the Board and ensuring its effectiveness. He facilitates the contribution of the Non-Executive Directors and the relationship between them and the Executive Directors.

Shareholder Engagement

Portsmouth Water is a subsidiary of South Downs Capital Limited, which is 73% owned by South Downs Trustees Limited on behalf of the South Downs Employee Benefit Trust. Although the Independent Directors of South Downs Trustee Limited are not entitled to sit on the Portsmouth Water Board, the Directors of Portsmouth Water do treat South Downs Trustee Limited's Directors as majority shareholders. They are sent Board Agendas and are entitled to attend, as observers, any meeting they wish. The Portsmouth Water Chairman meets with those Shareholder Directors on an annual basis and they have access to both the Senior Independent Non-Executive Director and the Company Secretary. Finally, all shareholders receive an annual presentation each year which follows the AGM.

Risk Management and Internal Control

The Board is responsible for the Company's system of internal control and risk management and considers this to be fundamental to the achievement of the Company's strategic objectives. These systems and procedures are designed to identify, manage and, where practicable, reduce and mitigate the effects of the risk of failure to achieve business objectives. They are not designed to eliminate such risk recognising that any system can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board is of the view that there is an ongoing process for identifying, evaluating and managing the Company's significant risks, that it has been in place for the year ended 31 March 2016 and up to the date of approval of the Annual Report and Accounts, that it is regularly reviewed by the Directors. The Board have also set the Risk Appetite for the business and it is reviewed annually.

The key procedures, which have been established with a view to providing effective internal control, are as follows:

Organisation
The Company's activities are operated through a Board of Directors with clearly defined reporting lines and delegation of authority. The Directors meet at least monthly to consider a schedule of matters required to be brought to them for decision making. A standing sub-committee of the Board meets weekly for the purpose of ensuring that full and effective control is maintained over appropriate financial, regulatory and operational issues.

Budgetary Control
Each year the Directors approve an annual plan produced from a comprehensive budgeting system. Actual results are reported against the approved plan on a monthly basis to provide a timely and regular monitoring of performance.

Investment Appraisal
The Company has a clearly defined framework for assessing capital expenditure needs and options, while post project appraisal looks at relevant improvement in the internal control procedures. Board approval is required for any project exceeding a quantified expenditure level and those authorisation levels were reviewed during the past year.

Business, Operational and Compliance Risks
The Company assesses the risks facing its business on an ongoing basis and has identified them under ten main headings – operational, water quality, financial, environmental, regulatory, information technology, health and safety of employees, human resources, legal (including whistle-blowing and fraud) and business continuity. They are subject to regular reporting to the Directors. The Board reviews the controls established to mitigate these risks and its insurance requirement on an annual basis. The Directors also receive reports from independent regulatory bodies, which comment on the performance of the core water business. Any issues raised in these reports are identified and dealt with in an appropriate manner.

During the past year the Board invited Senior Managers to join them for a session on risk identification with the express intention of identifying new or emerging business risks.

At the Board meeting on 29 April 2016, the Directors carried out their annual assessment, including consideration of events since the year end. They also reviewed the Company's Risk Management Policy and processes. They agreed that this annual assessment, coupled with the Board's ongoing analysis of risks provided an effective Risk Management Strategy.

Board Committees

A range of key matters delegated to the Board's Committees are set out on pages 40 to 47 of this Corporate Governance Report.

The Terms of Reference of each of the Board's Committees are available upon request from the Company Secretary at the Company's Registered Office.

Governance

Audit Committee

HV Benjamin

Heather Benjamin
Chair of Audit Committee
27 May 2016

Audit Committee Members
Heather Benjamin (Chair)
Mike Kirk
Martin Johnson

Role of Committee

The purpose of the Committee is to ensure the preservation of good financial practices throughout the Company, to ensure that controls are in place to ensure the integrity of those practices and to monitor them, to review the interim and annual financial statements and to provide, by way of timely meetings, a line of communication between the Board and the external auditors. During these meetings with the external auditors the Audit Committee have asked to be made aware of significant issues, discovered by the Auditors on the financial statements. No issues have been identified which would have had a material impact on the financial statements.

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

Activities during the Year

In addition to fulfilling its ongoing duties, the Committee has an extensive agenda of items addressing issues relating to the day-to-day activities of the business with which it deals in conjunction with senior management, the Report and Auditor and the Company finance team. There were four scheduled meetings of the Committee during the year. Items on the agenda included:

- Reviewing the Year End and Interim Results, going concern statement and accompanying press releases.
- Proposing recommendations to change the Company's Bad Debt Provision
- The change of Accounting Standards to FRS 102
- Reviewing the Audit and Assurance work carried out by the Company's Reporter
- Reviewing and amending the Committee's Terms of Reference
- Considering the Independence and Performance of the Company Reporter and extending their contract
- Reviewing the Ofwat Company Monitoring Framework
- Assessing the calculations of the 2016 Customer Tariffs

External Audit and Non-Audit Services

The Committee reviews the independence and objectivity of the external auditors. This includes reviewing the nature and extent of non-audit services supplied by the external auditors to the Company, seeking to balance objectivity and value for money. The non-audit services provided during the year were for advice given on taxation matters and for advice on dealing with statutory reporting, including new accounting standards. These services would be those expected to be provided by the Company's external auditor, with the requisite independence safeguards in place.

The review of the Auditors includes consideration of the audit process, the effectiveness and performance of the audit team, and the output, quality and cost effectiveness of the audit. The last review of the Auditor's independence and objectivity was carried out in 2013.

The current Auditors have been in tenure for ten years, at which time the last formal tender was conducted. The Board have decided that it is appropriate that a formal tender for External Audit Services be carried out during 2016.

The Committee does not consider that an internal audit function is required for the Company due to the size and nature of the business. This recommendation is reviewed annually.

Committee Performance and Effectiveness

An annual review of the Committee's performance was undertaken as part of the external Board Evaluation process. No material shortcomings in the operation of the Committee were highlighted.

Annual Report and Accounts

The Audit Committee considers the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

Governance

Nomination Committee

Mike Kirk
Chair of Nomination Committee
27 May 2016

Nomination Committee Members

Mike Kirk (Chair)
Heather Benjamin
Martin Johnson
Neville Smith

Role of Committee

The Committee's primary function is to advise the Board in relation to the appointment of Executive and Non-Executive Directors. This includes the following:

- Taking responsibility for identifying and nominating for the approval of the Board candidates to fill Board vacancies as and when they arise
- Before any appointment is made, evaluating the balance of skills, knowledge, experience and diversity on the Board and, in the light of this evaluation, preparing a description of the role and capabilities required for a particular appointment

The Committee comprises of all three Independent Non-Executive Directors and the Managing Director.

Activities during the Year

Although the Committee did not formally meet during the year they were delighted, that following a Committee recommendation in the previous year, Helen Orton was appointed as the Finance and Regulation Director with effect from 12 October 2015. Helen previously held a senior audit position at accountants PricewaterhouseCoopers where she gained considerable Water Industry knowledge working with a number of companies on audit, assurance and regulatory matters.

Board composition

Executive
50%

Non-Executive
50%

Male
67%

Female
33%

Age 40-50
33%

Age 50-60
67%

Governance

Remuneration Committee

Martin Johnson
Chair of Remuneration Committee
27 May 2016

Remuneration Committee Members
Martin Johnson (Chair)
Mike Kirk
Heather Benjamin

Role of Committee

The primary objective of the Committee is to set a policy to ensure that competitive reward packages and offered that will attract, retain and motivate talented senior executives to run the business effectively and to promote the success of the Company.

Within these arrangements, a proportion of reward is based on performance against demanding targets. These targets are set by the Committee based on key strategic priorities benefiting customers, investors and other stakeholders and consistent with a Board approved level of risk.

Activities during the Year

During the year the Committee dealt with the following matters:

- Annual executive salary review and achievement of performance targets
- Determining performance targets in respect of 2015/16 annual incentive bonus plan and also the longer term five year targets for 2015/2020

Remuneration Report

Remuneration Policy
The objective is to attract, retain and motivate high calibre Senior Executives through pay arrangements which are competitive and fair and reasonable for the responsibilities involved. In addition to individual performance, reference is made to pay levels in companies of similar size and within the same industry.

The remuneration packages of the Executive Directors, as reported in the accounts, includes a performance related element. The performance related element is based upon the achievement of agreed financial, customer service and personal targets for the whole of the previous year.

Service Contracts
All Executive Directors appointed to the Board are employed on service contracts of no fixed term with a notice period of one year, both by the Company and the Director. Each Executive Director is entitled to pension provision and certain contractual benefits, details of which are summarised below. Each Executive Director also participates in bonus or incentive arrangements at the sole discretion of the Remuneration Committee which are also described later in this Report. All Executive Directors are subject to retirement by re-election at the AGM.

None of the Executive Directors serves as a Non-Executive Director for another Company.

The Chairman and other Non-Executive Directors have service contracts but these can be terminated without compensation. All Non-Executive Directors are subject to re-election at the AGM.

Future Remuneration Policy Table

Element, purpose and link to strategy	Operation, performance measures, deferral	Maximum opportunity	Performance metric
Base Salary (Fixed Pay) To pay a fair salary, commensurate with the individual's role, responsibilities and experience, and having regard to the market rates for similar roles in the water/utility sector and other comparable companies.	Reviewed annually, taking account of market salary levels, Company performance, individual performance, changes in responsibility and levels of increase for the broader employee population. The remuneration committee considers the impact of any base salary increase on the total remuneration package.	There is no prescribed maximum salary or maximum rate of increase. The remuneration committee is guided by the general increase for the broader employee population but on occasions may need to recognise, for example, development in role, change in responsibility, specific retention issues, market practice or changes in regulatory requirements. Details of the outcome of the most recent salary review are provided in the annual report on remuneration.	None
Benefits (Fixed Pay) To provide cost-effective taxable benefits and to support the wellbeing of employees.	The Company currently provides a range of taxable benefits such as medical insurance; life insurance and paid holiday. Specific benefits provision may be subject to minor change from time to time, within this policy.	Taxable benefits are not subject to a specific cap, but represent only a small element of total remuneration. The costs associated with benefits provision are closely monitored and controlled.	None
Pension (Fixed Pay) To provide market competitive pension arrangements, to assist with recruitment and retention.	Employer contributions are made to appropriate pension schemes.	10% of salary into a defined contributions scheme. Under the defined benefits scheme a maximum future accrual of 1/80th of career averaged earnings for each year of service.	None
Annual bonus (Variable Pay) To reward performance by linking to achievement of key performance objectives aligned to the strategy of the Company.	Bonus awards to Executive Directors are made each year and are approved by the remuneration committee. Executive bonus awards take account of the Company's key financial and service performance indicators for the relevant financial year. Details of the performance indicators for the most recent financial year and performance against them are provided in the annual report on remuneration.	The maximum bonus potential for each Director is 20% of base salary.	The incentive scheme is split between three distinct areas as follows: 5% customer service measures 5% personal objective 10% key performance objectives
Long-term incentive bonus (Variable Pay) To incentivise Executive Directors to deliver sustained long-term performance	Long term bonus awards to Executive Director calculated on an annual basis but paid out at the end of the five year performance period, subject to the achievement of performance conditions.	10% of salary per year paid at the end of year five.	Awards at the end of the five year performance period, based on achievement of eight specified performance conditions.
Employment contracts, and loss of office To facilitate recruitment and retention, and support pay for performance, by providing fair but not excessive contract features.	Notice periods from the Company are limited to 12 months.	N/A	N/A
New Executive Director appointments To facilitate recruitment of necessary talent.	Remuneration for new appointments will be set in accordance with the policy detailed in this table.	N/A	N/A

Governance

Remuneration Committee

Statement of Consideration of Employment Conditions Elsewhere in the Company

The remuneration approach for the Executive Directors is broadly consistent with that for employees across the Company as a whole. However, the exception is that general employees do not receive an annual performance related bonus. However all employees, apart from the Managing Director, do receive their twice annual payment from the Employment Benefit Trust (EBT). The EBT owns a majority shareholding in the Company's shares on behalf of the employees. Payments are made to all employees in June and November each year.

Annual Report on Remuneration

Directors Remuneration as a Single Figure (Audited Information)

Remuneration is analysed by Director below:

	Salary/Fees £000	Benefits £000	Bonus Scheme £000	EBT £000	Pension £000	**Total 2016 £000**	Total 2015 £000
Executive:							
R. C. Porteous	102	14	14	16	62	**208**	183
H. M. G. Orton (appointed 12 October 2015)	57	6	-	-	5	**68**	-
N. Smith	143	19	-	-	-	**162**	223
Non-Executive:							
H. V. Benjamin	24	-	-	-	-	**24**	24
M. Johnson (appointed 1 July 2014)	24	-	-	-	-	**24**	18
M. P. Kirk	37	-	-	-	-	**37**	30
	387	39	14	16	67	**523**	478

Share options

The Company does not operate an Executive Share Option Scheme.

Directors' interests (Audited information)

The Directors' beneficial holdings of shares in South Downs Capital Limited, the ultimate parent undertaking, are detailed below and, in total, represent 8% of the issued share capital of this holding Company. They have no direct interests in the shares of Portsmouth Water Limited.

	'C' Ordinary Shares
N. Smith	450

There have been no changes to this shareholding between the 31 March 2016 and the date of this report.

Directors' emoluments waived during the year

There were no Directors' emoluments waived during the year.

Taxable benefits

Benefits comprise company cars and medical insurance.

The table below provides a breakdown of taxable benefits provided to directors in the period.

	2016 £000	2015 £000
Car and Fuel benefit	**30**	36
Medical insurance	**9**	5
Total	**39**	41

Variable pay/performance measured pay for Executive Directors

Short term annual bonus scheme

The remuneration package of the Executive Directors, as reported in the accounts, includes a performance related element. The performance related element is based upon the achievement of agreed financial, customer service and personal targets and is paid in the form of a payment at the end of the year.

The Executive Directors can earn up to 20% of basic salary for the annual performance related element. The assessment of this element is based upon:

- 25% based on Customer Service performance including meeting the outcomes agreed at the Final Determination 2014 and being a top performer in the Service Incentive Mechanism. Also includes water quality achievement, interruption to supply, leakage, complaints and abandoned calls.
- 25% Personal Objectives individually set by the Remuneration Committee.
- 50% Financial and Business Objectives such as cost efficiency, reduction in gearing, being top performing SIM company, KPI delivery and zero reportable accidents.

The achievements were:	% of salary (out of possible 20%)	Bonus £000
R. C. Porteous	14%	14

The Managing Director does not receive a performance related element. This has been waived due to his shareholding in the holding company, South Downs Capital Limited. The Finance and Regulation Director was not employed by the Company during 2014/15.

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

	Customer Service Measure 1 %	Personal Objectives Measure 2 %	Financial/ Business Objectives Measure 3 %	Total %
R. C. Porteous	25	25	50	100
H. M. G. Orton	25	25	50	100
N. Smith	N/A	N/A	N/A	N/A

The above weightings convert into maximum percentages of salary payable as follows:

	Customer Service Measure 1 %	Personal Objectives Measure 2 %	Financial/ Business Objectives Measure 3 %	Total %
R. C. Porteous	5	5	10	20
H. M. G. Orton	5	5	10	20
N. Smith	N/A	N/A	N/A	N/A

Summary of directors' performance targets and maximum variable pay achievable.

	Target %	Customer Service Measure 1 Value £	Target %	Personal Objectives Measure 2 Value £	Target %	Financial/ Business Objectives Measure 3 Value £	**Maximum Variable Pay Achievable 2016**	Maximum Variable Pay Achievable 2015
R. C. Porteous	5	5,100	5	5,100	10	10,200	**20,400**	20,000
H. M. G. Orton	5	2,100	5	2,100	10	4,200	**8,400**	N/A
N. Smith	N/A	-	N/A	-	N/A	-	**-**	-

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

	Achieved %	Customer Service Measure 1 Value £	Achieved %	Personal Objectives Measure 2 Value £	Achieved %	Financial/ Business Objectives Measure 3 Value £	**Maximum Variable Pay Achieved 2016**	Variable Pay Achieved 2015
R. C. Porteous	3	3,000	5	5,000	8	8,000	**16,000**	14,000
H. M. G. Orton	3	1,500	4	2,000	8	4,000	**7,500**	N/A
N. Smith	N/A	-	N/A	-	N/A	-	**-**	-

Governance

Remuneration Committee

Long term bonus scheme

The Directors can earn up to 10% per annum of basic salary for achieving long term objectives over the 5 years of the regulatory period. This long term bonus scheme commenced on 1 April 2015. This payment is made at the end of a five year performance period, subject to the achievement of performance conditions.

The long term objectives, paid in 2020 if achieved include the delivery of a comprehensive Open Water plan, achieving culture change targets, being the top performing company in SIM, refinancing, reducing leakage and per capita consumption, improving credit ratings and migration from the current IT mainframe system.

The maximum percentages of salary payable as follows:	Long -Term Objectives per annum %	5 Year Total %
R. C. Porteous	10	50
H. M. G. Orton	10	50
N. Smith	10	50

Summary of directors' performance targets and maximum variable pay achievable.

	Target %	Long-Term Objectives Value £	**Maximum Variable Pay Achievable 2016**	Maximum Variable Pay Achievable 2015
R. C. Porteous	10	10,200	**10,200**	N/A
H. M. G. Orton	10	4,700	**4,700**	N/A
N. Smith	10	14,300	**14,300**	N/A

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

	Achieved	Long-Term Objectives Value £	**Maximum Variable Pay Achievable 2016**	Maximum Variable Pay Achievable 2015
R. C. Porteous	7%	7,000	**7,000**	N/A
H. M. G. Orton	7%	3,300	**3,300**	N/A
N. Smith	7%	10,000	**10,000**	N/A

All variable pay has been awarded in accordance with the remuneration policy and criteria outlined at the commencement of the period. No discretion has been exercised over any variable pay awarded.

Mr. R. C. Porteous also received payment from the Employee Benefit Trust on the same basis as other employees. Mr. N. Smith, as a shareholder of the Parent Company, is not entitled to payments from the Employee Benefit Trust.

Pension Entitlements (Audited Information)

The Company participates in the Brockhampton Pension Scheme to provide pension benefits for its employees, including two of the Executive Directors - Mr. N. Smith and Mr. R. C. Porteous.

Mrs. H. M. G. Orton is a member of the defined contribution scheme. Contributions amounting to £4,861 were made on her behalf by the Company in the year. The Non-Executive Directors are not members of either of the pension schemes.

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

The Executive Directors who have accrued pension benefits under the Brockhampton Pension Scheme, which is a defined benefit scheme, during the year are detailed below:

	Value of increase in scheme benefit 2015/16 £000	**Directors contributions 2015/16 £000**	**Total included in single figure remuneration table 2015/16 £000**	Value of increase in scheme benefit 2014/15 £000	Directors Contributions 2014/15 £000	Total included in single figure remuneration table 2014/15 £000	**Accrued Pension 31/03/16 £000pa**	Accrued Pension 31/03/15 £000pa
R. C. Porteous[1]	**67**	**5**	**62**	52	5	47	**54**	50
N. Smith[2]	**-**	**8**	**-**	71	8	63	**90**	88

The value of the increase in accrued pension in excess of inflation, less each Directors' own contributions is included in the Directors' single figure remuneration table above. There was no post inflation increase in accrued pension benefit for Mr. N. Smith during the year.

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.

[1]The pensionable salary used to calculate Mr. R. C. Porteous' accrued pension excludes £18,328 (2014/15 - £21,215) of non-pensionable salary.
[2]The pensionable salary used to calculate Mr. N. Smith's accrued pension excludes £1,420 (2014/15 - £nil) of non-pensionable salary.

No additional benefits will become available to directors who retire early. For further details regarding each of the pension schemes, please refer to note 25 in the financial statements.

Payments to Past Directors
No payments requiring disclosure were made to past directors during the period.

Remuneration of the Managing Director
The table below summarises the remuneration of the Managing Director for each of the last five financial years. The Managing Director does not receive a performance related element of remuneration. These figures do not include amounts accruing under defined benefit pension arrangements as the figures for historic years are not readily available.

Year ending 31 March:	2011	2012	2013	2014	2015	**2016**
Total remuneration excluding pension (£000)	166	137	153	157	160	**162**

The above figures for Managing Directors remuneration are all in respect of Mr. N. Smith except for 2012 which represents only part of the year for Mr. N. Smith as he was appointed as Managing Director in December 2011.

Percentage Change in Remuneration of the Managing Director
The following table shows the percentage change in the base salary, benefits and annual bonus of the Managing Director between the current and previous financial year compared to the average for all employees of the Company.

% change in:	Managing Director	Average for all employees
Base salary[1]	1.0%	2.3%
Benefits[2]	0%	0%
Annual bonus[3]	N/A	N/A

[1]This increase represents the annual pay award.
[2]There were no changes made to the underlying value of benefit payments provided during the year.
[3]This does not include payments made to employees from the Employee Benefit Trust.

Statement of Implementation of Remuneration Policy in the Following Financial Year
The Remuneration Committee intends to continue to apply broadly the same key performance metrics as in the previous year and to assess performance taking account of strategic and annual expectations for the Company.

Approval
This report was approved by the Board on 27 May 2016 and will be subject to shareholder approval at the Annual General Meeting to be held on 27 July 2016.

M. P. Johnson
Chair of the Remuneration Committee

Governance

Directors' Report

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 March 2016.

Principal Activity and Business Review

The principal activity of the Company and a detailed review of its operations, strategy and business model is provided in the Chairman's Statement on page 4 and the Strategic Report on pages 6 to 31.

The Company's Area of Supply is shown on page 1 of this report.

Financial Risk Management Objectives and Policies

A detailed review of the Company's financial risk management objectives and the policies employed are set out in the Strategic Report on pages 28 and 29.

Financial Results and Dividends

The Company's profit before taxation amounts to £4.2m (2015 - £2.5m). After deducting the tax charge of £0.7m (2015 - £0.5m), a profit of £3.5m has been transferred to reserves (2015 - £1.9m).

The Directors are recommending the payment of a final dividend of £0.6m.

Fixed Assets

Capital expenditure on tangible fixed assets was £9.3m (2015 - restated £5.8m). Information relating to these and other changes in fixed assets is shown in note 13 to the accounts.

The Directors are of the opinion that the current market value of the land and buildings included in tangible fixed assets is in excess of the value shown in the balance sheet. As they are held for operational purposes, no professional valuation has been obtained and the excess has not, therefore, been quantified.

Board of Directors

The Directors who held office at 27 May 2016 are shown on pages 36 and 37.

Mrs H. V. Benjamin who retires by rotation, offers herself for re-election.

Mrs. H. M. G. Orton was appointed on 12 October 2015 and offers herself for election.

The interests of the Directors in Group shares are detailed in the Report on Remuneration on page 44.

The Company maintains appropriate Directors' indemnity insurance.

Substantial Shareholder

At 31 March 2016, Portsmouth Water Holdings Limited owned the entire voting capital of the Company.

Regulatory Accounts

A set of accounts for regulatory purposes is required by the Water Services Regulation Authority. These accounts relate solely to the regulated water supply business and copies may be obtained on request from the Registered Office or via our website at www.portsmouthwater.co.uk.

Employees

Direct communication with employees is maintained through the Company in-house newsletter. In addition, the Joint Information and Consultative Committee met regularly and ensured effective communication with employee representatives.

The Directors consider health and safety to be an important issue within the Company, with the active participation of employee safety representatives taking place through the Health and Safety Committee. During the year, a number of initiatives were undertaken, which ensured that health and safety continues to maintain its high profile throughout the organisation.

The Company has, for the last eleven years, been awarded eleven Gold Awards in the RoSPA Occupational Health and Safety Awards and was also awarded an Industry Sector Award in 2009. In recognition of this the Company has been awarded the President's Award for the past two years.

Environment

The Company is aware of its obligations to both customers and the environment. In recent years, it has adopted an active approach to environmental issues and further information is set out in the Strategic Report on pages 18 to 21. The total amount of gross Greenhouse Gas Emissions that resulted from the Company's operations in the financial year is estimated to be 11,813 tCO_2e.

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.

The Board have decided that it is appropriate that a formal tender for External Audit Services be carried out during 2016.

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, the Directors are also responsible for preparing a Directors' Report, Strategic 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 2016; and
- the Directors' Report, Strategic 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 ACIS
Secretary
Havant
27 May 2016

Governance

Company Information

Registered Office

PO Box 8
West Street
Havant
Hampshire
PO9 1LG

Telephone: 023 9249 9888
Fax: 023 9245 3632
www.portsmouthwater.co.uk

Company Number: 2536455

Company Secretary: Christopher Hardyman ACIS

Auditors
Saffery Champness
71 Queen Victoria Street
London
EC4V 4BE

Bankers
Lloyds Bank plc
25 Gresham Street
London
EC2V 7HN

Insurance Brokers
Willis Watson Towers
The Anchorage
34 Bridge Street
Reading
Berkshire
RG1 2LU

Independent Auditor's Report to the Members

We have audited the financial statements for the year ended 31 March 2016 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Company Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows, the related notes and the part of the report on remuneration to be audited. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (Financial Reporting Standard 102).

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 Directors' Responsibilities Statement, 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 and express an opinion on the financial statements 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. In addition, we read all the financial and non-financial information in the Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2016 and of its profit for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice – Financial Reporting Standard 102; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and 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 Report on Remuneration 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.

Nicholas Kelsey
Senior Statutory Auditor
13 June 2016

For and on behalf of
Saffery Champness
Chartered Accountants
Statutory Auditors
71 Queen Victoria Street
London
EC4V 4BE

Income Statement

For the year ended 31 March 2016

	notes	2016 £000	2015 Restated £000
Turnover	3	**39,795**	38,838
Cost of sales		**(20,011)**	(20,660)
Gross profit		**19,784**	18,178
Net operating expenses	4	**(11,582)**	(11,489)
Operating profit before (loss)/profit on disposal of fixed assets		**8,202**	6,689
(Loss)/profit on disposal of fixed assets	6	**(562)**	3
Operating profit after (loss)/profit on disposal of fixed assets		**7,640**	6,692
Gain on revaluation of investment property		**-**	30
Profit on ordinary activities before interest		**7,640**	6,722
Investment income	7	**996**	974
Other finance income	25	**382**	859
Interest payable and similar charges	8	**(4,778)**	(6,106)
Profit on ordinary activities before taxation	6	**4,240**	2,449
Taxation of profit on ordinary activities	9	**(712)**	(538)
Profit for the financial year		**3,528**	1,911

The accompanying notes form an integral part of these accounts.
The income statement has been prepared on the basis that all operations are continuing operations.

Statement of Other Comprehensive Income

For the year ended 31 March 2016

	notes	2016 £000	2015 Restated £000
Profit for the financial year		**3,528**	1,911
Remeasurement of net defined benefit asset	25	**6,274**	(9,361)
Movement on deferred tax relating to pension asset	21	**(1,129)**	1,872
Effect of change to corporation tax rate on pension asset	21	**225**	-
Total comprehensive income for the year		**8,898**	(5,578)

Statement of Financial Position

For the year ended 31 March 2016

	notes	2016 £000	2016 £000	2015 Restated £000	2015 Restated £000
Fixed assets					
Intangible fixed assets	11	**77**			
Investment properties	12	**440**		440	
Tangible fixed assets	13	**123,003**		120,444	
Investments	14	**55,984**		56,334	
			179,504		177,218
Current assets					
Investments	15	**2**		2	
Stocks		**592**		744	
Debtors	16	**7,897**		7,030	
Cash at bank and in hand	17	**9,206**		6,776	
		17,697		14,552	
Creditors: Amounts falling due within one year	18	**(16,817)**		(14,674)	
			880		(122)
Total assets less current liabilities			**180,384**		177,096
Creditors: Amounts falling due after more than one year	19		**(97,724)**		(96,673)
Accruals and deferred income: Capital contributions	20		**(24,429)**		(23,817)
Provisions for liabilities	21		**(6,386)**		(6,949)
Net assets excluding pension asset			**51,845**		49,657
Pension asset	25		**14,575**		9,030
Net assets including pension asset			**66,420**		58,687
Capital and reserves					
Called up share capital	23		**1,078**		1,078
Share premium account			**1,539**		1,539
Capital redemption reserve			**3,250**		3,250
Profit and loss account			**60,553**		52,820
Shareholder' funds			**66,420**		58,687

The accompanying notes form an integral part of these accounts.

The accounts were authorised for issue and approved by the Board on 27 May 2016 and signed on its behalf by

H. M. G. Orton
Director

Company Number: 2536455

Statement of Changes in Equity

For the year ended 31 March 2016

	Called up share capital £000	Share Premium account £000	Capital redemption reserve £000	Retained earnings Restated £000	Total Restated £000
Balance as at 31 March 2014 (as previously stated)	1,078	1,539	3,250	60,144	66,011
Changes on transition to FRS 102	-	-	-	(973)	(973)
Balance as at 1 April 2014 as restated	1,078	1,539	3,250	59,171	65,038
Profit for the year	-	-	-	1,911	1,911
Remeasurement of net defined benefit asset	-	-	-	(9,361)	(9,361)
Movement on deferred tax relating to pension scheme	-	-	-	1,872	1,872
Total comprehensive income for the year	-	-	-	(5,578)	(5,578)
Dividends	-	-	-	(773)	(773)
Balance at 31 March 2015	1,078	1,539	3,250	52,820	58,687
Profit for the year				3,528	3,528
Remeasurement of net defined benefit asset	-	-	-	6,274	6,274
Movement on deferred tax relating to pension scheme	-	-	-	(1,129)	(1,129)
Effect of change to corporation tax rate on pension asset	-	-	-	225	225
Total comprehensive income for the year	-	-	-	8,898	8,898
Dividends	-	-	-	(1,165)	(1,165)
Balance at 31 March 2016	1,078	1,539	3,250	60,553	66,420

The retained earnings balance represents accumulated profits and losses, including unrealised profits on the remeasurement of investment properties, net of dividends paid and other adjustments. As at 31 March 2016 £60.265m (2015 - £52.532m) was distributable in accordance with company law and £0.288m (2015 - £0.288m) was not distributable.

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

Statement of Cash Flows

For the year ended 31 March 2016

	notes	2016 £000	2016 £000	2015 Restated £000	2015 Restated £000
Cash generated from operations	24		**13,651**		11,891
UK corporation tax paid		**(180)**		19	
Payments for group relief		**(107)**		5	
			(287)		24
Net cash inflow from operating activities			**13,364**		11,915
Cash flows from investing activities					
Purchase of tangible assets		**(8,613)**		(5,563)	
Capital contributions received		**1,194**		1,317	
Sale of tangible fixed assets		**34**		10	
Interest received		**1,001**		974	
Net cash used in investing activities			**(6,384)**		(3,262)
Cash flows from financing activities					
Loan repayment from group companies		**350**		3,050	
Repayment of borrowings		**-**		(5,000)	
Equity dividends paid		**(1,165)**		(773)	
Interest paid		**(3,735)**		(3,657)	
Net cash (used in) financing activities			**(4,550)**		(6,380)
Net increase in cash and cash equivalents			**2,430**		2,273
Cash and cash equivalents at beginning of year			**6,776**		4,503
Cash and cash equivalents at end of year	17		**9,206**		6,776

Notes to the Financial Statements

For the year ended 31 March 2016

1. Accounting policies

Portsmouth Water Limited is a private company incorporated in England and Wales under the Companies Act 2006. The Company's registered office is PO Box 8, West Street, Havant, PO9 1LG and the registered number is 2536455.

The financial statements of Portsmouth Water Limited have been prepared in compliance with UK Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" ("FRS 102") and the Companies Act 2006.

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied, unless otherwise stated. Details of the transition to FRS 102 are set out in note 30. The prior year figures have been restated to reflect material adjustments on adoption of FRS 102 in the current year. The financial statements are presented in pounds sterling.

The Company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it in respect of its financial statements. Exemptions have been taken from disclosing information relating to financial instruments and key management personnel remuneration. The Company's financial statements have been consolidated into the accounts of South Downs Capital Limited, copies of which are available from the registered office.

In view of the licence conditions under which the Company operates as a water supplier, it is required to publish information about its annual results as if it were a company covered by the listing Rules of the Financial Conduct Authority, except where it is considered inappropriate to do so. Earnings per share disclosures are not presented as the Company is a wholly owned subsidiary. Segmental reporting has not been presented as, in the opinion of the Directors, the Company undertakes a single activity.

The principal accounting policies are as follows:

1.1 Basis of preparation

These financial statements have been prepared on a going concern basis, under the historical cost convention, as modified by the revaluation of certain assets which have been measured at fair value.

The preparation of financial statements requires the use of critical accounting estimates. They also require management to estimate judgement in the application of group accounting policies. Those areas that involve a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 2.

1.2 Going concern

The Company meets its day to day working capital requirements through its bank facilities including a £4m committed overdraft facility. Where necessary, in order to meet the needs of significant fixed asset schemes, the Company utilises a £10m revolving credit facility. The Company's forecasts and projections, taking account of reasonably possible changes in cash collection, infrastructure renewals & capital activity and ongoing servicing of debt, together with its financing covenant requirements, show that the Company should be able to continue to operate within the level of its current facilities. After making appropriate enquiries the Directors have a reasonable expectation that the Company will continue in operational existence for the foreseeable future. The Company, therefore, continues to adopt the Going Concern basis of preparation of the financial statements.

1.3 Turnover

Turnover, which excludes value added tax, represents the income receivable for goods and services provided to external customers in the ordinary course of business. It comprises the value of water supplied and other related charges. Revenue is recognised at the fair value of the consideration received or receivable.

Turnover from the regulated water business includes amounts billed for the year, together with an estimation of amounts unbilled at the year-end, for measured water customers.

Unmeasured income bills are based on the rateable value of properties. Unmeasured customers are billed annually in advance on 1 June and amounts invoiced in advance are not recognised in turnover until earned. Measured income arises from customers who have meters fitted at their premises and amounts billed, therefore, are based on actual water consumption. The estimation of the amounts unbilled at the year end uses a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

Turnover includes the amortisation of capital contributions received in connection with the enhancement of mains infrastructure. This is set out further below.

1.4 Investment properties

The Directors consider certain holdings of freehold land and buildings to be investment properties. In accordance with FRS 102, they are included in the statement of financial position at their open market value. The surplus or deficit on revaluation is recognised in the profit or loss for the year, along with the related deferred tax charge or credit. Depreciation is not provided in respect of these holdings. It is the Company's policy to obtain an external third party valuation of 1/5th of the property portfolio on a rolling basis with the remainder being valued based on a management review and using relevant indices.

Notes to the Financial Statements

1.5 Tangible fixed assets

The Company holds both above ground assets and a below ground infrastructure network of mains.

Mains infrastructure (below ground assets)

Infrastructure assets comprise a network of mains, communications pipes and boundary boxes. The Company undertakes expenditure on this network in order to maintain it in an ongoing serviceable condition. Where this expenditure meets certain criteria (set out below) it is capitalised. All other expenditure is expensed as incurred.

Expenditure on infrastructure assets relating to increases in capacity or other economic enhancement is capitalised. Other economic enhancements relate primarily to the installation of new boundary boxes, schemes addressing specific water quality issues or areas where mains have been diverted to avoid damage.

Such items are treated as additions and included in property, plant and equipment at cost. The cost of infrastructure assets is their purchase cost, together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company.

The assets are depreciated over their useful lives of between 40 and 100 years on a straight line basis. There are no expected residual values.

Other fixed assets (above ground assets)

Other assets comprise buildings and reservoirs, pumping plant, vehicles, mobile plant and office equipment. The cost of other assets is the purchase cost, together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the Company.

Depreciation is provided on all fixed assets, with the exception of freehold land. It is calculated to write off the cost of assets over their estimated useful economic lives using the straight line method. There are no expected residual values. Those lives are estimated as follows:

Building and reservoirs	100 years
Pumping and other plant (including solar panels)	15-25 years
Office equipment	5-10 years
Vehicles and mobile Plant	5-7 years

Assets in the course of construction

Assets in the course of construction are included in tangible fixed assets at cost but are not depreciated until they come into use.

1.6 Intangible fixed assets other than goodwill

Intangible assets acquired separately from a business are recognised at cost and are subsequently measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised so as to write off the cost or valuation of assets over their useful lives on the following basis:

Software	3 years
Consultancy and internal staff costs	3 years

Intangible assets in the course of construction

Intangible assets in the course of construction are included in intangible fixed assets at cost but are not amortised until they come into use.

1.7 Capital contributions

Mains contributions

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. In accordance with the Companies Act 2006 and FRS 102 requirements to include fixed assets at cost, such contributions are treated as deferred income and released to the income statement over the useful economic life of the corresponding assets.

Infrastructure charges

Infrastructure charges are made in respect of new connections in accordance with Condition 'C' of the Instrument of Appointment. These charges are treated as mains contributions as explained above.

1.8 Financial Instruments

Financial assets and financial liabilities are recognised when the Company becomes party to the contractual provisions of the instrument.

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for financial assets classified as fair value through profit and loss, which are initially measured at fair value (normally transaction price excluding transaction cost).

If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Debt instruments which meet the applicable conditions are recognised as basic financial instruments and subsequently measured at amortised cost using the effective interest rate method. Instruments that are payable or receivable within one year of initial recognition and meet the applicable conditions are measured at the undiscounted amount of consideration expected to be paid or received, net of impairment.

Financial assets are derecognised when and only when the contractual rights to the cash flows from the financial assets expire or are settled, or the company transfers substantially all of the risks and rewards of ownership of the financial asset.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

Investments

Investments consist of non-current and current investments.

Non-current investments are in respect of loans to group companies. They are measured at amortised cost using the effective interest rate method.

Current asset investments are held at cost less impairment since fair value cannot be measured reliably.

1.9 Impairment

Assets other than those measured at fair value, are assessed for indicators of impairment at each statement of financial position date. If there is objective evidence of impairment, an impairment loss is recognised in the income statement.

Non-financial assets

Assets are impaired when evidence indicates that the assets recoverable amount is less than its carrying amount. Recoverable amount is the lower of fair value less cost to sell and its value in use.

Financial assets

For financial assets carried at amortised cost, the amount of impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial assets original effective interest rate.

For financial assets carried at cost less impairment, the impairment loss is the different between the asset's carrying amount and the best estimate of the amount that would be received for the asset if it were to be sold at the reporting date

1.10 Stocks

Stocks of raw materials are valued on a weighted average cost basis at the lower of cost or net realisable value. In accordance with established practice in the water industry, no value is placed upon the water in reservoirs, mains or in the course of treatment.

1.11 Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax is recognised on all timing differences where the transactions or events that give the Company an obligation to pay more tax in the future, or the right to pay less tax in the future, have occurred by the statement of financial position date. Deferred tax assets are recognised when it is more likely than not that they will be recovered. Deferred tax is measured using rates of tax that have been enacted or substantively enacted by the statement of financial position date.

Deferred tax is recognised when assets are revalued and the gain or loss expected to arise on sale has been recognised in the financial statements.

1.12 Leases

All leases are regarded as operating leases. Operating lease payments are charged to the income statement on a straight line basis over the lease term. Lease income is recognised on a straight line basis over the lease term.

1.13 Pension costs and other post-retirement benefits

Portsmouth Water Limited, a subsidiary undertaking, is the principal employer and its parent company, Brockhampton Holdings Limited, is the participating employer in the Brockhampton Pension Scheme. This scheme is a defined benefit scheme. The assets of the scheme are held in a separate trustee administered fund. As principal employer Portsmouth Water includes the pension asset in its financial statements.

The current service costs are charged to the income statement and included as staff employment costs. The interest cost and interest income are shown as a net amount within other finance income. Re-measurements of the net defined benefit asset are recognised immediately in other comprehensive income.

Notes to the Financial Statements

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

Pension scheme assets are valued at fair value at the statement of financial position date. The pension scheme surplus is recognised in full on the statement of financial position.

The deferred tax relating to a defined benefit asset is offset against the defined benefit asset and not included with other deferred tax liabilities. Detailed information regarding the surplus and actuarial position of the scheme is given in note 25 to the accounts.

The Company also operates a defined contribution pension scheme. The charge to the income statement amounts to the contributions payable to the scheme in respect of the accounting period.

1.14 Provisions

A provision is recognised when the Company has a legal or constructive obligation as a result of past events and it is probable that an outflow of economic benefits will be required to settle the obligation. The effect of the time value of money is not material and therefore the provisions are not discounted.

2. Critical accounting judgements and key sources of estimation uncertainty

Estimates and judgements are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting estimates made will, by definition, seldom equal the actual results that out-turn over time. Those estimates and assumptions that have a risk of causing a material adjustment to the carrying values of assets and liabilities within the next financial year are set out below;

Estimation of unbilled measured income

As set out in note 1.3 above, the estimation of the amounts unbilled at the year end uses a defined methodology based upon valuing an estimate of unbilled water consumed. This is calculated using known factors such as the date of the customers' last bill and the customer tariff rate together with an estimate of the water consumed. The estimated water consumed is calculated from various factors including; the number of days elapsed since the last meter read, historical consumption levels for each premises (which is calculated from historical customer billing data) or estimated average consumption per property type (where a historic actual is not available). The assumptions reflect historic experience and current data. Management review both the data sets used, the outcome of the calculation and quarterly trends in determining the year end position.

Useful Economic lives of Mains Infrastructure

By the nature of below ground assets it is more difficult to directly establish remaining estimated useful economic lives ("UEL"). In setting the UELs the directors have consideration of a number of factors including the age and construction material of the pipes, historic experience in relation to both replacement & burst rates and industry averages.

Defined benefit pension scheme

The Company has obligations to pay pension benefits to certain employees and former employees. The cost of these benefits and the present value of the related obligation depend upon a number of factors including; life expectancy, salary increase, asset valuations and the discount rate based on corporate bonds. Management estimate these factors in determining the net pension obligation in the balance sheet. The assumptions reflect historic experience and current trends and are set in consultation with appropriately qualified and experienced professional advisors.

3. Turnover

	2016 **£000**	2015 Restated £000
Unmeasured supplies	**21,545**	21,417
Measured supplies	**16,126**	15,151
Bulk supply to Southern Water Services	**107**	226
Amortisation of developer contributions	**582**	567
Other	**1,435**	1,477
	39,795	38,838

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

4. Net operating expenses

	2016 **£000**	2015 Restated £000
Administrative expenses	**11,964**	11,892
Other operating income	**(382)**	(403)
	11,582	11,489

5. Directors and employees

	2016 £000	2015 £000
Employment costs:		
Wages and salaries	**8,774**	8,208
Social security costs	**736**	711
Defined benefit pension costs (note 25)	**1,495**	1,312
Defined contribution pension costs (note 25)	**136**	109
	11,141	10,340
Transferred to capital schemes	**(682)**	(577)
Net employment costs charged to the income statement	**10,459**	9,763

Average numbers employed during year:	2016 Number	2015 Number
Operations	**151**	152
Administration	**100**	94
	251	246

	Highest Paid Director 2016 £000	Highest Paid Director 2015 £000	Total 2016 £000	Total 2015 £000
Total remuneration	**162**	160	**456**	490
Pension scheme benefit	**-**	63	**67**	110
	162	223	**523**	600

One director (2015 - Nil) is accruing benefits under a defined contribution pension scheme. The number of directors for whom retirement benefits are accruing under defined benefit pension schemes amounted to 2 (2015 - 2).

Payments were made in respect of compensation for loss of office amounting to £Nil (2015 - £69,000) made up of both cash and an asset transfer.

Further details relating to Directors' remuneration are set out in the Report on Remuneration on pages 42 to 47. The information set out in that Report which is subject to audit forms part of these financial statements.

6. Profit on ordinary activities before taxation

	2016 £000	2015 Restated £000
Profit on ordinary activities is after charging:		
Depreciation - infrastructure assets*	**1,483**	1,234
- non infrastructure assets	**4,626**	3,844
(Loss)/profit on disposal of fixed assets	**(562)**	3
Rates	**2,069**	2,023
Water abstraction charges	**1,322**	1,327
Hire of plant and machinery	**23**	8
Operating lease charges	**192**	241
Auditors' remuneration:		
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**32**	31
Fees payable to the Company's auditor for other services:		
Audit related assurance services	**53**	21
Taxation compliance services	**5**	4
Other non-audit services	**3**	19
Fees in respect of the Brockhampton Pension Scheme: Audit**	**3**	3

*Restated in accordance with FRS 102 (note 30)
**Not paid by the Company

Notes to the Financial Statements

7. Investment income

	2016 £000	2015 £000
On loan from group company	**967**	955
Interest on short term deposit	**26**	9
Other interest receivable	**3**	10
	996	974

8. Interest payable and similar charges

	2016 £000	2015 £000
£66.5m loan:		
Interest	**3,564**	3,517
Indexation	**994**	2,400
Amortisation of fees	**57**	57
Administration fees	**110**	44
Other bank loans and overdraft	**41**	75
Debenture stock	**10**	10
Other interest payable	**2**	3
	4,778	6,106

9. Taxation

	2016 £000	2015 Restated £000
Current tax		
United Kingdom corporation tax at 20% (2015 - 21%)	**1,172**	402
Adjustment in respect of prior periods	**64**	-
	1,236	402
Deferred tax		
Origination and reversal of timing differences	**132**	40
Effect of change to corporation tax rate	**(695)**	-
Difference between pension cost charge and pension cost relief	**39**	96
	(524)	136
Tax on profit on ordinary activities	**712**	538

Factors affecting the tax charge for the year		
Profit on ordinary activities before tax	**4,240**	2,449
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2015 - 21%)	**848**	514
Effect of:		
Expenses not deductible for tax purposes	**68**	4
Depreciation on assets not qualifying for capital allowances	**100**	93
Effect of change in tax rate	**(695)**	-
Other tax adjustments	**88**	(73)
Prior year adjustment - current tax	**64**	-
Prior year adjustment - deferred tax	**239**	-
Total tax charge for year	**712**	538

No deferred tax balances are expected to reverse during the year to March 2017 (2016 - none).

10. Dividends

	2016 £000	2015 £000
Equity: Ordinary/"A" Ordinary		
Interim paid	**585**	578
Final paid	**580**	195
	1,165	773

The directors are proposing the payment of a final dividend of £0.6m for the year ended 31 March 2016. This dividend has not been accounted for within the current year financial statements, as it has yet to be approved.

11. Intangible fixed assets

	Intangible fixed assets £000
At 1 April 2015	-
Amounts reclassified for tangible fixed assets	127
Amortisation	(50)
At 31 March 2016	77

	Software, consultancy and internal staff costs £000
Cost	
At 1 April 2015	-
Transferred from fixed assets	127
Additions	-
At 31 March 2016	127
Amortisation	
At 1 April 2015	-
Transferred from fixed assets depreciation	50
Charge for year	-
At 31 March 2016	50
Net book value	
At 1 April 2015	-
At 31 March 2016	77

Intangible fixed assets primarily comprise software costs and the in house development of bespoke software and related IT solutions.

12. Investment properties

	Investment properties Restated £000
Valuation	
At 1 April 2015	440
Additions	-
Revaluation	-
Disposals	-
At 31 March 2016	440

The historic cost of the investment properties at 31 March 2016 was £0.195m (2015 - £0.195m)

Investment properties were revalued at open market value as at 31 March 2016 by Vail Williams LLP, an independent valuer. The property portfolio is valued on a five year cyclical basis with 1/5 of properties valued independently each year. This is then used as the basis of a Directors valuation to update the value of the total portfolio. The method of determining fair value was on an open market basis taking account of RICS guidance. There was no material uplift in values for the year.

There are no restrictions on the realisability of investment property. There are no contractual obligations to purchase, construct or develop investment property or to make any repairs or enhancements.

Notes to the Financial Statements

13. Tangible fixed assets

	Freehold land, buildings, & reservoirs Restated £000	Mains Restated £000	Pumping plant £000	Vehicles, mobile plant & office equipment £000	Total Restated £000
Cost					
At 1 April 2015 (as previously stated)	52,958	145,522	42,049	20,915	261,444
FRS 102 adjustments	(195)	(91,975)	-	-	(92,170)
At 1 April 2015 (restated)	52,763	53,547	42,049	20,915	169,274
Additions	522	1,712	4,635	2,474	9,343
Revaluation	-	-	-	-	-
Disposals	(171)	(88)	-	(3,494)	(3,753)
Reclassification to intangible fixed assets	-	-	-	(127)	(127)
At 31 March 2016	53,114	55,171	46,684	19,768	174,737
Depreciation					
At 1 April 2015 (as previously stated)	11,818	90,300	22,056	13,767	137,941
FRS 102 adjustments	(43)	(89,066)	-	-	(89,109)
At 1 April 2015 (restated)	11,775	1,234	22,056	13,767	48,832
Charge for year	528	1,483	2,121	1,977	6,109
Disposals during year	(44)	-	-	(3,113)	(3,157)
Reclassification to intangible fixed assets	-	-	-	(50)	(50)
At 31 March 2016	12,259	2,717	24,177	12,581	51,734
Capital Contributions					
At 1 April 2015 (as previously stated)	-	24,384	-	-	24,384
FRS 102 adjustments	-	(24,384)	-	-	(24,384)
At 1 April 2015 (restated)	-	-	-	-	-
Net book value					
At 31 March 2016	40,855	52,454	22,507	7,187	123,003
At 31 March 2015 (restated)	40,990	52,313	19,993	7,148	120,444

Assets in the course of construction

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

	Freehold land, buildings, & reservoirs £000	Mains £000	Pumping Plant £000	Vehicles, mobile plant & office equipment £000	Total £000
Cost					
At 1 April 2015	178	-	497	1,207	1,882
Transferred to intangible fixed assets	-	-	-	(127)	(127)
Additions	61	-	3,210	1,042	4,313
At 31 March 2016	239	-	3,707	2,122	6,068
Depreciation					
At 1 April 2015	-	-	-	39	39
Transferred to amortisation within intangible fixed assets	-	-	-	(50)	(50)
Charge for year	-	-	-	144	144
At 31 March 2016	-	-	-	133	133
Net book value					
At 31 March 2016	239	-	3,707	1,989	5,935
At 31 March 2015	178	-	497	1,168	1,843

No depreciation has so far been provided on the above cost, with the exception of certain minor elements of the new Works and Asset Management System, part of which has now been brought into use.

Included within freehold land, buildings and reservoirs at cost was an amount of £0.611m relating to a capital project involving the design and construction of a winter storage reservoir at Havant Thicket. Costs incurred to date were in respect of initial design, planning application and environmental impact studies. This project is unlikely to start in the foreseeable future and therefore the expenditure is considered to have no economic benefit. An impairment provision was made in the year 2014. An earlier impairment provision of £1.086m had been made as at the 31 March 2011, therefore the total costs to date relating to this project of £1.697m have been taken as impaired and provided for.

14. Fixed asset investments

	Loans to Group undertakings £000
At 1 April 2015	56,334
Repayment	(350)
At 31 March 2016	55,984

Non-current asset investments represent a loan to the parent entity South Downs Limited. These loans are repayable other than by instalments and are held at amortised cost.

15. Current asset investments

	Unlisted Investments £000
As at 1 April 2015 and 31 March 2016	2

16. Debtors

	2016 £000	2015 £000
Trade debtors	**3,631**	3,368
Amount owed by Group companies	**3,845**	3,190
Prepayments and accrued income	**14**	15
Other debtors	**407**	457
	7,897	7,030

All of the above amounts fall due within one year.

As at 31 March 2016, trade debtors had a carrying value of £7.176 (2015 - £6.723m) before provision for bad debt. Trade debtors in arrears are provided for on a sliding scale depending on age of debt. The amount of the provision was £3.545m as at 31 March 2016 (2015 - £3.355m).

The ageing of these debtors was as follows:	**2016 £000**	2015 £000
Up to 12 Months	**4,040**	4,061
Over 12 Months	**3,136**	2,662
	7,176	6,723

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.

	2016 £000	2015 £000
At 1 April 2015	**3,355**	2,779
Provision for bad debt required in the year	**809**	1,125
Debt written off in the year as uncollectable	**(619)**	(549)
At 31 March 2016	**3,545**	3,355

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.

17. Cash at bank and in hand

Of the total amount shown of £9.206m (2015 - £6.776m), £1.801m (2015 - £1.777m) is held specifically for the payment of the next half yearly loan interest charges.

	2016 £000	2015 £000
Cash at bank and in hand	**9,206**	6,776

Notes to the Financial Statements

18. Creditors: amounts falling due within one year

	2016 £000	2015 Restated £000
3% Perpetual debenture stock	**60**	60
3½% Perpetual debenture stock	**185**	185
4% Perpetual debenture stock	**39**	39
Payments received on account	**2,414**	2,743
Trade creditors	**1,800**	1,382
Amounts owed to group companies	**1,640**	1,522
Social security and other taxation	**624**	252
Other creditors	**2,111**	1,231
Accruals	**1,010**	668
Water rates in advance	**6,934**	6,592
	16,817	14,674

Included in creditors is a liability for current year Corporation Tax of £0.361m (2015 - credit of £0.479m).

19. Creditors: amounts falling due after more than one year

	2016 £000	2015 £000
In five years or more:		
Bank loan	**98,662**	97,668
Less: deferred arrangement costs	**(938)**	(995)
	97,724	96,673

The thirty year £66.5m index-linked loan was issued on 26 June 2002, is repayable on 30 September 2032, and is secured upon the assets of the Company. The capital value of the loan is adjusted by the change in the Retail Prices Index from year to year. The fees associated with the loan issue of £1.722m are amortised over the life of the loan. The balance shown above is net of deferred arrangement costs of £0.938m (2015 - £0.995m).

The loan interest is calculated by adjusting the value of the loan by the Retail Prices Index and then charging interest on this amount at 3.635% per annum.

20. Deferred income: Capital contributions

	2016 £000	2015 Restated £000
Capital contributions	**25,011**	24,384
Release of capital contribution to turnover	**(582)**	(567)
	24,429	23,817

21. Provisions for liabilities

	2016 £000	2015 Restated £000
Deferred taxation:		
At 1 April 2015	**6,949**	6,909
Charged during the year in income statement	**(563)**	40
At 31 March 2016	**6,386**	6,949

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

	2016 £000	2015 Restated £000
Total deferred taxation including deferred tax on pension asset:		
Accelerated capital allowances	**9,905**	10,890
Other timing differences	**(3,519)**	(3,941)
	6,386	6,949
Pension asset (note 25)	**3,200**	2,257
Total provision for deferred tax	**9,586**	9,206

	2016 £000	2015 Restated £000
At 1 April 2015	**9,206**	10,942
Deferred tax charge in income statement (note 9)	**(524)**	136
Deferred tax charged to the statement of comprehensive income	**904**	(1,872)
At 31 March 2016	**9,586**	9,206

Notes to the Financial Statements

22. Financial instruments

The Company has financial instruments in the form of inter-company balances and third party loans. The carrying values of Company's financial assets and liabilities are summarised by category below:

	2016 £000	2015 £000
Financial assets		
Fixed asset investment	**55,984**	56,334
Current asset investment	**2**	2
Cash at bank and in hand	**9,206**	6,776
	65,192	63,112

	2016 £000	2015 £000
Financial liabilities		
Bank loans and overdrafts	**97,724**	96,673
Debenture stock	**284**	284
	98,008	96,957

Sterling	**Fixed Rate 2016 £000**	Fixed Rate 2015 £000	**Floating Rate 2016 £000**	Floating Rate 2015 £000	**Total 2016 £000**	Total 2015 £000
Liabilities						
Bank loans and overdraft	**97,724**	96,673	**-**	-	**97,274**	96,673
Debenture stock	**284**	284	**-**	-	**284**	284
	98,008	96,957	**-**	-	**98,008**	96,957

Fixed Rate	**Weighted average interest rate % 2016**	Weighted average interest rate % 2015	**Weighted average period for which rate is fixed Years 2016**	Weighted average period for which rate is fixed Years 2015
Sterling	**3.6**	3.6	**16**	17

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 2016 is detailed below:

	2016 £000	2015 £000
In one year or less	**284**	284
In more than five years	**97,724**	96,673
	98,008	96,957

The Company had undrawn committed borrowing facilities at 31 March 2016, in respect of which all conditions precedent had been met, as follows:

	2016 £000	2015 £000
Expiring within one year	**4,000**	4,000
Expiring between one and two years	**10,000**	10,000
	14,000	14,000

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

23. Called up share capital

	2016 £000	2015 £000
Authorised:		
Equity:		
6,000,000 Ordinary Shares of 10p each	**600**	600
10,500,000 'A' Ordinary Shares of 10p each	**1,050**	1,050
	1,650	1,650
Non-equity:		
3,250,000 Redeemable Preference Shares of £1 each	**3,250**	3,250
Total	**4,900**	4,900
Allotted, called up and fully paid:		
Equity:		
4,265,177 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 share. The Ordinary Shares are the only class of share to carry voting rights.

In a distribution on the winding up of the Company, the Ordinary and 'A' shareholders are entitled to share the balance of any surplus assets pari passu according to the amount paid up or credited as paid up on their shares.

24. Cash generated from operations

	2016 £000	2015 Restated £000
Profit on ordinary activities before taxation	**4,240**	2,449
Adjustments for:		
Finance costs recognised in income statement	**4,778**	6,106
Notional pension costs	**168**	374
Investment income recognised in income statement	**(996)**	(974)
Other finance income	**(382)**	(859)
Increase in fair value of investment property	**-**	(30)
Loss on disposal of asset	**562**	190
Depreciation and impairment of plant, property and equipment	**6,109**	5,076
Amortisation of capital contributions	**(582)**	(567)
Movements in working capital:		
Decrease/(increase) in stocks	**152**	(200)
(Increase) in debtors	**(1,351)**	(294)
Increase in creditors	**953**	620
Cash generated from operations	**13,651**	11,891

Notes to the Financial Statements

25. Pensions

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

The formal actuarial valuation as at 31 March 2013 was updated to 31 March 2016 accounting date by an independent qualified actuary in accordance with FRS 102. As required by FRS 102, the value of the defined benefit liabilities has been measured using the projected unit method.

The estimated contributions expected to be paid to the Scheme by Portsmouth Water Limited for the year commencing 1 April 2016 is £1.4m (2015 actual - £1.3m). Of this amount, £1.1m is contributed directly by that Company and £0.3m is contributed by employees by salary sacrifice under the SMART arrangement.

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

	2016 % per annum	2015 % per annum	2014 % per annum
RPI inflation	**3.0%**	3.1	3.5
CPI inflation	**2.1%**	2.2	2.6
Discount Rate	**3.4%**	3.2	4.3
Pension increases	**2.1%**	2.2	2.6
Salary growth	**5.25%**	5.35	5.75

Life expectancy of a male aged 65 at the accounting date is 23.7 years and for a female is 26 years.

Allowances for future improvements in the life expectancy mean that life expectancy of a male aged 65 at the accounting date plus 20 years is 26 years and for a female is 27.9 years.

The fair value of assets in the scheme, a breakdown of the assets into the main asset classes, the present value of the FRS 102 defined benefit obligation and the surplus of assets over the FRS 102 defined benefit obligation (which equals the gross pension asset) are set out below:

	%	**2016 Fair Value £000**	%	2015 Fair Value £000	%	2014 Fair Value £000
Equities	**34**	**47,932**	44	63,285	49	65,741
Absolute Return Fund	**23**	**33,134**	6	8,912	7	9,004
Bonds	**-**	**-**	40	58,372	36	48,819
LDI	**21**	**29,557**	-	-	-	-
Property	**10**	**14,032**	3	4,102	3	4,422
Cash	**12**	**17,125**	7	9,544	5	6,625
	100	**141,780**	100	144,215	100	134,611

	2016 £000	2015 £000
Total fair value of scheme assets	**141,780**	144,215
FRS 102 value of scheme defined benefit obligation	**(124,005)**	(132,928)
Gross pension asset	**17,775**	11,287
Related deferred tax liability	**(3,200)**	(2,257)
Net pension asset	**14,575**	9,030

Under FRS 102, the scheme is represented on the statement of financial position at 31 March 2016 by an asset of £17.775m (2015 - £11.287m), which amounts to £14.575m net of deferred tax (2015 - £9.030m).

Portsmouth Water Limited paid contributions at a rate of 20.6% of earnings. Members pay contributions at a rate of 5% of earnings via salary sacrifice.

Portsmouth Water Limited also operates a defined contribution pension scheme. The contributions payable by Portsmouth Water Limited for the year in respect of the defined contribution scheme amounted to £136,433 (2015 - £108,910).

Movement in the net balance sheet position

The FRS 102 value of scheme assets moved over the period as follows:	**2016 £000**	2015 £000
Opening net asset	**11,287**	20,163
Expense charged to profit and loss	**(1,113)**	(453)
Gain recognised outside of profit and loss	**6,274**	(9,361)
Employer contributions	**1,327**	938
Closing net asset	**17,775**	11,287

Movement in present value of defined benefit obligation

The FRS 102 value of scheme defined benefit obligation moved over the period as follows:	**2016 £000**	2015 £000
Opening scheme liabilities	**132,928**	114,448
Employer's part of current service cost	**1,495**	1,312
Interest on scheme liabilities	**4,191**	4,864
Benefits paid	**(3,971)**	(3,987)
Actuarial (gain)/loss	**(10,638)**	16,291
Closing scheme defined benefit obligation	**124,005**	132,928

Movement in fair value of scheme assets

The FRS 102 value of scheme assets moved over the period as follows:	**2016 £000**	2015 £000
Opening fair value of scheme assets	**144,215**	134,611
Interest on scheme assets	**4,573**	5,723
Contributions by Portsmouth Water Limited, including employee contributions under the SMART arrangement	**1,327**	938
Benefits paid	**(3,971)**	(3,987)
Actuarial (loss)/gain	**(4,364)**	6,930
Closing fair value of scheme assets	**141,780**	144,215

Expense recognised in income statement

The following amounts have been included within operating profit:	**2016 £000**	2015 £000
Current service cost (employer's part only)	**(1,495)**	(1,312)
Past service cost	**-**	-
Total operating charge	**(1,495)**	(1,312)
The following amounts have been included as other finance income under FRS 102:		
Interest on pension scheme assets	**4,573**	5,723
Interest on pension scheme defined benefit obligation	**(4,191)**	(4,864)
Net return	**382**	859
Total expense recognised in the income statement	**(1,113)**	(453)

Accounts recognised outside income statement

The following amounts have been recognised within the statement of changes in equity:	**2016 £000**	2015 £000
Actual return less interest	**4,364**	6,930
Experience (gains)/losses arising on scheme defined benefit obligation	**(4,398)**	285
(Gain) due to changes in assumptions	**(6,240)**	(16,576)
Remeasurement of net defined benefit asset	**(6,274)**	(9,361)

The actual return on plan assets was £0.209m in the year to 31 March 2016 (2015 - £12.653m).

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

26. Lease commitments

At the reporting date the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2016 £000	2015 £000
Within one year	**192**	192
Between one and five years	**-**	192
In more than five years	**-**	-
	192	384

Notes to the Financial Statements

27. Ultimate controlling party

At 31 March 2016 the Company's ultimate parent undertaking was South Downs Capital Limited, which is the parent of both the smallest and largest groups of which the Company is a member. There is no ultimate controlling party but South Downs Capital Limited is controlled by the Directors of the Employee Benefit Trust which is the ultimate controlling shareholder. Copies of the consolidated accounts can be obtained on request from the Registered Office.

28. Capital commitments

	2016 £000	2015 £000
Relating to fixed assets	**6,734**	2,649
Relating to intangible assets	**200**	-
	6,934	2,649

This increase is due to a new UV and discharge treatment works at Farlington (£3.682m), Eastergate/Westergate (£1.2m) and a chlorination treatment works (£1.194m).

29. Related Party Transactions

The Company has taken advantage of the exemption available in FRS 102 "Related Party Disclosures" whereby it has not disclosed transactions with any wholly owned subsidiary undertaking of the Group.

30. Explanation of transition to FRS 102

This is the first year that the Company has presented its financial statements under Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council. The following disclosures are required in the year of transition. The last financial statements under previous UK GAAP were for the year ended 31 March 2015 and the date of transition to FRS 102 was therefore 1 April 2014. The accounting policy changes required in order to comply with FRS 102 are explained below.

Reconciliation of balance sheet	note	**At 1 April 2015 As previously stated £000**	**At 1 April 2015 Effect of transition £000**	**At 1 April 2015 FRS 102 (as Restated) £000**	At 31 March 2014 As previously stated £000	At 31 March 2014 Effect of transition £000	At 31 March 2014 FRS 102 (as Restated) £000
Fixed assets							
Investment properties		**-**	**440**	**440**	-	410	410
Tangible assets	A & C	**99,119**	**21,325**	**120,444**	100,043	19,829	119,872
Investments		**56,334**	**-**	**56,334**	59,384		59,384
Financial assets		**155,453**	**21,765**	**177,218**	159,427	20,239	179,666
Current assets							
Stocks		**744**	**-**	**744**	544	-	544
Debtors		**7,030**	**-**	**7,030**	6,760	-	6,760
Investments		**2**	**-**	**2**	2	-	2
Bank and cash		**6,776**	**-**	**6,776**	4,503	-	4,503
		14,552	**-**	**14,552**	11,809	-	11,809
Creditors due within one year							
Loans and overdrafts		**(284)**		**(284)**	(5,284)		(5,284)
Trade Creditors		**(4,125)**	**-**	**(4,125)**	(3,072)	-	(3,072)
Taxation and social security		**(252)**	**-**	**(252)**	(235)	-	(235)
Other creditors	B	**(8,900)**	**409**	**(8,491)**	(9,021)	743	(8,278)
Inter-company amounts		**(1,522)**	**-**	**(1,522)**	(1,506)	-	(1,506)
		(15,083)	**409**	**(14,674)**	(19,118)	743	(18,375)
Net current liabilities		**(531)**	**409**	**(122)**	(7,309)	743	(6,566)
Total assets less current liabilities		**154,922**	**22,174**	**177,096**	152,118	20,982	173,100
Creditors due after one year							
Loans and overdrafts		**(96,673)**	**-**	**(96,673)**	(94,216)	-	(94,216)
		(96,673)	**-**	**(96,673)**	(94,216)	-	(94,216)
Provisions for liabilities							
Deferred tax liabilities	D	**(8,363)**	**1,414**	**(6,949)**	(8,021)	1,112	(6,909)
Accruals and deferred income	C	**-**	**(23,817)**	**(23,817)**	-	(23,067)	(23,067)
Pension scheme asset		**9,030**	**-**	**9,030**	16,130	-	16,130
Net assets		**58,916**	**(229)**	**58,687**	66,011	(973)	65,038
Capital and reserves							
Share capital		**1,078**	**-**	**1,078**	1,078	-	1,078
Share premium account		**1,539**	**-**	**1,539**	1,539	-	1,539
Capital redemption reserve		**3,250**	**-**	**3,250**	3,250	-	3,250
Income statement		**53,049**	**(229)**	**52,820**	60,144	(973)	59,171
Shareholders' funds		**58,916**	**(229)**	**58,687**	66,011	(973)	65,038

Notes

A. Property Plant and Equipment

Treatment of Mains Infrastructure
Under previous GAAP a particular accounting treatment was available for Utility companies known as "infrastructure renewals accounting". This accounting treatment is no longer permitted under FRS 102. Accordingly, a number of adjustments were made to reverse infrastructure renewals charges, write off infrastructure renewals prepayments to reserves and to expense infrastructure which did not meet the Company's capitalisation policy (see note 1 Accounting Policies). These were replaced by a depreciation charge on mains infrastructure and capitalisation of mains expenditure which met the Company's accounting policy. The detailed adjustments made are summarised below;

	£'000
Reversal of Infrastructure Renewals Accounts (net)	1,594
Depreciation charge on infrastructure assets	(1,234)
Write off infrastructure renewals "prepayment"	(3,086)
Reclassify capital contributions as deferred income	24,384
Mains disposals	(183)
	21,475

Investment Properties
Investment properties at net book value of £150,000 were re-classified from "Tangible Fixed Assets" to "Investment Properties" and revalued to their market value of £440,000.

B. Other Creditors

Holiday Pay Accrual
FRS 102 requires a provision for any accrued but unused paid leave entitlement of £70,000.

Corporation Tax Payable
Adjustments required as a result of FRS 102 have been tax affected with a net reduction of £479,000

C. Capital Contribution
The Company routinely receives payments as contribution towards the cost of new mains ("capital contributions"). Previously these were accounted for as a reduction of the carrying value of fixed assets and not recognised in the Profit and Loss account.

In accordance with the requirements of FRS 102 these have been reclassified as deferred income and will be amortised to turnover over the useful economic life of the related mains assets (see Accounting Policies note A). This has resulted in an increase in turnover of £567,000 in the year.

D. Deferred Tax
Under previous UK GAAP deferred tax was discontinued back to present value. Discounting of deferred tax is not permitted under FRS 102 therefore this adjustment reflects the reversal of the discounting of £907,000. This is offset by the deferred tax impact of accounting for infrastructure assets of £4,653,000 as explained in notes A and C above.

Reconciliation of profit (For the year ended 31 March 2015)

	note	As previously stated £000	Effect of transition £000	FRS 102 (as Restated) £000
Turnover	C	38,271	567	38,838
Cost of sales	E	(20,839)	179	(20,660)
Gross profit		17,432	746	18,178
Net operating expenses	F	(11,490)	1	(11,489)
Operating profit		5,942	747	6,689
Profit/(loss) on sale of plant, property and equipment		3	-	3
Investment property revaluation	G	-	30	30
Profit on ordinary activities before interest		5,945	777	6,722
Interest receivable		974	-	974
Other finance income	H	2,323	(1,464)	859
Interest payable		(6,106)	-	(6,106)
Profit on ordinary activities before taxation		3,136	(687)	2,449
Taxation	I	(798)	260	(538)
Profit for the year		2,338	(427)	1,911

Notes to the Financial Statements

E. Cost of Sales

The net decrease in cost of sales of £179,000 arises primarily for the changes in accounting for main infrastructure explained in note A.

- Infrastructure renewals costs (not capitalised) of £3,667,000 net have been expensed. Depreciation charges on mains have fallen by £4,027,000 (being the reversal of Infrastructure renewals charges of £5,261,000 offset by depreciation on mains of £1,234,000)
- Mains disposals of £183,000 have been recognised.

In addition there was a reversal of depreciation previously charged on investment properties of £2,000.

F. This is the reduction in the holiday pay accrual of £1k between 2014 and 2015 year ends (see note B).

G. This represents the change in fair value of the investment property recognised during the year (see note A).

H. Remeasurement of net defined benefit obligation

This relates to the change in the FRS 17 report figures from an expected return on scheme assets to actual interest on assets. The pension scheme asset has remained the same; therefore the difference has been recognised as a decrease to the actuarial loss of £1,464,000 within the statement of comprehensive income.

I. Taxation

The taxation charge for the period reflects the tax effects of adjustments made the most significant relating to changes in mains infrastructure accounting. These have been summarised below;

	£		
Current Tax Charge	335,000	Mains Infrastructure	note A, C
Deferred Tax Charge	(241,000)	Mains Infrastructure	note A, C
Deferred Tax Charge	(293,000)	Pension	note H
Deferred Tax Charge	(61,000)	Removal of Discounting	note D
	(260,000)		

Statement of Changes in Other Comprehensive Income (Year ended 31 March 2015)

	note(s)	As previously stated	Effect of Transition	FRS 102 as Restated
Profit for the Financial Year		2,338	(427)	1,911
Remeasurement of net defined benefit obligation	H	(10,825)	1,464	(9,361)
Deferred tax on remeasurement of defined benefit obligation	H & I	2,165	(293)	1,872
Other comprehensive income for the year net of tax		(8,660)	1,171	(7,489)
Total comprehensive income for the year		(6,322)	744	(5,578)

Statement of Changes in Equity (Year ended 31 March 2015)

	note(s)	As previously stated	Effect of Transition	FRS 102 as Restated
Balance as at 1 April 2014		66,011	(973)	65,038
Profit for the year		2,338	(427)	1,911
Other comprehensive income for the year	H & I	(8,660)	1,171	(7,489)
Total comprehensive income for the year		(6,322)	744	(5,578)
Dividend		(773)	-	(773)
Balance as at 31 March 2015		58,916	(229)	58,687

Notice of Meeting

Notice is hereby given that the Annual General Meeting of Portsmouth Water Limited will be held at the Company's Registered Office, PO Box 8, West Street, Havant, Hants, at 11.00am on Wednesday, the 27th day of July 2016, on the following business:

1. To receive and consider the Directors' Report and Accounts for the year ended 31 March 2016 and the Auditors' Report thereon.

2. To approve the Report on Remuneration.

3. To elect Mrs. H. M. G. Orton a Director of the Company.

4. To re-elect Mrs. H. V. Benjamin a Director of the Company.

5. To approve a total final dividend of £602,000 to be made to the holders of Ordinary and 'A' Ordinary Shares.

6. 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
27 May 2016

By order of the Board
C. Hardyman ACIS
Secretary

Notes:

i) Debenture holders are reminded that the holding of debenture stock does not entitle them to attend or vote at the meeting.

ii) Shareholders are reminded that no voting rights attach to the 'A' Ordinary Shares. 'A' Ordinary Shareholders are not entitled to attend the meeting.

iii) A proxy form is enclosed for Shareholders entitled to vote at the meeting.

iv) To be valid proxies must reach the Company's Registered Office not later than forty-eight hours before the time fixed for the meeting.

Appendix 1 KPI Calculations

a) Gearing - Net Debt: RCV	**2016**	2015
	£000	£000
(i) Debt		
Bank loan (note 19)	**98,662**	97,668
Debenture stock (note 18)	**284**	284
Cash at bank and in hand	**(9,206)**	(6,776)
Net debt	**89,740**	91,176
Regulatory capital value indexed to 31 March	**127,912**	125,964
(iii) Gearing - Debt: RCV ratio (i) ÷ (ii)	**70.2%**	72.4%

For the purposes of this ratio, debt excludes the deferred arrangement costs of £0.938m (2015 - £0.995m) and the current asset investment of £0.002m (2015 - £0.002m).

b) Cash interest cover	**2016**	2015
		Restated
	£000	£000
Operating profit	**8,202**	6,689
Add back Employee Benefit Trust payment	**1,209**	1,157
Notional pension costs (note 24)	**168**	374
Depreciation charges (note 13)	**6,109**	5,078
Loss on disposal of fixed assets (below operating profit)	**(562)**	-
Other items	**0**	10
Interest received, excluding amounts for inter-company loan (note 7)	**29**	19
Taxation, excluding payments for group relief	**(180)**	19
Capital expenditure (net of contributions)	**(7,419)**	(4,246)
Amortisation of deferred capital contributions	**(582)**	(567)
Loan repayment from Group company	**350**	3,050
Repayment of loan	**0**	(5,000)
	7,324	6,583
(ii) Interest paid	**3,735**	3,657
(iii) Cash interest cover ratio (i) ÷ (ii)	**1.96**	1.80

c) Return on regulatory equity	**2016**	2015
		Restated
	£000	£000
Revenue	**39,795**	38,838
Operating costs, excluding Employee Benefit Trust payments and depreciation	**(24,275)**	(25,914)
Current cost depreciation	**(5,540)**	(5,911)
Infrastructure depreciation	**(1,483)**	(1,234)
Earnings before interest and tax	**8,497**	5,779
Current tax charge	**(1,236)**	(402)
Interest payable, excluding indexation and amortisation	**(3,727)**	(3,649)
(i) Return	**3,534**	1,728
(ii) Average Regulatory Capital Value, equity element only	**37,881**	33,680
(iii) Return on regulatory equity (i) ÷ (ii)	**9.3%**	5.1%