Portsmouth Water Limited

Preliminary results for the year ended 31 March 2018

Portsmouth Water Limited, a supplier of water to Hampshire and West Sussex, announced its results for the year to 31 March 2018.

Company Number: 2536455

Highlights

- At £100 our average household bill continues to the lowest in England and Wales
- Over 5,000 households have joined our Social Tariff scheme
- RoSPA Presidents Award winner for the fourth successive year
- Received the ServiceMark charter from the Institute of Customer Service and ranked top water utility company
- Established Wholesaler in the non-household Open Water market
- Completed and signed off all required environmental schemes

Turnover

£40.5m

2018	40.5m
2017	40.3m
2016	39.8m

Cash generated from operations[1]

£12.6m

2018	12.6m
2017	10.6m
2016	13.7m

Capital expenditure

£7.5m

2018	7.5m
2017	9.4m
2016	9.3m

Operating profit[2]

£6.4m

2018	6.4m
2017	5.6m
2016	7.6m

(Loss)/profit before tax

£(1.1)m

2018	(1.1)m
2017	1.5m
2018	4.2m

[1]*After adjusting £11.0m atypical cash balance*
[2]*After loss on disposal of fixed assets and before other exceptional items*

Chairman's Statement

I have great pleasure in presenting the Annual Report and Accounts for what has been a productive year for Portsmouth Water. We have maintained our focus on delivering excellent customer service, alongside the lowest household bill in the county (by a significant margin) whilst maintaining a sound underlying financial performance. Our programme of capital works to maintain and, where necessary, to enhance our infrastructure progressed well during the year. Alongside this, we have seen a significant increase in the work required to prepare for the forthcoming 5-yearly price review that is undertaken by our economic regulator, Ofwat. This involves extensive consultation with our customers to ensure that our Business Plan delivers the Outcomes that are important to them.

This Business Plan will see the start of the delivery of the Havant Thicket Winter Storage Reservoir ("HTWSR") project. This will create a major new regional water resource and the associated works can also enhance operational resilience to Portsmouth Water's customers.

Our Customers

We were pleased to be ranked 4th for customer satisfaction in the Independent Service Incentive Mechanism (SIM) survey conducted for Ofwat. The survey contributes 75% of the overall SIM score, with the remainder relating to quantitative measures recording complaints and unwanted telephone contacts. We are mindful that our customers' expectations on customer service are driven not just by how we compare to other water companies, but to a wide range of companies that they have experience of. We therefore took the decision in 2015 to become a member of the Institute of Customer Service who conducted a satisfaction survey of our customers for the second time this year. The results were very positive, with our score being the highest of any water company member and the second highest of any utility company member. The number of written complaints that we receive per 10,000 customers fell to 10.3, this is expected to be one of the lowest in the industry.

Although we have the lowest average water bills in the country, we realise that affordability remains an issue for some customers on low incomes and our Helping Hand Social Tariff provides support for those who have genuine difficulty paying bills. We now have over 5,300 customers signed up which is ahead of our target. This is part of our range of services to help support those in society that need help or support, either at specific times of increased vulnerability, or more generally.

In the third year of the current regulatory period, we achieved all but four of our Outcome Deliver Incentives (ODI's) – the measures that were agreed as representing how we are meeting the standards expected in those areas of our service that matter the most to our customers.

Leakage for the year at 32.9Ml/day was higher than the target of 29.8Ml/day (although this is a target that is measured over the whole five years of the review period and the average over the three years to date is 30.3Ml/day). Whilst this was impacted by some extreme weather in the early part of 2018, this is not acceptable and we continue to make significant investment to reduce this to below the target level over the five year period.

Water quality contacts for taste and appearance remained over our target, despite being at a level which is amongst the lowest in the Industry and is indicative of the high standards we set ourselves.

Water Quality is fundamental to our business and whilst 99.93% of samples taken from customer taps met the standards set by the Drinking Water Inspectorate, this fell below our performance standard of 99.95%. This was driven by three customer-side failures; two relating to household lead plumbing and the final relating to contamination due to the use of herbicide in a neighbour's garden.

The volume of water used by each household customer (per capita consumption) is higher than our target of 145 litres per day by 2 litres. Whilst we make significant efforts to advise customers how to use water efficiently we cannot control their usage which, in dry periods, increases significantly.

We are pleased with our strong performance in the other areas.

Our Infrastructure

Over many years we have invested in the operational resilience of our infrastructure and have a robust network of pipes and treatment works. We are able to move water across our region and we are capable of providing water from more than one source to almost all of our customers. In the year we completed construction of ultra violet (UV) treatment at our largest works at Farlington. The improvements were made to address the increased risk of cryptosporidium in the raw water, which, although low can, if left untreated, can cause illness.

During the year we invested a total of £5.5m replacing and repairing 23km of pipes and constructing a further 7km to maintain the long term reliability of our network. Over the five years of this regulatory period we expect to replace 110km of pipe representing 3.3% of the network. We have also completed a detailed study of the resilience of all our resources to pollution and flooding. Although the study showed we have a highly resilient infrastructure, we have identified the need for some focused investment, which we will bring forward into the PR19 Business Plan.

Our Business

During the year, we have committed significant resources to preparatory work for the PR19 Business Plan. This has involved multiple work streams across the business and support from a range of specialists. As highlighted earlier, our PR19 strategy builds on the Company's strong water resources position, with plans to support increasing levels of bulk water supply to our neighbouring water company, through the development of a major regional water resource, the HTWSR, over a period of eight years. Alongside this, we are planning ambitious reductions in levels of leakage and per capita consumption, to ensure that we use our existing resources in the most effective way. Our extensive customer engagement programme has progressed well, including the major programme for consultation on the Water Resource Management Plan. We have also undertaken a major engineering programme to analyse operational risk and develop an optimised capital and operating programme for PR19.

Our People

We were delighted to receive the President's Award from the Royal Society for the Prevention of Accidents (RoSPA) for the fourth consecutive year. This recognises 14 consecutive years of winning 10 Gold Awards, four President's Awards and one Industry Sector award. Healthy and Safety remains our number one priority and we are immensely proud of this achievement.

This has been a busy year for our staff, achieving high levels of customer's service and preparing for the PR19 Business Plan submission. On behalf of the Board I would like to thank our staff for the hard work and dedication that has made this possible.

Our Environment

During 2017/18 our work focused on actions to address the areas at higher risk of nitrate pollution. Our Catchment Management Team has been a successful partner in a European Union Interreg project bid to trial "payments for ecosystems services" across our area of supply. This involves looking at new and innovative ways of supporting farmers and landowners to alter their practices and behaviours to deliver cleaner groundwater in our catchments and so avoid the need for costly new processes at our treatment works to remove nitrates. We expect our Catchment Management work to be a long term programme and will see a step change in activity during PR19.

There were no general restrictions to customer supplies in 2017/18. Although the winter was very dry before Christmas, our groundwater levels have since recovered to a level above the long term average and we do not expect any restrictions this summer.

During the year we have constructed and began commissioning infrastructure to enable a new bulk supply to Southern Water from our River Itchen treatment works. This will increase the resilience of the water supply into their Hampshire zone, including Southampton, without reducing the security of supply for our own customers. This scheme is the first of three planned over the next ten years as part of the regional solution to meeting customer requirements across the South East. It is also an important element of the broader Water Resources in the South East plan to ensure adequate supplies across the region now and in the future.

Our Investors

During the year the Group's majority owners, the South Downs Employee Benefit Trust, together with the other individual shareholders, took the decision to sell the entire share capital of the South Downs Capital Group to funds managed by Ancala Partners LLP ("Ancala"). Ancala is an independent mid-market infrastructure investment manager. The acquisition completed in March 2018. The Directors welcome David Owens, an Ancala Industry Partner, to the Board of Portsmouth Water.

The choice of Ancala will allow the Company to continue to maintain a level of independence and will support the Company in continuing to deliver on its strategy to achieve excellence for our customers, employees and the environment. Ancala's investment will also allow the Company to pursue growth opportunities by providing access to additional capital, which will be fundamental to pursuing the HTWSR project.

Financial Results

The results for the year show an operating profit of £6.4m (2017 - £5.6m) before exceptional items. The results benefited from lower infrastructure renewals expenses of £1.4m driven by higher amounts capitalised (due to the nature of specific schemes undertaken). In addition Turnover showed a modest £0.1m increase, staff costs rose by a total of £0.7m and depreciation and amortisation increased by £0.8m. These increases were offset by a range of smaller savings across operational activities.

Two exceptional items arose; a £1.8m gain following the disposal of the non-household retail business and exceptional employers NIC and related charges of £3.0m in connection with the distribution of proceeds to employees following the sale of the business (note 31).

Net interest payable has increased significantly from £4.1m to £6.4m due to higher indexation on the long term loan driven by higher RPI.

Gross capital expenditure in the year fell to £7.5m and reflects the two large projects undertaken in the prior year. The Company renewed 13.8km and built or replaced a further 16.8km of mains at a total cost of £5.5m of which £2.8m is charged to the income statement. The company also began an extensive capital programme of maintenance on above ground assets, which is being executed through an innovative collaborative agreement with contractors. Finally works to enable a new bulk supply of water at the river Itchen have been substantially completed at a cost of £1m.

Higher closing cash of £26.7m (2017 - £11.6m) was impacted by timing differences of £11.0m in cash relating to the distribution of sale proceeds to employees. This relates to PAYE and NIC and was settled in April 2017. Gearing has been adjusted to reflect this atypical balance. In addition cash benefited from lower capital expenditure in the period and issue of equity shares of £3.0m offset by net reduction in borrowings of £1m.

Gearing, after adjusting for the £11m cash timing difference noted above, at 63.6% (2017 – 68.6%) reflects both improved cash and RCV growth.

The cash interest cover ratio of 2.20 times remains above the target of 1.4. Return on Regulatory Equity (RORE) 7.03% (also using an adjusted gearing of 63.6%) is consistent with the prior year of 7.5%.

Mike Kirk
Chairman
24 May 2018

Financial Performance

Gearing and liquidity

Net debt to regulatory capital value is a key covenant defined by the Company's index linked loan documents. Gearing at 55.9% (2017 - 68.6%) improved as a result of higher cash balances, largely driven by transactions relating to the distribution of sales proceeds to employees which have resulted in a temporary increase in cash of £11m. This is explained further in note 31. Once adjusted for this, atypical cash increase gearing at 63.6% is largely consistent with the prior year. Gearing remained comfortably within the 86% ceiling imposed by the bond covenants.

The Company utilised £3m of the £10m revolving credit facility at the year end. The £2m overdraft facility was unused at the year end. These facilities, both with Lloyds Bank, 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 in May 2021 and annually 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 2 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 2.20 times (2017 - 1.44 times) remains comfortably above the 1.4 times covenant required.

Return on regulatory equity (RoRE)

RORE, based on adjusted gearing, at 7.03% remains consistent.

Review of trading performance
Operating Profit

Operating profit at £6.5m shows an increase on the prior period of £5.8m. This was primarily driven by a reduction in infrastructure renewals charged to the income statement of £1.4m. This was offset by a number of one off costs and is discussed further below;

Revenue

The modest increase in turnover was largely driven by average tariff increases of 2% and 2,000 new properties. There was a £0.2 reduction in chargeable work due to levels of activity and a £0.3m increase due to the recognition of meter reading income.

Operating costs

Total operating costs fell by £0.3m which resulted from a number of movements the most significant of which are as follows;

Infrastructure renewals charged to the income statement fell by £1.4m primarily as a result of higher capitalisation due to the nature of programmes undertaken.

Depreciation increased by £0.5m as a result of ongoing increases in capital expenditure and accelerated depreciation on decommissioning of one membrane plant. In addition, amortization increased by £0.3m representing a full year's charge of significant additions in 2017.

Average headcount in the business has increased from 255 to 261 reflecting operational requirements. This, together with the annual salary increase of 2.3% and increased pension charges of £0.3m (due to higher FRS 102 charges) have resulted in increased employee costs (after amounts capitalised) of £0.7m.

Other exceptional items

Two items which we're exceptional in terms of their size and nature were charged to the income statement.

A gain on the disposal of the non-household retail business, which completed on 1 April 2017, of £1.8m (note 32).

As a result of the distribution of sales proceeds to employees, which was deemed to be by virtue of their employment, an exceptional charge of £2.9m arose relating to employers national insurance contributions and apprenticeship levy. To offset this charge share capital and share premium of the same value was injected by our investors. This is explained further in note 31.

Interest & other finance income

Interest payable shows an overall increase of £1.9m which is primarily due to £1.8m higher 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. Investment income fell by £0.1m due to lower interest rates.

Taxation

The tax charge in the period of £0.04m includes a current tax charge of £0.07m and deferred tax credit of £0.03m. The increase in current tax in the period was due to one off credits during the prior year primarily driven by R&D tax credits.

Deferred tax charges reversed primarily due to higher capital allowances.

Dividends

The dividends paid during the year totaled £1.1m (2017 - £1.2m). Dividends are paid up to the parent company with part of the payment being used to service interest payments on an inter-company loan 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 second interim dividend (including amounts servicing intercompany debt) proposed for the year is £1.8m expected to be paid in June.

Capital investments

Gross capital investment in the year was £7.5m (2017 - £9.4m). Further information on the capital programme is set out in the Engineering Report on page 24.

Mains activity

	2017/18 £m	2016/17 £m
Renewals charged in the income statement	**2.8**	4.2
Mains capitalized	**2.7**	1.4
Total mains investments	**5.5**	5.6

During the year the Company renewed 13.8km of mains (2017 - 21.4km) at a cost of £2.8m (2017 - £4.2m) charged to the income statement. A further 16.8km (2017 - 13.9km), of new mains and enhancements to the network were capitalized at a cost of £2.7m (2017 - £1.4m).

Capital contributions

The Company receives capital contributions, primarily in connection with new mains for housing developments, which amounted to £1.2m (2017 - £1.2m). In accordance with the requirements of FRS 102 these contributions are deferred and amortised to the Income Statement.

Pensions

The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest actuarial valuation as at 31 March 2017 was carried out in accordance with FRS 102 and shows a net pension asset (after deferred tax) of £24.8m (2017 - £11.4m). The overall increase in the surplus on actuarial valuation has largely been driven by a number of small movements in key assumptions as set out in note 25.

Income Statement
For the year ended 31 March 2018

	notes	2018 £000	2017 £000
Turnover	3	**40,489**	40,342
Cost of sales		**(22,643)**	(22,872)
Gross profit		**17,846**	17,470
Net operating expenses	4	**(11,384)**	(11,720)
Operating profit before loss on disposal of fixed assets		**6,462**	5,750
Loss on disposal of fixed assets	6	**(16)**	(143)
Exceptional items:			
Exceptional staff costs relating to sale of business	5,31	**(2,988)**	-
Gain on disposal of non-household business	32	**1,843**	-
Operating profit after loss on disposal of fixed assets and exceptional items and before interest		**5,301**	5,607
Investment income	7	**841**	953
Other finance income	25	**346**	625
Interest payable and similar charges	8	**(7,603)**	(5,696)
(Loss)/profit on ordinary activities before taxation	6	**(1,115)**	1,489
Taxation of (loss)/profit on ordinary activities	9	**(41)**	368
(Loss)/profit for the financial year		**(1,156)**	1,857

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 (note 30).

Statement of Other Comprehensive Income
For the year ended 31 March 2018

	notes	2018 £000	2017 £000
(Loss)/profit for the financial year		**(1,156)**	1,857
Remeasurement of net defined benefit asset	25	**16,602**	(4,147)
Movement on deferred tax relating to pension asset	21	**(2,822)**	705
Effect of change to corporation tax rate on pension asset	21	**-**	63
Total comprehensive income/(loss) for the year		**12,624**	(1,522)

Statement of Financial Position

For the year ended 31 March 2018

	notes	**2018 £000**	**2018 £000**	2017 £000	2017 £000
Fixed assets					
Intangible fixed assets	11	**1,674**		2,237	
Investment properties	12	**440**		440	
Tangible fixed assets	13	**126,936**		125,255	
Investments	14	**55,484**		55,484	
			184,534		183,416
Current assets					
Investments	15	**2**		2	
Stock		**608**		474	
Debtors	16	**8,164**		10,903	
Cash at bank and in hand	17	**26,744**		11,644	
		35,518		23,023	
Creditors: Amounts falling due within one year	18	**(31,080)**		(22,864)	
			4,438		159
Total assets less current liabilities			**188,972**		183,575
Creditors: Amounts falling due after more than one year	19		**(103,294)**		(99,613)
Accruals and deferred income: Capital contributions	20		**(25,493)**		(25,012)
Provisions for liabilities	21		**(6,764)**		(6,703)
Net assets excluding pension asset			**53,421**		52,247
Pension asset	25		**24,794**		11,446
Net assets including pension asset			**78,215**		63,693
Capital and reserves					
Called up share capital	23		**1,078**		1,078
Share premium account			**4,527**		1,539
Capital redemption reserve			**3,250**		3,250
Profit and loss account			**69,360**		57,826
Shareholder' funds			**78,215**		63,693

The accompanying notes form an integral part of these accounts.

The accounts were authorised for issue and approved by the Board on 24 May 2018 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 2018

	Called up share capital £000	Share Premium account £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Balance as at 1 April 2016	1,078	1,539	3,250	60,553	66,420
Profit for the year	-	-	-	1,857	1,857
Remeasurement of net defined benefit asset	-	-	-	(4,147)	(4,147)
Movement on deferred tax relating to pension scheme	-	-	-	705	705
Effect of change to corporation tax rate on pension asset	-	-	-	63	63
Total comprehensive income for the year	-	-	-	(1,522)	(1,522)
Dividends	-	-	-	(1,205)	(1,205)
Balance at 31 March 2017	1,078	1,539	3,250	57,826	63,693
Profit for the year	-	-	-	(1,156)	(1,156)
New share capital/share premium issued	-	2,988	-	-	2,988
Remeasurement of net defined benefit asset	-	-	-	16,602	16,602
Movement on deferred tax relating to pension scheme	-	-	-	(2,822)	(2,822)
Effect of change to corporation tax rate on pension asset	-	-	-	-	-
Total comprehensive profit for the year	-	2,988	-	12,624	15,612
Dividends	-	-	-	(1,090)	(1,090)
Balance at 31 March 2018	1,078	4,527	3,250	69,360	78,215

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 2018 £69.072m (2017 - £57.538m) was distributable in accordance with company law and £0.288m (2017 - £0.288m) was not distributable.

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

The accompanying notes form an integral part of these accounts.

Statement of Cash Flows

For the year ended 31 March 2018

	notes	2018 £000	2018 £000	2017 £000	2017 £000
Cash generated from operations	24		**23,601**		10,589
UK corporation tax refund/(paid)		**494**		(555)	
Net payments for group relief		**-**		(167)	
			494		(722)
Net cash inflow from operating activities			**24,095**		9,867
Cash flows from investing activities					
Purchase of tangible assets		**(7,884)**		(11,144)	
Purchase of intangible fixed assets		**(83)**		(823)	
Capital contributions received		**1,120**		1,165	
Sale of tangible fixed assets		**36**		37	
Interest received		**840**		953	
Net cash used in investing activities			**(5,971)**		(9,812)
Cash flows from financing activities					
Proceeds from sale of non-household retail activities*	32	**-**		2,900	
Loan repayment from group companies		**-**		500	
Receipts from borrowings		**3,000**		4,000	
Repayment of borrowings		**(4,000)**		-	
Equity dividends paid		**(1,090)**		(1,205)	
Equity payment received		**2,988**		-	
Interest paid		**(3,922)**		(3,812)	
Net cash generated/(used in) financing activities			**(3,024)**		2,383
Net increase in cash and cash equivalents			**15,100**		2,438
Cash and cash equivalents at beginning of year			**11,644**		9,206
Cash and cash equivalents at end of year	17		**26,744**		11,644

*Payment in advance which includes the fair value of future meter reading services (note 32).

Notes

1. The financial information included in this announcement as regards the Company has been prepared in accordance with United Kingdom accounting standards and does not constitute statutory accounts for the relevant periods within the meaning of Section 434 of the Companies Act 2006.

2. Statutory accounts for the Company for the financial year ended 31 March 2016, upon which the Auditors of the Company have given an unqualified report, have been delivered to the Registrar of Companies. Statutory accounts for the Company for the financial year ended 31 March 2018 will be delivered to the Registrar of Companies as soon as practicable after approval at the next Annual General Meeting.

For further information, please contact:
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