ANNUAL PERFORMANCE REPORT 2018

Company Number: 2536455

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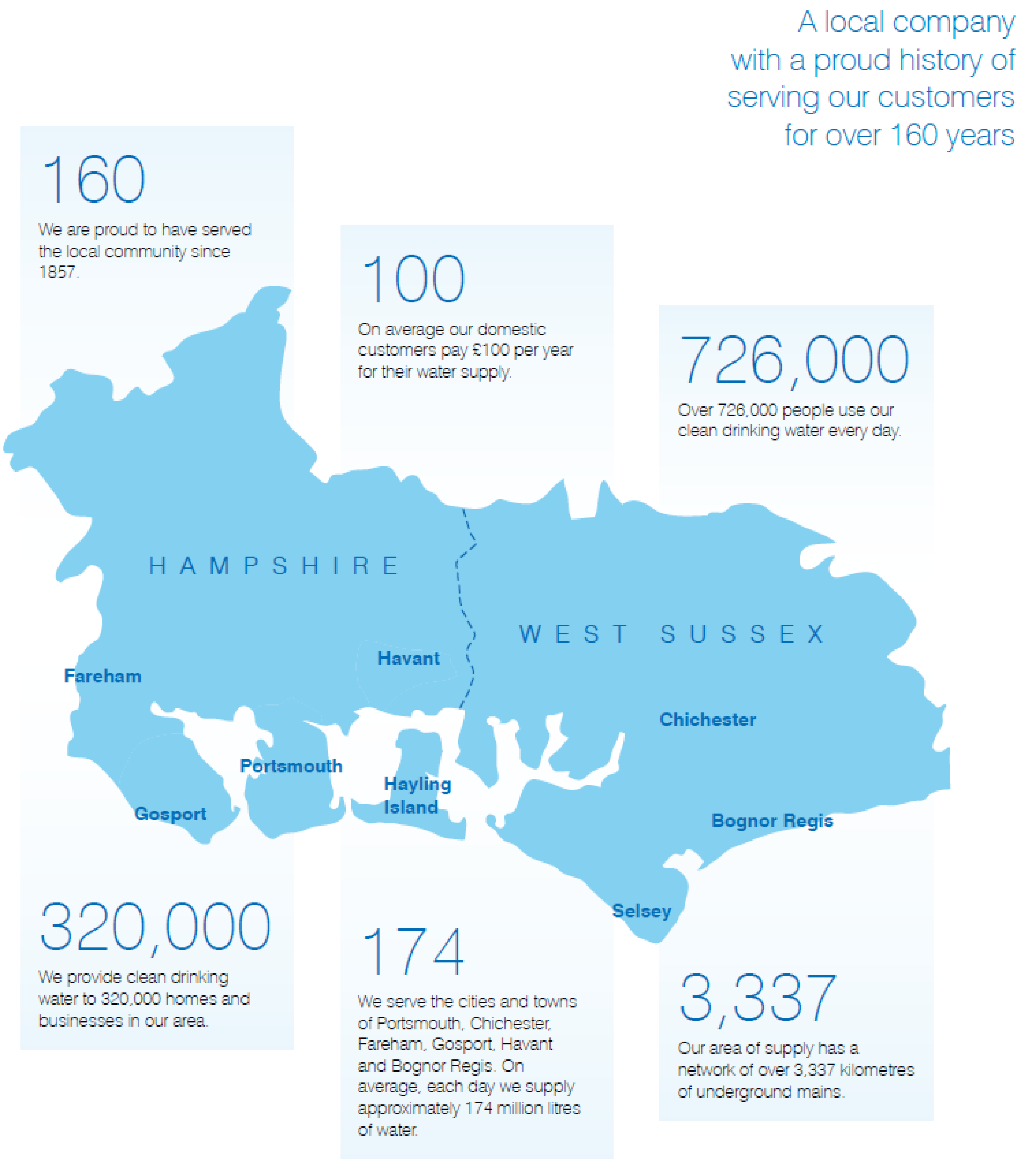
INTRODUCTION

Portsmouth Water Limited is a water supplier operating under an Instrument of Appointment granted by the Secretary of State for the Environment under the Water Industry Act 1991. In accordance with the requirements of the Company's licence conditions and Ofwat guidance the Company both operates and prepares its statutory Annual Report and Accounts ('ARA') having regard to the requirement of Disclosure and Transparency Rules and the relevant elements of the UK Corporate Governance Code. This Annual Performance Report ('APR') has been prepared in accordance with the requirements of Regulatory Accounting Guidelines published by Ofwat. The Company does not prepare a combined document covering both ARA and APR but, as permitted and where appropriate, cross references to the published ARA. Copies of the ARA can be obtained from the Company Secretary at PO Box 8, West Street, Havant, PO9 1LG and on the Company's website at www.portsmouthwater.co.uk.



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

CORPORATE GOVERNANCE

The Board of Portsmouth Water Limited comprises three Executive Directors, three independent Non-Executive Directors and one newly appointed Investor Director. The Executive Directors are Neville Smith who is the Managing Director, Rod Porteous Engineering Director and Helen Orton who is the Finance and Regulation Director. The independent Non-Executive Directors are Mike Kirk (Chairman), Heather Benjamin and Martin Johnson. In addition, one Investor Director, David Owens, has been newly appointed.

The Ofwat principles require that independent Non-Executives should constitute the largest fraction of Directors. We currently consist of three independent Non-Executive Directors (including the Chairman), three Executive Directors and one newly appointed Investor Director. Previously, when the Chairman had the casting vote we complied with the spirit of the proposal. However, the recent appointment of Mr Owens (in March 2018) required us to review the position. As a consequence, the Nomination Committee have been tasked with appointing a new Independent Non-Executive to the Board and we hope the appointment will be completed in September. Once this appointment is in place we believe that we will be compliant with the Ofwat principals. In addition Mr Porteous has given notice to the Board of his intention to retire in December 2018 and the Nomination Committee have commenced the search for his replacement.

Portsmouth Water are committed to high standards of Corporate Governance and take the lead from those principles 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.

Detailed information in connection with the Company's Corporate Governance processes and compliance, including operation of the Board, Risk Management and Internal Control is set out on pages 38-55 of the Company's ARA.

Compliance

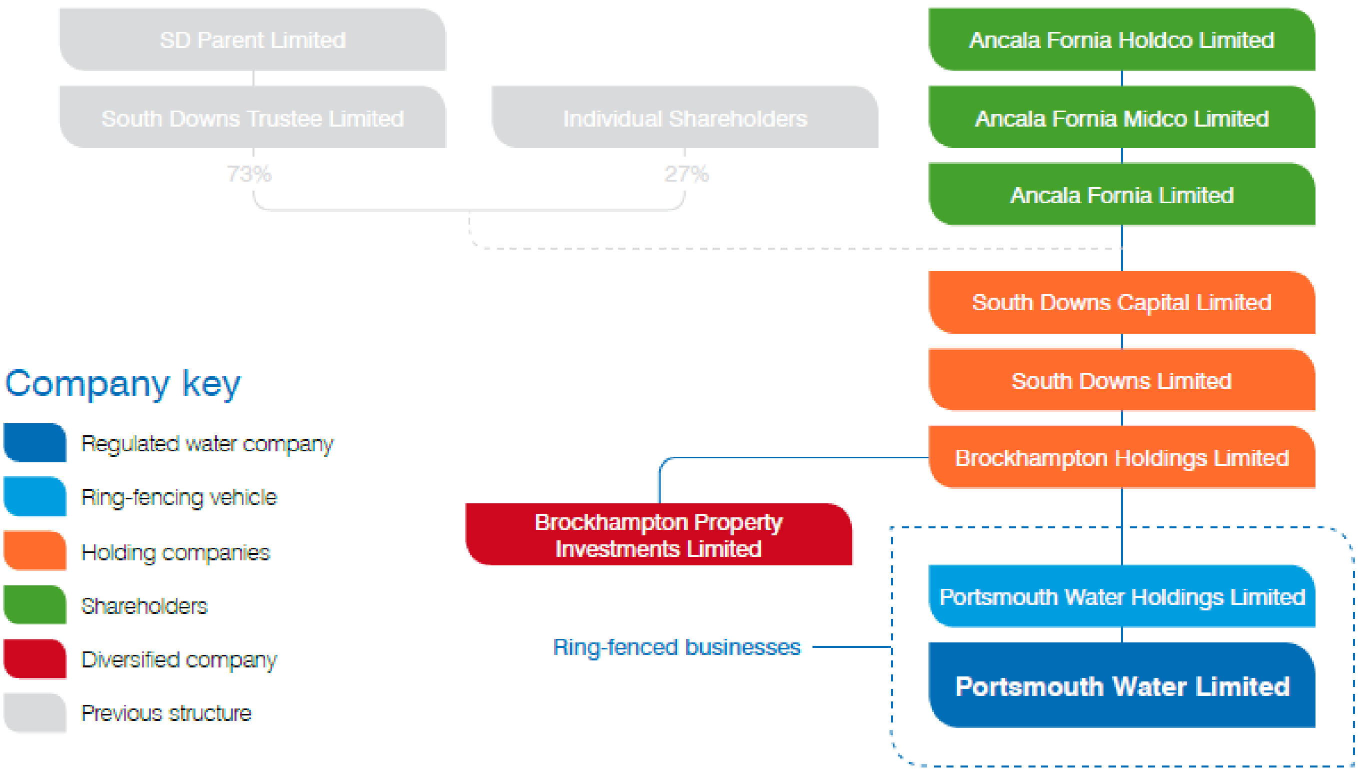
In 2014 Ofwat published the principles by which water companies should deal with Board leadership, transparency and governance. In March 2014 the Company adopted its own Governance Code which can be found on the Portsmouth Water website. The Board complies with the Ofwat principles in all areas with the exception of Board Composition, as noted above.

Auditor Change

As reported last year, in accordance with the provisions of the Corporate Governance Code, the Board completed a tender for External Audit Services in 2016. As a result of that tender, at the 2017 AGM, KPMG LLP were appointed as new auditors of the Company.

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 of Ownership Structure

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.

On 16 March 2018 the whole of the issued share capital of South Downs Capital was disposed of by South Downs Trustees Limited (73%) and individual shareholders (27%) to funds managed by Ancala Partners LLP ('Ancala') (as set out in the group structure above).

Ancala is a UK based and domiciled infrastructure fund manager. It's investors are primarily UK corporate and local authority pension plans. The acquisition of South Downs Capital Limited was implemented by a new company, Ancala Fornia Limited, which is incorporated in the UK. The ultimate parent undertaking is Ancala Fornia Holdco Limited ("AFHL") which is incorporated in the UK. The investors in AFHL comprise a number of investment vehicles, all focused primarily on UK long-term infrastructure investment and managed by Ancala.

Ancala manages £850 million of funds with investment from UK and European pension plans and institutional investors with a long term investment horizon.

As noted in the group structure South Downs Employee Benefit Trust was the ultimate shareholder of 73% of the share capital of South Downs Capital Limited. By virtue of the sale of the investment in South Downs Capital Limited the beneficiaries of the Employee Benefit Trust (being the majority of employees and certain former employees) received a share of the net sales proceeds. This is explained further in note 24 to the APR.

We consider AFHL to be the ultimate holding company and ultimate controlling entity. Consolidated group financial statements have been prepared at the level of South Downs Capital Limited for the 12 months to 31 March 2018. Consolidated financial statement for the 54 weeks ending 31 March 2019 will be prepared at the level of Ancala Fornia Holdco Limited and this will be the largest Group for which consolidated financial statements are prepared.

Setting Strategy and Objectives

As a monopoly supplier company the Board has constant regard to the moral and statutory responsibility to do the right thing for our customers, our people and our environment. The mission *"To supply high quality drinking water, whilst providing excellent levels of service for our customers, at the lowest price in the country*" is underpinned by relentless focus on customer service achieved through a motivated and committed work force. The Company's strategic direction is informed by both a medium term, 5 year, view (driven by the regulatory planning cycle) and a longer term position. The regulatory planning cycle is clearly a key element in driving company strategy and performance objectives. In developing our Business Plan, as part of this process, we are closely informed by the view of our customers and our wider stakeholder groups.

As part of development of the PR14 Business Plan the Company established six "outcomes" which are aligned to our Outcome Delivery Incentives ("ODIs") and many of which are established as Company Key Performance Indicators (KPIs). We also include metrics supporting our financial resilience. We have set out on pages 8 and 9 of our Annual Report and Accounts a summary of how our strategy aligns our Outcomes to KPIs and related risks, together with a summary of how these are delivered. Our measurement and trend of KPI performance is summarised on pages 10 and 11 of the ARA together with a clear indication of our performance.

As part of the PR14 Business Plan process the Board challenged the Company as to the level of ambition and this process continues into the PR19 Business Plan process. This is also informed by ongoing dialogue with customers, our CCG and other stakeholders such as Ofwat, DEFRA, the EA, the DWI and local environmental groups. The Board Governance processes and Board composition allows for a process of robust challenge both in terms of level of ambition and performance. In addition, Company objectives, driven by the strategy, for Executive Directors and Managers are set annually by the Board and linked to executive remuneration (both short and long term).

Company Performance

Company performance is tracked through a suite of KPIs which are reviewed and discussed monthly both at the Board and Senior Management level. These KPIs are closely aligned to the Business Plan Outcomes and ODIs, together with key financial outturn against the Final Determination. Where common performance metrics are available the Company also has regard to industry-wide performance. A key measure of whether the Company is delivering against its strategy is the position within the Service Incentive Mechanism ("SIM") and the net promotor score for the Institute of Customer Services. We recognise that to be at the industry frontier in these measures requires constant adaptation and development of our services.

This drive to be an industry leader in customer service requires the Board to have a dynamic approach to managing the business and in setting ongoing strategy and making key business decisions. It also requires a close alignment between company objectives and executive remuneration. Company out-performance has generally been used to invest in service or asset improvement rather than payment to investors. The dividend policy has remained consistent with the PR14 Final Determination.

As set out in the Annual Report and Accounts the Company has performed well against its KPIs in the majority of areas during the first three years of the Business Plan.

Totex performance is in a favourable position relative to the Final Determination. This is driven by operational efficiencies and in particular, innovative contracting arrangements relating to infrastructure renewals.

Levels of customer satisfaction remain high with continued upper quartile SIM performance (and having been the industry leader in the overall measure for 15/16 & 16/17) and high (85%) levels of developer satisfaction. As a member of the Institute of Customer Service we were also proud to be the highest ranked water company and second highest utility company. However, we strive to achieve the levels of net promoter scores seen for top performing UK business such as John Lewis Partnership and Amazon. We continue to develop our Customer Service offering and are developing further services to enhance this.

In the majority of areas the Company performs consistently well and benchmarks in the upper quartile of the industry. This includes bursts, interruptions, SIM and water quality contracts. Although for the latter measure, whilst in 2016/17 we remained top industry performer we fell below our target KPI.

In connection with leakage and per capita consumption ("PCC") our performance is more challenging. In both measures we perform "mid table" in comparison to the industry overall. Our recent leakage levels have been disappointing and we are investing both resource and technology to reduce this. We are planning an ambitious 15% reduction as part of the PR19 Business Plan. PCC levels of 147.6 l/h/d are above our target. We are investigating approaches to influence PCC, including a "not for billing" metering strategy aiming to influence water consumption in unmeasured customers through providing customers with more information on their usage. At present we are unable to compulsory meter customers; a key tool to reduce PCC. We will continue to lobby DEFRA regarding a legislative change to allow compulsory metering as we view this as both the fairest way to charge and an effective method of demand-side management.

Water quality is currently measured through Mean Zonal Compliance ("MZC") and in future will use the DWI's new Compliance Risk Index ("CRI"). Disappointingly we have a MZC of 99.94 for the current period falling below the 99.98 target. This measure was disproportionally impacted in the year by 3 customer side failures; 2 as a result of domestic lead plumbing and 1 due to contamination by herbicide used in the garden. Under the alternate CRI measure these instances have a proportionally lower impact on the scores and, based on CRI measures to date, we have shown a consistently upper quartile performance.

Finally, performance in relation to key financial metrics is satisfactory and stable. In the Board's view this supports a business which continues to be financially resilient. The Company maintains a stable and transparent dividend policy in line with levels of expected notional equity returns.

On balance the Board's view is that the Company's overall performance is delivering for customers and stakeholders and that levels of executive remuneration and investor return are both appropriate and consistent with this level of company performance. Further detailed information on executive remuneration is set out on pages 13 and 14 of the APR and pages 46 to 51 of the ARA.

Financial Viability

The Company's financial position is set out in the ARA on pages 56 to 76, including cash flows, liquidity position, borrowing facilities and loan maturities. The Strategic Report, on pages 6 to 35 of the ARA, also covers aspects such as the overall financial performance and financial risks. Finally the Viability Statement on pages 32 to 34 of the ARA (and repeated on pages 7-10 below) 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 7 years to the end of the next PR19 Business Plan.

Company's Assurance Process and Outcomes

The Company set out its approach to data assurance, including assurance over the APR, in its Final Audit Plan which was published on 4 April 2018. We have completed our data assurance in accordance with that plan and have published a summary of the relevant results in the Data Assurance Summary dated July 2018. The Board and the Audit Committee have considered the results of data assurance processes, together with the Company's proposed response to relevant findings, and are satisfied with the overall outcome.

1. Assessment of prospects

The Board has assessed the prospects of the Company over a period of 7 years.

Background information

The Company's business model and strategy are central to an understanding of its prospects, further explanation can be found on page 7 of the ARA. 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 this 5 year period. More information in respect of the regulatory regime is set out in pages 27 to 29 of the ARA.

The Company is currently in the process of finalizing its regulatory Business Plan submission for the following regulatory review cycle (from 1 April 2020 to 31 March 2025) which will be submitted to Ofwat on 3 September 2018 (the "Draft Business Plan"). Whilst this Draft Business Plan has not been submitted or approved, it does capture the Company's current business strategy into the next regulatory period together with detailed financial projections. The Company considers that this represents the best current indication of future operating activity and financial results at this time. This Draft Business Plan includes the development of a new water resource, Havant Thicket Winter Storage Reservoir ("HTWSR"), which will result in significant capital activity throughout the next 5 year period and beyond.

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 and as developed in the Draft Business Plan. 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 in the Draft Business Plan resulting from the development of HTWSR, the lower anticipated WACC, and more challenging regime of rewards and penalties.

The assessment process of the Company prospects

Budget process

The Company's prospects are routinely 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 (2018/19) financial period.
- Five year analysis to 2019/20 comprising 3 year actuals, 1 year detailed budget and 1 year projection. These are compared against the Final Determination.
- Cash flow projections to 2019/20 (3 years detailed monthly and 2 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 2018.

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
- Levels of activity and cost related to leakage

5 year Business Plan process

In addition, given the proximity to the Draft Business Plan submission, the Company's prospects are also considered in relation to the financial modelling and overall Business Plan documents which will be provided to Ofwat to support the determination for the Period 2020-2025.

The Development of the Draft Business Plan for submission is a detailed and complex process including the following activities;

- Customer research
- Capital assessment and planning
- Optimization of schemes & activities
- Detailed financial modelling
- Design of rewards & penalties
- Assessment of resilience
- Financeability testing
- Assurance
- Governance & Board approval

These activities culminate in the development of a detailed business plan in line with Ofwat's guidance & methodology.

The critical assumptions underpinning the business plan include;

- A hybrid RPI/CPI WACC of 2.95% including a company specific premium
- Totex benchmarking and efficiencies
- Capex and mains renewals levels and profile
- Projected RPI & CPI
- Levels of rewards & penalties
- Any historic true up required
- Distribution levels
- Costs relating to HTWSR
- Bill level & profile
- Availability of financing

In addition the Company has produced financial modelling of the business performance for a further 10 year period beyond the Draft Business Plan. This is based, primarily, on a roll forwards of the Draft Business Plan, modified by key assumptions such as expected Weighted Average Cost of Capital (WACC), efficiency levels and longer term assumptions such as RPI and CPI levels. It also reflects the impact of HTWSR construction and operating costs.

The further assumptions in the additional 10 year projections relate to;

- A hybrid RPI/CPI WACC of 2.95% real including a company specific premium
- Projected RPI and CPI (which will be used to drive tariffs in future periods)
- Levels of efficiency projected
- Levels of capital and renewals spend together with assessment of the need for any significant new capital schemes.

Risk assessment

Alongside these activities, 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 2018. As part of the Draft Business Plan preparation the Company has performed an assessment of "resilience in the round" building form an understanding of operational risks through financial resilience and with regard to overall company resilience including Governance and management effectiveness. Board review and approval in relation to this assessment took place in February & March 2018. The overall summary of the principal risks and uncertainties (set out on pages 30 to 31 of the ARA) reflects this consideration of "resilience in the round".

Details of the Board risk assessment process are set out on page 43 of the ARA. The purpose of the principal risks table is, primarily, to summarise those matters that could prevent the Company 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.

In setting out specific scenarios for the Viability Statement we have reviewed the risk register together with resilience modelling prepared as part of the PR19 Business Plan together with Board analysis prepared to support "resilience in the round". Using this information we have developed a range of relevant severe, plausible and reasonable business scenarios which have been linked to the relevant business risks. These were reviewed and approved by the Board and are summarized in section 2 below.

The period of assessment
The Board conducted the assessment for a period of 7 years to 31 March 2025. The Board considers that this period of 7 years to be most appropriate given the current stage of the regulatory review cycle. This period covers the 2 years remaining of the current regulatory period and the period to the end of the next Price Review. This is consistent with the fact that, at this point, Ofwat's methodology for the next regulatory review cycle has been finalised and Company's Draft Business Plan (for the 5 years to March 2025) is sufficiently well developed.

The Board feels that this is an appropriate length of time to permit a reasonable assessment of likely business performance and to make reasonable estimates of key assumptions. As set out above, the Ofwat Final Determination, the Draft Business Plan and the related Outcomes are significant drivers of the business strategy & performance. This is a key driver to the end of the next regulatory period of 2025. Whilst the Board considers 7 years to be an appropriate horizon to consider the continuing viability of the Company, they do also consider the viability over a longer term beyond this period as indicated above.

2. Assessment of viability
The Assessment of Viability therefore uses a period of 2 years of budgeted information to the end of the current regulatory period and the 5 years of financial performance modelled in the Draft Business Plan to 31 March 2025.

Although the budget and Draft Business Plan financial model reflect 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 (such as gearing, net debt:RCV and interest cover).

These scenarios (which are summarised below), which have been driven from the Boards assessment of "resilience in the round" as part of the Draft Business plan (and are reflected in the principal risks and uncertainties set out in pages 30 to 31 of the ARA) represent 'severe, plausible and reasonable' circumstances that the Company could experience.

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/Consumer 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.

It has also been assumed that adverse impacts, set out on page 10, which may have an adverse but short lived (1 year) effect on financial ratios, could be managed by careful discussion with key stakeholders such as bond holders and the rating agencies.

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. This included both the restriction and elimination of dividend payments.

3. 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 seven year period ending 31 March 2025.

4. 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 in the APR.

Scenario	Link to Risk	Outcome	Mitigation
The loss of a significant Water Treatment Works	Operational, Financial, Business continuity	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
A combination of 2 risk events (driven by operational risk scenario modelling)	Operational, Financial, Business continuity	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
A £12m pension deficit arising.	Financial	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by managing costs and additional debt finance.
A maximum one year ODI penalty.	Regulatory, Financial	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
A regulatory fine 3% turnover	Operational, Regulatory	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
Loss of a critical IT system for one month in combination with two different scenarios;	Business continuity	Cash flow deficit and minor deterioration of interest cover ratios.	No mitigation needed on a stand-alone basis.
i) loss of a significant treatment works (see assumption above);	Operational, Financial, Business continuity	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
ii)a £12m pension deficit arising.	Financial	Cash flow deficit and minor deterioration of interest cover ratios over the period of recovery.	Mitigated by short term restriction of infrastructure renewals activity and draw down on RCF.
An upper limit capital expenditure test of £20m	Financial, Operational	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Mitigated by increasing RFF and raising additional debt.
Development of Havant Thicket Winter Storage Reservoir	Financial, Operational	This major £90m, 8 year capital scheme has been modelled to assume funding through a combination of debt and equity. Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	N/A
Sensitivity testing of key assumptions - inflation -1% - WAAC to 2%	Financial	Cash flow deficit and deterioration of interest cover ratios below covenants & rating agency thresholds for one year.	Both mitigated by raising additional debt in the near term. In the longer term dividends may need to be restricted or equity injected to manage gearing (after 7+ years).

Corporate Structure
The Group structure in which the Company resides, has recently changed and is set out on page 3. The Group is wholly owned by funds managed by Ancala Partners LLP ("Ancala") through a UK holding company Ancala Fornia Holdco Limited. Ancala is a UK based and domiciled independent infrastructure fund manager.

Portsmouth Water is committed to full compliance with all statutory obligations. As a Company we understand that collecting and paying tax is an important part of contributing to the economic environment that we operate in and in addition to paying corporation tax we also contribute as a result of indirect taxes, employee related taxes and environmental taxes. The Company's tax affairs are managed in a way which takes into account the wider corporate reputation. At all times the tax affairs are managed in line with the Company values of Integrity, Excellence and Respect.

Governance in relation to UK taxation

- The ultimate responsibility for the tax strategy of Portsmouth Water Limited sits with the Board.
- The Finance and Regulation Director is the Board member with executive responsibility for tax matters.
- The day-to-day management of the tax affairs is delegated to the Financial Controller who reports to the Finance and Regulation Director.
- Members of the Finance team are trained to a level that ensures tax compliance and a continuous cycle of training occurs to ensure all skills are relevant and up to date.
- For tax filing, specialist advice and support Portsmouth Water engage the services of specialist Finance and Accountancy professionals.

Risk Management
Attitude towards tax planning and level of risk
Portsmouth Water Limited manages risks to ensure compliance with legal requirements in a manner which ensures payment of the correct amount of tax.

Portsmouth Water's attitude towards tax planning is one of prudence; seeking to comply fully with relevant tax legislation and to achieve a high degree of certainty in the company's tax affairs. The wider group of Companies applies the same approach to tax planning as a whole.

At all-times Portsmouth Water seeks to comply fully with its regulatory and other obligations and to act in a way which upholds its reputation as a good corporate citizen.

In relation to any specify issue or transaction the Board is ultimately responsible for identifying the risks, including tax risks, which need to be address and for determining what actions should be taken to manage those risks. In doing so the Board has regard to the materiality of the amounts and obligations in question. Where specific risks occur the Company will seek specialist professional advice.

In line with the Company's ethos to strive for continuous improvement through innovation we are able to utilise government tax initiatives such as the R&D Tax Credits scheme to reduce our corporation tax charge and therefore continue to maintain one of the lowest costs to serve in the industry.

Working with HMRC
Portsmouth Water seek to have a transparent, respectful and proactive relationship with HMRC at all times, be that directly or through intermediaries acting on our behalf.

Any inadvertent errors that may occur in any submission made to HMRC are fully disclosed as soon as reasonably practicable after they are identified and independent specialist advisors are commissioned to validate the value of any error. Following this, an internal review will then identify any required process changes of internal controls, to ensure full and ongoing compliance.

Future tax changes are considered through Water UK's Tax Forum, of which Portsmouth Water is a member. This group allows us the opportunity to discuss how future tax legislation should be interpreted and applied to the Water Industry.

Corporate Criminal Offences Code of Conduct
Tax evasion, tax fraud and attempts to facilitate such actions are unethical and inconsistent with the ethos of Portsmouth Water. Portsmouth Water is committed to complying in full with the UK tax laws, and we expect everyone working with the Company to fully comply with their tax obligations. We believe in paying our fair share, and that everyone working with us should too.

Accountability & Governance
The board of our Company has approved a code of conduct policy and supports our commitment to no tolerance of tax evasion or its facilitation. The Finance and Regulation director is responsible for monitoring compliance with the policy and is supported by the Board and the management team in doing so.

Employee responsibilities
Our code of conduct sets the standards of behaviour we expect all employees to adhere to if employees are ever asked to act in any way that could facilitate tax evasion, this must be reported without delay.

Risk assessment and mitigating factors
Our business risk assessment covers those areas of business operation where there is a risk of tax evasion. In relation to these risks we have considered relevant mitigating factors (including internal controls). Where necessary we have developed further activities and controls to mitigate areas of exposure.

Our commitment
Portsmouth Water is committed to the following principles:

- Our business is carried out fairly, honestly, and openly in every part of our work.
- Our values inform everything we do.
- We will never transact with any supplier where it is known or suspected that any aspect of the transaction is being misused, abused or otherwise corrupted for the purposes of tax evasion.
- We will immediately terminate any agreement or business relationship if we learn of or suspect tax evasion may be taking place.
- We will not do business with others who do not also hold to at least the same standard of preventing tax evasion.
- Any employee found in breach of our policy will be subject to disciplinary action.
- No employee will suffer demotion, penalty, or any other adverse action for reporting or from refusing to carry out an action which may lead to tax evasion.

Remuneration Committee

Role of Committee

The primary objective of the Committee is to set a policy to ensure that competitive reward packages are 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 2017/18 annual incentive bonus plan

Remuneration Report

<u>Remuneration Policy</u>

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.

<u>Service Contracts</u>

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.

Mrs. H. M. G. Orton serves as a Non-Executive Director for UKWIR, an organisation set up by the 20 water and sewerage undertakers in England, Wales, Scotland, Northern Ireland and the Republic of Ireland to identify and provide research requirements to meet the industry's business needs.

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.

For full details of the Remuneration Report see pages 46-51 of the ARA.

Link between Directors' Remuneration and Standards of Performance

The Company, through the oversight of the Remuneration Committee, seeks to demonstrate a transparent linkage between the discretionary elements of remuneration and standards of business performance. In particular this has a clear linkage to those areas of company performance which customers' value through alignment with the targets set for Company Outcomes and Business Plan objectives.

The bonus package for Executive Directors is based on an annual and a long term element (the latter which is aligned to Company performance over the AMP). Annual Company-wide objectives are set by the Board aligning to the strategic and operational priorities of the business. These have regard to a range of priorities relevant to different stakeholders with particular emphasis on all elements of Customer Service performance.

The long term element of the bonus scheme is linked directly to the Company's performance in relation to key strategic outcomes for each of the 5 years of the AMP, together with other strategic business objectives. Whilst this is accrued annually it is awarded at the end of the AMP, determined by overall levels of performance throughout the regulatory period.

By implementing the short and long-term elements of discretionary Executive remuneration the Board and the Remuneration Committee believes that there is appropriate balance between delivering the Outcomes for the AMP together with the flexibility to deliver any particular areas of business strategic focus. This permits a dynamic element of the approach to discretionary remuneration.

The executive incentive plan has been in operation in the business since 2010 and the overall objectives are reviewed on a quinquennial basis in line with the business planning cycle. The elements of the bonus structure are summarised below.

Annual Incentive Scheme – maximum 20% award

Maximum Percentage Award	Measure
Up to 5%	**Key customer service measures** (0.5% for each measure); MZC, interruptions, hosepipe restrictions, written complaints, abandoned calls, customer experience survey, PCC, bursts, leakage, water quality contacts.
Up to 5%	**Personal objectives**. These are linked to the Directors' own areas of responsibility and reflect strategic objectives of the Business. This includes a number of service measures and key programmes for the development and implementation of systems and processes to improve future performance.
Up to10 %	**Business objectives** (2% for each measure); TOTEX performance, financial resilience (gearing, interest cover ratio, & credit rating), overall ODI performance, zero reportable accidents, top SIM performer

Long term Incentive Scheme (5 years aligned to AMP)

Maximum 10% award based on a range of strategic objectives including; consistent SIM performance, staff engagement and culture, leakage, PCC and financial resilience.

Analysis of incentive award by nature

The following summarises the maximum incentive award by nature. This demonstrates both alignment to the overall business strategy and a balance of the award across a range of relevant measures.

	Annual	Long term
Customer service related	9%	3.5%
Personal (including development and implementation of new systems and processes)	5%	
Other		
• Totex performance	2%	
• Financial resilience	2%	2%
• Health & Safety	2%	
• Overall ODI performance		4.5%
Total	**20%**	**10%**

Determination of performance

The majority of the executive bonus scheme is linked to clearly defined performance metrics, the majority of which are ODIs. These are subject to external audit as part of the APR and other regulatory reporting processes. The assurance processes are also set out in detail in the "Company Monitoring Framework", which is subject to annual review and consultation and published annually on the Company's website. Other performance metrics, such as credit rating, are unambiguous measures.

When personal objectives are set these follow the SMART approach for objective setting (Specific, Measureable, Achievable, Realistic and Time limited). As part of the Remuneration Committee's review these are challenged and agreed at the start of the objective setting process and supporting evidence is sought at the end of the assessment period before an award is made.

In this way the Board has confidence that the performance can be objectively assessed.

Summary of Directors' remuneration

A detailed report on Director's remuneration, including the operation of the incentive bonus scheme is set out in detail on pages 46 to 51 of the ARA.

Statement of Directors' Responsibilities

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

The Directors responsibilities are in accordance with the requirements;

Under Condition F of the Instrument of Appointment by the Secretary of State for the Environment, Food and Rural Affairs (Defra) and as a water undertaker under the Water Industry Act 1991; the Company is required to prepare accounting statements in accordance with the regulatory accounting guidelines issued by Ofwat.

In preparing these accounting 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 also 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
- 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.

We confirm that to the best of our knowledge that the accounts are prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit of the Company;

Confirmation of disclosure of information to auditors

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 as directors to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Statement of Compliance with Licence Condition F6A

Certificate of compliance to the Water Services Regulatory Authority under licence condition F6A.

The Board of Directors certify that in their opinion;

- The Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Appointment); and
- The Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions; and
- That all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to/by the Appointee.

In providing this Certificate the Board of Directors have taken into account the following;

- the Company's Final Determination at PR14;
- the latest financial position as set out in the Company's Annual Report and Accounts and the most recent management accounts;
- the results of analysis carried out in relation to the Company Viability Statement;
- the approved budget and capital expenditure programme for the year ended 31 March 2019;
- cash balances of £26.7m and undrawn loan facilities of £7m as at 31 March 2018;
- the current level of gearing together with the projected level of headroom on key covenant ratios through to 31 March 2019;

- a stable and experienced senior management team, with a wide knowledge of the water industry together with a skilled and motivated workforce; and
- appropriate risk management and governance arrangements.

Statement of Compliance of Licence Requirement Condition K

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.

Statement of Compliance with Regulatory Accounting Guideline 5

The Directors hereby certify that, in their opinion, Portsmouth Water Limited complies with the objectives and principals of the above Regulatory Accounting Guideline, in so far as they apply to the Company, transactions with associated companies are at arm's length and that cross subsidy is not occurring.

Statement on Risk & Compliance

The Directors confirm that the Company, in their opinion:

- has a full understanding of, and is meeting, its statutory obligations and the expectations of its customers;
- has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations; and
- has appropriate systems and processes in place to allow it to identify, manage and review its risks.

In preparing this statement, the Directors confirm that the Company is aware of the obligations in legislation and in its licence with which it must comply. In particular, the Directors confirm that the Company:

- has sufficient rights and assets available to enable a special administrator to run the business;
- trade with associates is at arm's length;
- publishes a statement explaining the links between directors' pay and standards of performance; and
- maintains an investment grade credit rating.

The risk management, monitoring and control systems and processes upon which the Directors rely in making this statement are described in the Company's Annual Report and Accounts within the Strategic Report on pages 30 and 31 and the Corporate Governance Report on page 38.

Signed by:

M P Kirk ....

N Smith ....

H M G Orton ....

R C Porteous ....

M P Johnson ....

H V Benjamin ....

D Owens ....

SECTION 1 REGULATORY FINANCIAL REPORTING

1A INCOME STATEMENT

For the 12 months ended 31 March 2018

		Current year				
			Adjustments			
	Note	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
		£'000	£'000	£'000	£'000	£'000
Revenue	2	40,489	(1,209)	343	(1,552)	38,937
Operating costs	3	(34,027)	1,142	(367)	1,509	(32,518)
Other operating income	4	(16)	0	0	0	(16)
Operating profit/(loss)		6,446	(67)	(24)	(43)	6,403
Other income	5	0	1,334	125	1,209	1,209
<u>Exceptional items:</u>						0
National Insurance cost relating to exercise of share options		(2,988)	0	0	0	(2,988)
Gain on disposal of non-household business		1,843	0	0	0	1,843
Interest income	6	1,187	0	0	0	1,187
Interest expense	7	(7,603)	0	0	0	(7,603)
Other interest expense		0	0	0	0	0
(Loss)/Profit before tax and fair value movements		(1,115)	1,267	101	1,166	51
Fair value gains/(losses) on financial instruments		0	0	0	0	0
(Loss)/Profit before tax		(1,115)	1,267	101	1,166	51
UK Corporation tax	8	(69)	0	(19)	19	(50)
Deferred tax	8	28	0	0	0	28
(Loss)/Profit for the year		(1,156)	1,267	82	1,185	29
Dividends	9	1,090	1,267	82	1,185	2,275

Tax Analysis

Current Year	8	(69)	0	(19)	19	(50)
Adjustments in respect of prior years	8	0	0	0	0	0
UK Corporation Tax		(69)	0	(19)	19	(50)

1B STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March 2018

		Current year				
			Adjustments			
	Note	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
		£'000	£'000	£'000	£'000	£'000
(Loss)/Profit for the year		(1,156)	1,267	82	1,185	29
Remeasurement of net defined benefit asset	22	16,602	0	0	0	16,602
Movement on deferred tax relating to pension asset	20	(2,822)	0	0	0	(2,822)
Total Comprehensive income for the year		12,624	1,267	82	1,185	13,809

1C STATEMENT OF FINANCIAL POSITION

As at 31 March 2018

		Current year				
			Adjustments			
	Note	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
		£'000	£'000	£'000	£'000	£'000
Non-current assets						
Fixed assets	10	126,936	0	0	0	126,936
Intangible assets	11	1,674	0	0	0	1,674
Investments - loans to group companies	12	55,484	0	0	0	55,484
Investment Properties		440	0	0	0	440
Retirement benefit assets	22	24,794	0	0	0	24,794
Total non-current assets		209,328	0	0	0	209,328
Current assets						
Inventories		608	0	0	0	608
Trade & other receivables	13	8,164	0	0	0	8,164
Investments - other	14	2	0	0	0	2
Cash & cash equivalents	15	26,744	0	0	0	26,744
Total current assets		35,518	0	0	0	35,518
Current liabilities						
*Trade & other payables	17	(14,363)	0	(631)	631	(13,732)
Capex creditor	17	(575)	0	0	0	(575)
Borrowings	16	(3,284)	0	0	0	(3,284)
Current tax liabilities	17	(11,446)	0	0	0	(11,446)
Provisions	17	(1,412)	0	0	0	(1,412)
Total current liabilities		(31,080)	0	(631)	631	(30,449)
Net Current assets/(liabilities)		4,438	0	(631)	631	5,069
Non-current liabilities						
Borrowings	18	(103,294)	0	0	0	(103,294)
Deferred income - G&C's	19	(25,493)	0	0	0	(25,493)
Deferred tax	20	(6,764)	0	0	0	(6,764)
Total non-current liabilities		(135,551)	0	0	0	(135,551)
Net assets/(liabilities)		78,215	0	(631)	631	78,846
Equity						
Called up share capital	21	1,078	0	0	0	1,078
Retained earnings & other reserves	21	77,137	0	(631)	631	77,768
Total Equity		78,215	0	(631)	631	78,846

* The non-appointed amount is meter reading deferred income relating to the sale of the Non-household retail business.

1D STATEMENT OF CASHFLOWS

As at 31 March 2018

	Note	Current year				
			Adjustments			
	Note	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
		£'000	£'000	£'000	£'000	£'000
Operating profit		6,446	(67)	(24)	(43)	6,403
Other income		0	1,334	125	1,209	1,209
Exceptional cost relating to share options		(2,988)	0	0	0	(2,988)
Depreciation		6,409	0	0	0	6,409
Amortisation - G&C's		(638)	0	0	0	(638)
Changes in working capital		13,831	0	0	0	13,831
Notional Pension Costs		866	0	0	0	866
Movement in provisions		(341)	0	0	0	(341)
Goss on sale of fixed assets		16	0	0	0	16
Cash generated from operations		23,601	1,267	101	1,166	24,767
Net interest paid		(3,081)	0	0	0	(3,081)
Tax paid		493	0	(19)	19	512
Net cash generated from operating activities		21,013	1,267	82	1,185	22,198
Investing activities						
Capital expenditure		(7,967)	0	0	0	(7,967)
Grants & Contributions		1,120	0	0	0	1,120
Disposal of fixed assets		36	0	0	0	36
Other		0	0	0	0	0
Net cash used in investing activities		(6,811)	0	0	0	(6,811)
Net cash generated before financing activities		14,202	1,267	82	1,185	15,387
Cashflows from financing activities						
[1]Equity dividends paid		(1,090)	(1,267)	(82)	(1,185)	(2,275)
Equity payment received		2,988	0	0	0	2,988
Net loans received		(1,000)	0	0	0	(1,000)
Net cash generated from financing activities		898	(1,267)	(82)	(1,185)	(287)
Increase in net cash		15,100	0	0	0	15,100

[1] The Regulatory Accounts includes the Employee Ownership Trust bonus payment in Dividends, for consistency with the Final Determination, where it was deemed a cost of equity.

1E NET DEBT ANALYSIS (Appointed activities)

As at 31 March 2018

	Interest rate risk profile			
	*Fixed rate	Floating rate	Index linked	Total
	£'000	£'000	£'000	£'000
Borrowings (excluding preference shares)	284	3,000	104,118	107,402
Preference share capital				0
Total borrowings	284	3,000	104,118	107,402
**Cash				(15,707)
Short term deposits				0
Net Debt	284	3,000	104,118	91,695
Gearing				63.6%
Adjusted Gearing				n/a
Full year equivalent nominal interest cost	0.01	0.07	7.03	7.11
Full year equivalent cash interest payment	0.01	0.07	3.79	3.87
Indicative interest rates				
Indicative weighted average nominal interest rate	3.5%	2.4%	6.8%	6.6%
Indicative weighted average cash interest rate	3.5%	2.4%	3.6%	3.6%
Weighted average years to maturity	25	< 1	14	14

* Perpetual Debt

** Included within the cash at bank and in hand value, on the Balance Sheet, is an amount of £11.037m due to be paid to HMRC and relating to social security taxes. Funds to cover this payment were received from Ancala Partners in advance of the required settlement date. This amount is excluded from the cash balance used for the gearing calculation. Further details are set out in note 24.

For the 12 months ended 31 March 2018
(Price Base – 2012/13 RPI Average)

	Units	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
		%		
*Return on regulatory Equity	%	5.70%	5.34%	5.70%
Actual performance adjust. 2010/15	%	1.84%	1.72%	1.84%
Adjusted return on regulatory equity	%	7.54%	7.06%	7.54%
Regulatory Equity Base	£	46,757,000	46,757,000	43,798,380
Financing				
Gearing	%	0.00%	0.19%	0.20%
Variance in corporation tax	%	0.00%	-0.04%	-0.04%
Group relief	%	0.00%	0.00%	0.00%
Cost of debt	%	0.00%	-2.19%	-2.43%
Hedging instruments	%	0.00%	0.00%	0.00%
Sub total	%	7.54%	5.02%	5.27%
Operational Performance				
Totex out / (under) performance	%	0.00%	1.14%	1.22%
ODI out / (under) performance	%	0.00%	0.60%	0.64%
Retail out / (under) performance	%	0.00%	-1.00%	-1.06%
Sub Total	%	0.00%	0.74%	0.79%
Total earnings	%	7.54%	5.77%	6.06%
RCV growth	%	3.74%	3.74%	3.74%
Total shareholder return	%	11.28%	9.50%	9.80%
Net dividend	%	4.00%	2.48%	2.65%
Retained Value	%	7.28%	7.02%	7.15%
Dividends reconciliation				
Gross Dividend	%	4.00%	4.06%	4.34%
Interest Receivable on Intercompany loans	%	0.00%	1.58%	1.69%
Net dividend	%	4.00%	2.48%	2.65%

*The Notional return in regulatory equity has been adjusted for the sale of the non-household business. This amounts to -0.16%.

The notional returns and notional Regulatory Equity Base are taken from the Ofwat FD Risk Assessment Tool.
The gearing and cost of debt calculations use the RCV numbers published by Ofwat in ‘Regulatory Capital Values’.
The gearing calculation adjusts the actual return on net debt by the July RPI movement, in line with the actual loan arrangements.

Actual returns exclude exceptional items relating to the sale of the non-household business operations (note 25) and exceptional costs relating to the disposal of the business (note 24).

The Regulatory Equity Base has been calculated by applying the average gearing to the average published RCV.

Significant variances between the return assumed in the Final Determination and the actual return are driven by;

- higher gearing than the notional company (62.5% notional versus 65.0% actual)
- higher cost of debt than allowed in the Final Determination
- Elements of operational out and under performance
- Lower net dividend levels than assumed in the Final Determination

For the year ended 31 March 2018

	Statutory £'000	Regulatory £'000	Commentaries
PROFIT AND LOSS ACCOUNT			
Revenue	40,489	38,937	See a) below
Operating profit	6,446	6,403	See b) below
BALANCE SHEET			
Tangible fixed assets (net book value)	126,936	126,936	See c) below

a) The only difference relates to the way these figures have been presented in both sets of accounts. In the ARA, this figure includes amortisation of Developer Contributions and income from Connection Charges. In addition, there is non-appointed revenue of £0.002m, which relates to Sale of Stores and Water Efficiency, and £0.341m, which is income from the sale of the Non-Household business, and relates to meter reading services. All of these amounts are excluded from the Regulatory revenue.

	£'000
Statutory revenue	40,489
Amortisation of Developer Contributions	(638)
Income from Connection Charges	(571)
Non-appointed revenue	(2)
Non-appointed meter reading revenue	(341)
Regulatory revenue	38,937

b) The difference relates to the way these figures have been presented in both sets of accounts. In the ARA, this figure includes other income of £1.334m, but this is reported after operating profit in the APR. The breakdown of this income is shown below.

The cash payment in connection with the Employee Ownership Trust is not shown in operating costs in the Regulatory Accounts, but is shown as Dividends below the Profit after Taxation line. The amount for 2018 is £1.267m. This is consistent with the treatment in the Business Plan for PR14 and the Final Determination.

There is a non-appointed operating loss of £0.001m, which relates to Sale of Stores and Water Efficiency, as well as a number of other non-appointed items relating to the sold Non-Household Retail Business. These are excluded from Regulatory operating profit.

	£'000
Statutory operating profit	6,446
Amortisation of Developer Contributions	(638)
Income from Connection Charges	(571)
Rental Income	(124)
Home Assistance	(1)
Employee Ownership Trust Payment	1,267
Non-appointed operating profit	(1)
Non-appointed meter reading revenue	(341)
Non-appointed Castle Bad Debt Provision	316
Non-Household meter reading costs	29
Non-Household Operating Agreement	21
Regulatory operating profit	6,403

c) N/A

1 ACCOUNTING POLICIES

The statutory 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. This Annual Performance Report has been prepared on the basis of these statutory financial statements and have been presented and, where applicable, modified in accordance with the requirements of the Regulatory Accounting Guidelines ('RAGs') published by Ofwat and in force at the date of these accounts. The principal accounting changes in respect of the application of RAGs relate to the treatment of non-appointed business and the Employee Ownership Trust payments, which are not included in the operating costs, as in the Statutory Accounts.

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. The financial statements are presented in pounds sterling.

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, which have been applied consistently, are as follows:

(a) Revenue

Revenue, which excludes value added tax, represents the income receivable for goods and services provided to external customers in the ordinary course of business.

Revenue from the regulated water business includes amounts billed for the year, together with an estimation of amounts used but unbilled at the year end, for measured water customers. Where an invoice has been raised or payment received but the service has not been provided in the year this will be treated as a payment in advance. This will not be recognised within the current year's turnover but will instead be included within creditors as deferred income.

Unmeasured income bills are generally based on the rateable value of properties. Unmeasured customers are billed annually in advance of 1 July and amounts invoiced in advance are not recognised in turnover until earned.

Measured income arises from customers who have meters fitted at their premises therefore amounts billed are based on actual water consumption. In addition a 'measured income accrual' is calculated in order to estimate of the value of water used but unbilled at the year end. 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. There has been no change in the methodology for calculating the measured income accrual during the year.

Charges on income arising from court, solicitors and debt recovery agency fees are credited to operating costs and any out of pocket court costs are added to the relevant customer account. They are not recognised within turnover.

Differences between Statutory and Regulatory accounts
Non-appointed income is included within turnover in the statutory accounts but is excluded from turnover in the APR.

Void Properties
Empty properties are classed as "voids" and no bill is raised. There is a defined process for determining if a property is unoccupied. The first stage is that an Occupation Form is posted to the property, requesting details of the occupier. If there is no reply a reminder is sent. The meter continues to be read and monitored and, if consumption is present, further steps are taken. The next stage involves a Visit Notice being raised and given to an Inspector. The Inspector will then go to the property and confirm if the property is void or not, and will turn off the water supply if appropriate. Accordingly revenue is only recognised if the property can be shown not to be void.

Empty Property Charging Policy
Charges are payable if premises are furnished unless the Company is asked to turn off the supply. No retrospective allowances are given. If the premises do not have a separate supply pipe it may not be possible for the Company to turn off the supply.

Where turn-off is required pending the sale of a property, or for a planned period of more than six months, no charge will be made to turn the water back on, provided this is undertaken within normal working hours and sufficient notice has been given.

No charges are payable in respect of unoccupied unfurnished premises, where no water is being used. No retrospective allowances are given.

Where a property is unoccupied following the death of the owner/occupier, the Executors/Administrators can decide whether a supply is maintained to furnished premises, with charges accruing, or the supply is turned off. In either case, the bill outstanding will only become payable upon Probate or Letters of Administration having been obtained.

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as turnover.

If the developer is no longer responsible for the property and no new occupier has been identified the process referred to above, for void properties, is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

(b) Fixed assets

Tangible fixed assets
The Company holds both above ground assets and a below ground infrastructure network of mains. This classification, together with the value and nature of items, drives both the approval process and the accounting treatment of tangible fixed assets.

As part of the annual budgeting process a detailed capital programme is drawn up for the forthcoming financial year. This categorises capital schemes between mains infrastructure and above ground assets. This is approved by the Company's Board. Following Board approval individual schemes are programmed for the coming year by Project Managers responsible for delivering the schemes. The Project Managers are responsible for the control of expenditure on the schemes and authorise each individual item of expenditure incurred. The Financial Controller reviews the scheme expenditure in order to ensure that the correct accounting treatment has been applied. For small plant, equipment and vehicles a list is drawn up and also approved by the Company's Board. Purchases made are reviewed for correctness of treatment and to ensure that these are all capital items. The policy adopted by the Company is that only items above £500 are capitalised.

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 tangible 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
Computer and network hardware	5 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.

Impairment
The values of fixed assets are reviewed regularly to determine whether their carrying amounts exceed their fair values in use. Where such an excess is believed to exist, it is treated as an impairment loss and charged to the profit and loss account.

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 (acquired before 31st March 2016) 5 years
Software (acquired after 31st March 2016) 3 years
Consultancy and internal staff costs (acquired before 31st March 2016) 5 years
Consultancy and internal staff costs (acquired after 31st March 2016) 3 years

Intangible assets in the course of construction are included in intangible fixed assets at cost but are not amortised until they come into use. The purchase date may therefore place them in one category but the commencement of their economic life places them in another. Where this occurs the post March 2016 policy shall apply.

(c) 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.

(d) 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.

(e) 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.

(f) 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.

(g) 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.

(h) Pension costs and other post-retirement benefits

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

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

Pension scheme assets are valued at 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 22.

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.

(i) 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 costs 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.

The Company subsequently categorises financial instruments as follows:

- Fixed asset investments consist of loans to Group undertakings, which earn interest based on London Interbank rates and are classified as loans and receivables.
- Other financial assets consist of short term bank deposits and debtors and are classified as loans and receivables.

The Company's financial liabilities consist of fixed rate borrowings in the form of perpetual debentures and an index linked loan.

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.

(j) 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.

(k) Cost allocation policies

Accounting Separation

The tables which relate to the PR14 price controls have been completed in accordance with RAG 2 - Guideline for classification of costs across the price controls. The details of this classification are included in the separately published Accounting Separation Methodology Statement, which can be located on the Company website at www.portsmouthwater.co.uk.

The Methodology Statement details the systems in place and the sources of information used to populate the relevant tables in the Annual Performance Report. The detailed nominal ledger management information reports allow costs to be identified for each cost centre of the Company, and the direct costs of Business Units, for example Retail, can be readily identified.

The Company has used the guidance issued by Ofwat in the separating of costs and assets between the Wholesale and Retail business units. It has followed the prescribed hierarchy of cost drivers when deciding upon the most appropriate basis for allocation of both costs and assets. Where the Company has opted to base the allocation of a number of costs and assets on a management estimate, it is satisfied that this was the only valid option given the time and costs involved in other methods.

A summary of the bases of allocation for the operating costs, excluding depreciation, is included below:

ANNUAL PERFORMANCE REPORT - BUSINESS UNIT TABLES
2017/18

	BASIS OF ALLOCATION
DIRECT COSTS	
Employment Costs	Direct and management estimate
Power	Pumping Head
Hired & Contracted Services	Direct
Materials & Consumables	Direct
Service Charges	Direct
Other Direct Costs	Direct
GENERAL & SUPPORT ACTIVITIES	
Land & Property	Direct and prorata on direct
Mechanical & Electrical	Direct and prorata on direct
Supply Engineer	M&E basis
Supply General	Direct
Distribution General & Admin	Direct
Personnel Services	FTE's
Legal & Property	FTE's
Financial Services	FTE's
Directors	Time on activities and Board Agenda
Data processing	No. of computers & mobile devices
Operational / Technical Support	GMEAV of asset additions
Vehicles & Plant	No of vehicles and NBV of assets
Stores	Direct material costs
GENERAL ADMIN	
Directly identifiable items	Direct
Other General Admin	Direct/Floor space/FTE's
Other Business Activities	Direct/1/5 per Business Unit
Scientific Services	Quality samples
Doubtful Debts	Direct
General Rates	Floor space
Bulk Supply	Direct
Third Party Costs (RCW)	Direct
Renewals Expensed	Direct

The allocation of shared assets and the associated depreciation is based on the same methodology. Assets are grouped into categories, such as IT or Scientific Services, and allocated on the same basis as the corresponding operating costs.

2. REVENUE

	Appointed 2018 £000	Non Appointed 2018 £000	Total 2018 £000	Appointed 2017 £000	Non Appointed 2017 £000	Total 2017 £000
Unmeasured supplies	21,280	-	21,280	21,612	-	21,612
Measured supplies	15,376	-	15,376	14,893	-	14,893
Measured large users	1,893	-	1,893	2,175	-	2,175
Third party services	294	343	637	1,010	45	1,055
Other sources	94	-	94	25	-	25
	38,937	343	39,280	39,715	45	39,760

Measured Income Accrual

For the year 2016/17 the measured income accrual was £2,043,722, and the corresponding actual billed revenue was £2,091,288. This is a difference of £47,566.

3. ANALYSIS OF OPERATING COSTS

This note has been prepared in accordance with Condition 'F' of the Company's Instrument of Appointment.

	Appointed 2018 £000	Non Appointed 2018 £000	Total 2018 £000	Appointed 2017 £000	Non Appointed 2017 £000	Total 2017 £000
Manpower costs	10,644	29	10,673	9,926	6	9,932
Other costs of employment	297	-	297	346	-	346
Power	2,323	-	2,323	2,203	-	2,203
Rates	2,316	-	2,316	2,163	-	2,163
Hired and contracted services	3,950	-	3,950	4,243	1	4,244
Materials and consumables	1,397	-	1,397	1,960	18	1,978
Service charges	1,322	-	1,322	1,322	-	1,322
Renewals expensed	2,851	-	2,851	4,212	-	4,212
Provision for bad and doubtful debts	795	316	1,111	785	-	785
Other operating costs	214	22	236	746	-	746
Depreciation and Amortisation	6,409	-	6,409	5,594	-	5,594
	32,518	367	32,885	33,500	25	33,525

Manpower costs include a notional pension charge which should not be included for efficiency purposes, as the notional pension charge is excluded from the price determination. A comparison of these costs are shown below:

	2018 £000	2017 £000
Manpower as reported	10,644	9,926
Notional Pension Cost	(866)	(463)
Manpower Cost for Efficiency and Price Determination purposes	9,778	9,463

4. OTHER OPERATING INCOME

	Appointed 2018 £000	Non Appointed 2018 £000	Total 2018 £000	Appointed 2017 £000	Non Appointed 2017 £000	Total 2017 £000
Loss arising on disposal of fixed assets	(16)	-	(16)	(143)	-	(143)

5. OTHER INCOME	Appointed 2018 £000	Non Appointed 2018 £000	Total 2018 £000	Appointed 2017 £000	Non Appointed 2017 £000	Total 2017 £000
Rents	-	124	124	-	138	138
Home Assistance Service	-	1	1	-	1	1
Amortisation of Developer Contributions	638	-	638	582	-	582
S45 Connection Charges	571	-	571	601	-	601
	1,209	125	1,334	1,183	139	1,322

6. INTEREST INCOME	2018 £000	2017 £000
Loan to Group Company	832	914
Interest on short term deposits	9	39
Other Finance Income (see note 22)	346	625
	1,187	1,578

7. INTEREST EXPENSE		2018 £000	2017 £000
£66.5m loan	- interest	3,733	3,621
	- indexation	3,624	1,831
	- amortisation of fees	57	57
	- administration expenses	92	79
		7,506	5,588
Other bank loans and overdraft		84	97
Debenture stocks		10	10
Other interest payable		3	1
		7,603	5,696

8. TAXATION (APPOINTED BUSINESS ONLY)	2018 £000	2017 £000
Current tax		
United Kingdom corporation tax at 19% (2017 - 20%)	50	254
Group relief	-	(95)
Adjustment in respect of prior periods	-	(789)
	50	(630)
Deferred tax		
Origination and reversal of timing differences	(89)	141
Effect of change to corporation tax rate	-	(501)
Difference between pension cost charge and pension cost relief	-	28
Adjustment in respect of prior periods	61	562
	(28)	230
Tax on profit on ordinary activities	22	(400)

8. TAXATION (APPOINTED BUSINESS ONLY) (continued)

	2018 £000	2017 £000
The tax charge for the year is lower (2017 - lower) than the standard rate of Corporation tax in the UK of 19% (2017 - 20%), explained as follows:		
Profit on ordinary activities before tax	51	2,536
*Less EBT payment (RAG differences) (deductible)	(1,267)	(1,206)
(Loss)/Profit before tax (taxable)	(1,216)	1,330
(Loss)/Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 19% (2017 - 20%)	(231)	266
Effect of:		
Depreciation on assets not qualifying for capital allowances	173	25
Other tax adjustments (including FRS102 transition)	9	(5)
Difference between pension cost charged and relieved	99	(32)
Prior year adjustment	-	(789)
Receipts for group relief	-	(95)
Current tax charge/(credit) for the year	50	(630)

*As set out in note 9, payments to employees as beneficiaries under the EOT are charged to operating profit, and tax deductible, in the statutory accounts. This is a RAG difference.

RECONCILIATION BETWEEN CURRENT TAX CHARGE AND CURRENT TAX IN PRICE LIMITS

	Note	Statutory Accounts	RAG Difference	Non-Appointed	Appointed	Final Determination	Tax Difference @19%
		£'000	£'000	£'000	£'000	£'000	£'000
Profit before tax	1	(1,115)	1,267	(101)	51	3,270	612
EOT payment (RAG difference)	4				(1,267)	0	241
Ofwat adjustments gearing	1	0		0	0	(1,505)	(286)
PBT adjusted for gearing	1	(1,115)		(101)	(1,216)	1,765	566
Add depreciation	2	6,409			6,409	3,762	(503)
Less Capital allowances		(5,501)			(5,501)	(5,577)	(14)
Pensions difference		520			520	115	(77)
Other adjustments	3	49			49	300	48
Adjusted profit chargeable to CT @19% tax rate		362		(101)	261	365	20
Current Tax charge/(credit)		69		(19)	50	69	20

We have analysed the differences between the current tax charge of £0.050m for the appointed business against the tax charge calculated in the Final Determination of £0.069m. The significant movements (referenced above) are as follows:

1. Profit before tax of £0.051m is lower than the FD. However, this should be further adjusted for by a charge of £1.5m which relates to the Ofwat net tax adjustment for gearing. This reflects the higher actual finance cost when compared to the notional finance cost included in the FD.
2. Actual depreciation outturn is higher than estimated in the Business Plan submission.
3. The FD assumed significant disallowable expenses which did not occur.
4. The EOT payment, treated as a dividend for regulatory purposes, is tax deductible and therefore generates a tax difference between the FD and actual results. The FD tax calculation does not model this as a tax deductible.

9. DIVIDENDS

	2018 £000	2017 £000
Equity: Ordinary/'A' Ordinary		
- First interim paid	544	602
- Final paid	546	603
	1,090	1,205

The Directors are proposing the payment of a second interim dividend of £1.767m in June. This dividend has not been accounted for within the current year financial statements, as it has yet to be approved.

Dividend Policy
The Company's dividend policy covers two elements:

The first is a dividend payment which is ultimately paid to shareholders and the second is to cover the servicing of intercompany debt. The policy on the dividend element is to show real growth of 1.65% (i.e. RPI + 1.65%) on the previous year's payment.

The second part of the dividend is the payment to cover interest due from South Downs Limited on the loan from Portsmouth Water. This payment is made net of any group tax relief surrendered. This element is subsequently repaid by South Downs Limited to Portsmouth Water Limited to cover the next interest payment.

In addition to the above, payments to employees, as beneficiaries under the Employee Ownership Trust, amounting to £1.267m are charged to operating profit in the Statutory Accounts as an employee cost. For the regulatory accounts they are treated as a distribution to shareholders. This is consistent with the PR14 Business Plan and the FD14, in that they are funded through the return on capital element of the Price Control building blocks. The policy on these distributions in the same as the dividend to the remaining shareholders, i.e. a red growth of 1.65%.

	2018 £000	2017 £000
Dividend ultimately for group shareholders	422	408
Employee Ownership Trust	1,267	1,206
Servicing of intercompany debt net of tax	668	797
Deferred costs	-	4
Total Dividends	2,357	2,415

10. 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 1st April 2017	54,886	56,539	50,796	19,091	181,312
Additions	414	4,163	1,205	1,715	7,497
Disposals	-	(63)	-	(448)	(511)
At 31st March 2018	**55,300**	**60,639**	**52,001**	**20,358**	**188,298**
DEPRECIATION					
At 1st April 2017	12,742	3,772	26,003	13,540	56,057
Charge for year	790	1,119	2,251	1,603	5,763
Disposals during year	-	(30)	-	(428)	(458)
At 31st March 2018	**13,532**	**4,861**	**28,254**	**14,715**	**61,362**
NET BOOK VALUE					
At 31st March 2018	**41,768**	**55,778**	**23,747**	**5,643**	**126,936**
At 1st April 2017	42,144	52,767	24,793	5,551	125,255

ASSETS IN THE COURSE OF CONSTRUCTION

Included in the above table 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 1st April 2017	727	196	886	37	1,846
Additions	76	2,061	(1,070)	18	1,085
At 31st March 2018	**803**	**2,257**	**(184)**	**55**	**2,931**
DEPRECIATION					
At 1st April 2017	-	-	-	-	-
Charge for year	-	-	-	-	-
At 31st March 2018	-	-	-	**0**	**0**
NET BOOK VALUE					
At 31st March 2018	**803**	**2,257**	**(184)**	**55**	**2,931**
At 1st April 2017	727	196	886	37	1,846

No depreciation has so far been provided on the above cost.

11. INTANGIBLE FIXED ASSETS

	Software, Consultancy and Internal Costs £'000
COST	
At 1st April 2017	2,840
Additions (WIP completed assets)	83
Disposals	-
At 31st March 2018	**2,923**
AMORTISATION	
At 1st April 2017	603
Disposals	-
Charge for year	646
At 31st March 2018	**1,249**
NET BOOK VALUE	
At 31st March 2018	**1,674**
At 1st April 2017	2,237

Intangible fixed assets primarily comprise software costs and the in house development of bespoke software and related IT solutions. Included in the numbers above are no values to be included as intangibles work in progress.

12. FIXED ASSET INVESTMENT

	Loan to Group Undertakings £000
At 1 April 2017	55,484
	-
At 31 March 2018	55,484

13. DEBTORS

	2018 £000	2017 £000
Trade debtors	3,510	4,950
Amounts owed by Group companies	774	281
Prepayments and accrued income	3,343	4,507
*Other debtors	537	1,165
	8,164	10,903

All of the above amounts fall due within one year. Included within other debtors is corporation tax recoverable of £0.200m.

As at 31 March 2018, trade debtors had a carrying value of £8.853m (2017 - £8.833m) 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 £4.580m as at 31 March 2018 (2017 - £3.883m).

The ageing of these debtors was as follows:

	2018 £000	2017 £000
Up to 12 months	4,806	4,414
Over 12 months	2,047	4,419
	6,853	8,833

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.

Movement on the provision for bad debt are as follows:

	2018 £000	2017 £000
As at 1 April 2017	3,883	3,545
Provision for bad debt required in the year	1,111	784
Debt written off in the year as uncollectable	(414)	(446)
As at 31 March 2018	4,580	3,883

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.

	2018 £000	2017 £000
Total Debtors Outstanding > 30 days		
- Household	5,471	5,136
- Non-household	-	789
	5,471	5,925

Write Off Policy
Our bad debt write off policy has not changed within the period under review. However, we no longer report on Non-household customers, since the sale of the Retail business on 1 April 2017.

Customers who remain within our area of supply;

Domestic – written off upon Bankruptcy or the granting of a Debt Relief Order.

Customers who have moved outside of our area of supply;

Debt less than £50 – limited automated credit control and then periodic automatic write off.
Debt greater than £50 – credit control process then passed to a Debt Collection Agency (DCA) for recovery on a no success, no fee basis. Periodic write off exercise for accounts returned by DCA, following internal review.

Differences in amounts written off from year to year are generally the result of differences in the timing of write off exercises rather than as a result of any particular trends.

Provisioning policy
The provisioning policy has been consistently applied as follows:-

Unmeasured Customers: All debt
Provide for 100% of the outstanding balances over four years old
Provide for 80% of the outstanding balances that are one to four years old
Provide for 60% of the outstanding balances that are up to one year old

Measured Customers: Household debt
Provide for 80% of the outstanding balances relating to current occupiers that are over one year old
Provide for 60% of the outstanding balances relating to current occupiers that are up to one year old
Provide for 100% of the outstanding balances relating to former occupiers

14. INVESTMENTS

	2018 £000	2017 £000
Unlisted investments	2	2

15. CASH AT BANK AND IN HAND

Of the total amount shown of £26.744m (2017 - £11.644m), £1.909m (2017 - £1.847m) is held specifically for the payment of the next half yearly loan interest charges.

£11.037m of the increase in cash is due to proceeds of sale and share options being transferred from Ancala. This is to settle future incremental employment related social security liabilities bought about by the transaction (See note 24 of the APR)

16. BORROWINGS: DUE WITHIN ONE YEAR

	2018 £000	2017 £000
3% Perpetual debenture stock	60	60
3½% Perpetual debenture stock	185	185
4% Perpetual debenture stock	39	39
Bank loan	3,000	4,000
	3,284	4,284

The bank loan is part of a three year £10m working capital facility, which was secured upon the assets of the Company and bore interest at London Interbank rates.

17. OTHER CURRENT LIABILITIES	Appointed 2018 £000	Non Appointed 2018 £000	Total 2018 £000	Appointed 2017 £000	Non Appointed 2017 £000	Total 2017 £000
Payments received on account	2,820	-	2,820	2,351	-	2,351
Trade creditors	2,772	-	2,772	1,797	-	1,797
Amounts owed to Group companies	1,619	-	1,619	1,571	-	1,571
Other creditors	(710)	-	(710)	2,273	-	2,273
Accruals	837	-	837	1,510	-	1,510
Water rates in advance	7,025	-	7,025	6,424	-	6,424
Trade and other payables	14,363	-	14,363	15,926	-	15,926
Capex creditor	575	-	575	962	-	962
Other taxation and social security	11,446	-	11,446	280	-	280
Special Dividend (Brockhampton)	1,412	-	1,412	1,412	-	1,412
	27,796	-	27,796	18,580	-	18,580

18. NON-CURRENT LIABILITIES

	2018 £000	2017 £000
In five years or more:		
Bank loan	104,118	100,494
Less: deferred arrangement costs	(824)	(881)
	103,294	99,613

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

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

19. DEFERRED INCOME: CAPITAL CONTRIBUTIONS

	2018 £000	2017 £000
Capital Contributions	26,131	25,594
Release of Capital Contribution to Turnover	(638)	(582)
	25,493	25,012

20. PROVISIONS FOR LIABILITIES

	2018 £000	2017 £000
DEFERRED TAXATION:		
At 1 April 2017	6,703	6,386
Charged during the year in profit and loss account	61	317
At 31 March 2018	6,764	6,703

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

	2018 £000	2017 £000
Deferred tax excluding that relating to pension asset:		
Accelerated capital allowances	7,697	8,068
Other timing differences	(933)	(1,365)
Pension asset (note 22)	5,078	2,344
Total provision for deferred tax	11,842	9,047
At 1 April 2016	9,047	9,586
Deferred tax charge in profit and loss account (note 8)	(28)	230
Deferred tax charged to the statement of total recognised gains and losses	2,822	(768)
At 31 March 2017	11,842	9,047

21. RESERVES

	Called up Share Capital £'000	Share Premium £'000	Capital Redemption £'000	Profit and Loss £'000	Total £'000
Balance at 1st April 2017	1,078	1,539	3,250	57,826	63,693
Profit for Financial 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	-	-	-	0	0
Total comprehensive income for the year	-	2,988.0	-	12,624	15,612
Dividends	-	-	-	(1,090)	(1,090)
Balance at 31st March 2018	**1,078**	**4,527**	**3,250**	**69,360**	**78,215**

During the year the Company issued 10 new 10 pence ordinary shares at a premium of £2,987,999 for cash.

22. 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 2016 was updated to the 31 March 2018 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 Company contributions expected to be paid to the Scheme by Portsmouth Water Ltd for the year commencing 1 April 2018 is £1.3m (2017 actual: £1.3m). Of this amount, £1.1m is contributed directly by the Company and £0.2m is contributed by employees by salary sacrifice under the SMART arrangement.

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

	2018 % per annum	2017 % per annum	2016 % per annum
RPI inflation	3.2	3.3	3.0
CPI inflation	2.3	2.4	2.1
Discount rate	2.5	2.4	3.4
Pension increases	2.3	2.4	2.1
Salary growth	4.3	4.4	5.25

Life expectancy of a male aged 65 at the accounting date is 23.1 years and for a female is 25.2 years. Allowances for future improvements in life expectancy mean that life expectancy of a male aged 65 at the accounting date plus 20 years is 24.8 years and for a female is 27.0 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:

	%	2018 Fair Value £000	%	2017 Fair Value £000	%	2016 Fair Value £000
Equities	32	52,727	35	56,931	34	47,932
Absolute Return Fund	25	41,111	24	38,439	23	33,134
LDI	23	38,205	22	36,552	21	29,557
Property	11	17,525	9	14,653	10	14,032
Cash and other	9	15,480	10	16,733	12	17,125
	100	165,048	100	163,308	100	141,780

	2018 £000	2017 £000
Total fair value of scheme assets	165,048	163,308
FRS 17 value of scheme liabilities	(135,176)	(149,518)
Gross pension asset	29,872	13,790
Related deferred tax liability	(5,078)	(2,344)
Net pension asset	24,794	11,446

Under FRS 102, the scheme is represented on the statement of financial position at 31 March 2018 by an asset of £29.872m (2017 - £13.790m), which amounts to £24.794m net of deferred tax (2017 - £11.446m).

The Company paid contributions at a rate of 20.6% of earnings. Members pay contributions at a rate of 5% of earnings via salary sacrifice. The Company also operates a defined contribution pension scheme. The contributions payable by the Company for the year in respect of the defined contribution scheme amounted to £205,772 (2017 - £184,794).

Movement in the net balance sheet position

<u>The FRS 102 value of scheme assets moved over the period as follows:</u>

	2018 £000	2017 £000
Opening asset	13,790	17,775
Expense charged to profit and loss	(1,749)	(1,113)
Gain recognised outside of profit and loss	16,602	(4,147)
Employer contributions	1,229	1,275
Closing asset	29,872	13,790

Movement in present value of defined benefit obligation
The FRS 102 value of scheme defined benefit obligation moved over the period as follows:

	2018 £000	2017 £000
Opening scheme liabilities	149,518	124,005
Employer's part of current service cost	2,095	1,738
Interest on scheme liabilities	3,546	4,145
Benefits paid	(3,537)	(4,245)
Actuarial (gain)/loss	(16,446)	23,875
Closing scheme defined benefit obligation	135,176	149,518

Movement in fair value of scheme assets
The FRS 102 value of scheme assets moved over the period as follows:

	2018 £000	2017 £000
Opening fair value of scheme assets	163,308	141,780
Interest on scheme assets	3,892	4,770
Contributions by the Company, including employee contributions under the SMART arrangement	1,229	1,275
Benefits paid	(3,537)	(4,245)
Actuarial (loss)/gain	156	19,728
Closing fair value of scheme assets	165,048	163,308

Expense recognised in Income Statement
The following amounts have been included within operating profit:

	2018 £000	2017 £000
Current service cost (employer's part only)	(2,095)	(1,738)
Total operating charge	(2,095)	(1,738)

The following amounts have been included as other finance income under FRS 102:

	2018 £000	2017 £000
Interest on pension scheme assets	3,892	4,770
Interest on pension scheme defined benefit obligation	(3,546)	(4,145)
Net return	346	625
Total return recognised in the Income Statement	(1,749)	(1,113)

Amounts recognised outside Income Statement
The following amounts have been recognised within the Statement of Changes in Equity:

	2018 £000	2017 £000
Actual return less interest	(156)	(19,728)
Experience gains arising on scheme defined benefit obligation	(1,226)	(2,567)
Loss/(gain) due to changes in assumptions	(15,220)	26,442
Remeasurement loss/(gain) of net defined benefit asset	(16,602)	4,147

The actual return on plan assets was £4.048m in the year to 31 March 2018 (2017 - £24.498m).
The Accounting Standards Board have published guidance relating to best practice for disclosure of pensions information. The Company has decided not to follow the guidance at this time.

23. ULTIMATE CONTROLLING PARTY

On 16 March 2018 the entire share capital of the Company's ultimate parent Undertaking, South Down's Capital Ltd, was acquired by funds managed by Ancala Partners LLP ("Ancala") an independent infrastructure investment fund. The new group structure is set out on page 3 in the APR. The Ultimate controlling party is Ancala Fornia Holdco Ltd. For the period ended 31 March 2018 South Downs Capital Limited is the parent of the smallest group of which the Company is a member and consolidated accounts can be obtained on request from the Registered Office. Ancala Fornia Holdco Ltd is the parent of the largest group of which the Company is a member. Consolidated accounts for Ancala Fornia Holdco Ltd will be prepared for the 54 week accounting period ending 31 March 2019.

24. DISPOSAL OF THE SOUTH DOWNS CAPITAL GROUP

As noted in the Strategic Report and Corporate Governance sections of the Annual Report and Accounts, on 16 March 2018 the South Downs Capital Group (of which Portsmouth Water Limited is the primary trading company) was sold to funds managed by Ancala, an infrastructure investment fund. The Group was previously owned 73% by an Employee Benefit Trust (EBT) and 27% by external shareholders (comprising former senior management and one current director).

As a result of this transaction, share options relating to the 73% EBT shareholding were issued to the trust beneficiaries at market value (the majority of current employees and certain former employees). These options were exercised immediately and the shares disposed of as part of the transaction.

External tax advice and HMRC clearance indicated that the sales proceeds, due to employees, were deemed to have arisen "by virtue of their employment" by the Group. As such these distributions were subject to PAYE and NI contributions. In order to tax effect these sale proceeds due to employees the gross consideration was paid to the Company and processed through payroll with payments being made net to employees. As such, additional employee PAYE and NIC contributions were settled out of the gross proceeds and were payable during April 2018. This resulted in a beneficial cash flow position of £11.037m as at 31 March 2018 due to the timing of the receipt of proceeds for distribution and the settlement of PAYE and NIC liabilities.

It should be noted that the Company's role was merely one to distribute the proceeds and, therefore (with the exception of employer NIC and apprenticeship levy – discussed further below) no income statement charges arose on this transaction.

It should be noted that approximately 66% of the sales proceeds payable have been deferred for future payment to employees in March 2019 and March 2020.

A further impact of the transaction and its manner of distribution was the liability arising in respect of employers NIC and apprenticeship levy. As these are payable on payroll costs, a total additional charge of £2,988,000 arose in relation to the sale proceeds paid to employees. As this could not be deducted from the employees' distribution it results in a charge to the income statement which has been treated as an exceptional cost. However, this has been compensated for by the injection of additional share capital and share premium of £2,988,000 (note 21 in APR).

25. DISPOSAL OF THE NON-HOUSEHOLD BUSINESS

As previously disclosed, the non-household retail business was disposed of to Castle Water Limited on 1 April 2017, the date that the non-household market opened to competition. Proceeds of £2.9m, including deferred meter reading income, was received in the previous financial year. After taking into account transaction costs a profit of £1.8m was realised. Meter reading revenue has been deferred and amortised over a period of 5 years.

SECTION 2 PRICE REVIEW AND OTHER SEGMENTAL REPORTING

2A SEGMENTAL INCOME STATEMENT

For the 12 months ended 31 March 2018

Current year

	Retail		Wholesale			Total
	Household	Non-Household	Water Resources	Water Network+	Water Total	
	£'000	£'000	£'000	£'000	£'000	£'000
Revenue - price control	4,702	0		33,847	33,847	38,549
Revenue - non-price control	0	0		388	388	388
Operating expenditure	(4,629)	0	(4,030)	(17,450)	(21,480)	(26,109)
Depreciation - tangible fixed assets	(104)	0	(256)	(5,403)	(5,659)	(5,763)
Amortisation - intangible fixed assets	(179)	0	(35)	(432)	(467)	(646)
Other operating income	0	0	0	(16)	(16)	(16)
Operating profit before recharges	(210)	0			6,613	6,403
Recharges from other segments	(85)	0	(38)	0	(38)	(123)
Recharges to other segments	0	0	0	123	123	123
Operating profit	(295)	0			6,698	6,403

2B TOTEX ANALYSIS – WHOLESALE WATER

For the 12 months ended 31 March 2018

£'000	Water Resources	Water Network+	Water Total
Operating expenditure			
Power	923	1,321	2,244
Abstraction charges/ discharge consents	1,322	0	1,322
Bulk supply/ Bulk discharge	0	0	0
Other operating expenditure			
- Renewals expensed in year (Infrastructure)	0	2,851	2,851
- Renewals expensed in year (Non-infrastructure)	0	0	0
- Other operating expenditure excluding renewals	1,332	10,897	12,229
Local authority and Cumulo rates	453	1,649	2,102
Total operating expenditure excluding third party services	4,030	16,718	20,748
Third party services	0	732	732
Total operating expenditure	4,030	17,450	21,480
Capital expenditure			
Maintaining the long term capability of the assets - infra	0	1,432	1,432
Maintaining the long term capability of the assets - non-infra	50	1,493	1,543
Other capital expenditure - infra	0	1,196	1,196
Other capital expenditure - non-infra	8	2,313	2,321
Infrastructure network reinforcement	0	39	39
Total gross capital expenditure (excluding third party)	58	6,473	6,531
Third party services	0	1,049	1,049
Total gross capital expenditure	58	7,522	7,580
Grants and contributions	0	1,064	1,064
Totex	4,088	23,908	27,996

2C OPERATING COST ANALYSIS – RETAIL

For the 12 months ended 31 March 2018

£'000	Household	Non-Household	Total
Operating expenditure			
Customer services	1,963	0	1,963
Debt management	304	0	304
Doubtful debts	795	0	795
Meter reading	161	0	161
Services to developers	0	0	0
Other operating expenditure	1,406	0	1,406
Total operating expenditure excluding third party services	4,629	0	4,629
Third party services operating expenditure	0	0	0
Total operating expenditure	4,629	0	4,629
Depreciation - tangible fixed assets	104	0	104
Amortisation - intangible fixed assets	179	0	179
Total operating costs	4,912	0	4,912
Debt written off	413	0	413

2D HISTORIC COST ANALYSIS OF TANGIBLE FIXED ASSETS - WHOLESALE & RETAIL

£'000	Wholesale		Retail		Total
	Water Resources	Water Network+	Household	Non-Household	
Cost					
At 1 April 2017	13,572	166,545	1,134	61	181,312
Adjustments	0	0	61	(61)	0
Disposals	0	(455)	(56)	0	(511)
Additions	41	7,413	43	0	7,497
At 31 March 2018	13,613	173,503	1,182	0	188,298
Depreciation					
At 1 April 2017	3,360	51,909	748	40	56,057
Adjustments	0	0	40	(40)	0
Disposals	0	(407)	(51)	0	(458)
Charge for year	256	5,403	104	0	5,763
At 31 March 2018	3,616	56,905	841	0	61,362
Net book amount at 31 March 2018	9,997	116,598	341	0	126,936
Net book amount at 1 April 2017	10,212	114,636	386	21	125,255
Depreciation charge for year					
Principal Services	256	5,403	104	0	5,763
Third Party Services	0	0	0	0	0
Total	256	5,403	104	0	5,763

The net book value includes £2.9m in respect of assets in the course of construction.

2E ANALYSIS OF 'GRANTS AND CONTRIBUTIONS' AND LAND SALES - WHOLESALE

For the 12 months ended 31 March 2018

£'000	Current year			
	Fully recognised in income statement	Capitalised and amortised against depreciation	Fully netted off capex	Total
Grants and contributions - water				
Connection charges (s45)[1]	571	0	0	571
Infrastructure charge receipts (s146)	0	742	0	742
Requisitioned mains (s43, s55 & s56)	0	322	0	322
Other Contributions (price control)	0	0	0	0
Diversions (s185)	0	0	0	0
Other Contributions (non-price control)	0	0	0	0
Total	571	1,064	0	1,635

Movements in capitalised grants and contributions	Current year	
	Water	Total
Balance sheet		
Brought forward	25,013	25,013
Capitalised in year	1,064	1,064
Amortisation (in income statement)	(638)	(638)
Carried forward	25,439	25,439

	Current year	
Land sales	Water	Total
Proceeds from disposals of protected land	0	0

[1] Connection Charges (s45) were included in Revenue in the Business Plan, and not Grants and Contributions.

2F REVENUES BY CUSTOMER TYPE

For the 12 months ended 31 March 2018

HOUSEHOLD

	Wholesale charges revenue	Retail revenue	Total revenue	Number of customers	Average household retail revenue per customer
	£m	£m	£m	000s	£
Unmeasured water only customer	18.046	2.971	21.017	204.160	15
Measured water only customer	7.130	1.731	8.861	89.290	19
Total	25.176	4.702	29.878	293.450	16

NON-HOUSEHOLD

Portsmouth Water has exited the non-household retail business, so Table 2G has been excluded, as per the Ofwat guidance. The Wholesale revenue for the non-household business in 2017/18 is £8,671k.

For the 12 months ended 31 March 2018

£'000	Current year Household	Non-Household	Total
Wholesale charge - water			
Unmeasured	18,046	263	18,309
Measured	7,130	8,408	15,538
Third party revenue	0	0	0
Water Total	25,176	8,671	33,847
Wholesale Total	25,176	8,671	33,847
Retail revenue			
Unmeasured	2,971	0	2,971
Measured	1,731	0	1,731
Other third party revenue	0	0	0
Retail Total	4,702	0	4,702
Third party revenue - non-price control			
Bulk supplies			92
Other third party revenue			202
Principal Services - non-price control			
Other appointed revenue			94
Total appointee revenue	29,878	8,671	38,937

	Current year Water	Total
Wholesale revenue governed by price control	33,847	33,847
Grants and Contributions[1]	1,064	1,064
Total revenue governed by wholesale price control	34,911	34,911
Amount assumed in wholesale determination	34,986	34,986
Adjustment for WRFIM	(498)	(498)
Total assumed revenue	34,488	34,488
Difference[2]	423	423

[1] Relevant capital contributions as defined in FD

[2] Narrative explanation on page 44

2J INFRASTRUCTURE NETWORK REINFORCEMENT COSTS

For the 12 months ended 31 March 2018

£'000	Current year Network reinforcement capex	 On site/site specific capex (memo only)
Wholesale water network+ (treated water distribution)		
Distribution and trunk mains	39	506
Pumping and storage facilities	0	0
Other	0	0
Water Total	39	506
Wholesale Total	39	506

RETAIL PRICE CONTROL ANALYSIS

Household Retail
Operating expenditure within the household retail business was higher than the business plan assumptions, with 2017/18 showing a loss.

The principal variations were as follows:-

- Doubtful Debts. Our provision in the year increased by £367k as a result of a significant amount of debt reaching an age where it is fully provided for, within the provisioning policy.
- FRS102 Pension Charge. A charge of £41k was made in the year. No FRS17/FRS102 allowance was made in the original business plan modelling, given the nature of this charge.
- Customer Services costs, including staff costs. Staff costs increased by £71k. This, along with an increase in other direct customer service department costs resulted in us being unable to save the costs that were previously allocated to non-household retail.

WHOLESALE CONTROL RECONCILIATION

REVENUE £'000	Actual	FD	Difference
Wholesale Charge:			
Household – Unmeasured	18,046	17,883	163
Household - Measured	7,130	6,759	371
Non-Household - Unmeasured	263	257	6
Non-Household - Measured	8,408	8,412	(4)
Total revenue from charges	33,847	33,311	536
Grants and Contributions	1,064	1,177	(113)
TOTAL REVENUE	**34,911**	**34,488**	**423**

We have compared actual revenue with that implicit in tariff setting for 2017/18, and this complied with the Final Determination.

The Wholesale revenue variance is £0.423m reflecting additional revenue from standard charges of £0.536m and less capital contributions from developers for mains of £0.113m.

The household measured wholesale revenue reflects higher per property consumption than assumed, while the household unmeasured wholesale revenue reflects a greater number of properties, partly due to a lower take-up of meter optants than assumed at tariff setting.

The level of capital contribution is difficult to establish in advance, as it will be scheme specific. Our assumption was based on the historic five year average, and we will monitor this position going forward.

The variance of wholesale charges relative to the Final Determination is 1.6%.

The total variance of wholesale revenue relative to the Final Determination is 1.2%.

SECTION 3 PERFORMANCE SUMMARY

OUTCOME PERFORMANCE TABLE 3A

For the 12 months ended 31 March 2018

Row	Unique ID	Performance commitment	Unit	Unit description	Decimal places	2016-17 performance level - actual	2017-18 performance level - actual	2016-17 CPL met?	2017-18 reward or penalty (in-period ODIs)	2017-18 reward or penalty (in-period ODIs) £m (4 DPs)	2017-18 notional reward or penalty accrued	2017-18 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
1	PR14PRTWSW_A1	A1: Bursts	nr	No. of burst mains per year	0	298	347	-	-	-	-	-	-	-
2	PR14PRTWSW_A2	A2: Water quality standards	%	Mean zonal compliance (%)	2	99.99	99.93	No	-	-	Penalty	-0.3194	Penalty	-0.6388
3	PR14PRTWSW_A3	A3: Water quality contacts	nr	No. contacts per 1,000 population served	3	0.670	0.549	No	-	-	-	-	-	-
4	PR14PRTWSW_A4	A4: Temporary usage bans	nr	No. of temporary usage bans per year	0	0	0	Yes						
5	PR14PRTWSW_B1	B1: Leakage	nr	Megalitres per day (Ml/d)	2	30.37	32.87	No	-	-	-	-	-	-
6	PR14PRTWSW_C1	C1: Interruptions to supply	time	Mins:secs per property per year	mins:secs	4 min 9 secs	4 min 17 secs	Yes	-	-	-	-	-	-
7	PR14PRTWSW_D1	D1: Biodiversity	%	% (completion of agreed actions)	0	40	60	Yes	-	-	-	-	-	-
8	PR14PRTWSW_D2	D2: Water Framework Directive (WFD)	text	Programme completion	na	Progress as planned	Completed and signed off by EA	Yes	-	-	-	-	-	-
9	PR14PRTWSW_D3	D3: Carbon	%	Energy sourced from renewables (% increase)	0	> 95%	> 95%	Yes						
10	PR14PRTWSW_E1	E1: RoSPA Health and Safety accreditation	text	RoSPA Gold award	na	Awarded	Awarded	Yes						
11	PR14PRTHHR_A1	A1: Service incentive mechanism (SIM)	text	Service incentive mechanism (SIM) score ranking	na	87.68	87.85	-	-	-	-	-	-	-
12	PR14PRTHHR_B1	B1: Reducing per capita consumption (PCC)	nr	Litres per head per day (l/h/d)	2	145.10	147.54	-	-	-	-	-	-	-
13	PR14PRTHHR_C1	C1: Survey of developers	%	Satisfaction rate (%)	0	85	91	Yes						

Introduction
Table 3A shows the performance of the Company against its 13 Outcome Delivery Incentives. The performance data has been assured by the Board of Portsmouth Water, who have engaged Atkins to undertake an independent third party review of the data reported. This data has also been shared with our Customer Challenge Group and a comprehensive report was discussed with the CCG on 1 June 2018.

Background
The Company has 13 ODIs which apply for the five year period starting 1 April 2015. These were agreed as part the most recent Price Review, PR14. The table below classifies each ODI by division within the business, wholesale or retail and whether the ODI financial and attracts a reward / penalty or is reputational in nature.

	Wholesale	Retail	Total
Financial (Table 3A)	**7** (A1, A2, A3, B1, C1, D1 and D2)	**2** (A1 and B1)	**9**
Reputational (Table 3A)	**3** (A4, D3 and E1)	**1** (C1)	**4**
Total	**10**	**3**	**13**

Of our 9 financial ODIs, 5 reflect performance over the 5 year period from 1 April 2015. Therefore at this stage of the monitoring period there is no expectation that a reward or penalty will apply for any of these metrics. Further, 2 of our ODIs are agreed projects with set deadlines in the monitoring period, so again there is no expectation that a reward or penalty will apply. We have one specific ODI that is assessed annually, A2 - Mean Zonal Compliance and thus we can determine whether a penalty should apply or not. Finally we have an ODI which only applies in year 5, which therefore cannot be determined at this stage, given we are only at the end of year three of the five year period.

2017/18 performance
Table 3A shows the impact of performance in 2015/16, 2016/17 and 2017/18, and the determination of rewards and penalties which will apply from 2020.

Given the structure of our 9 Financial ODIs discussed above, the Company has only one entry, a penalty, which is the consequence of the water quality standard (as measured by the mean zonal compliance) being below 99.95%, in calendar years 2015 and 2017.

Further, whilst the number of contacts we receive from customers relating to water quality has been higher than target in calendar years 2015, 2016 and 2017, we believe there is scope to improve and mitigate the impact of this performance as this is a five year target.

Finally, the Company failed its 2017/18 leakage target. However, given this is a five year target, there is no reward or penalty recognised at this stage of the five year period.

All other ODIs have exceeded expectation in 2017/18 and if this performance is maintained for the period rewards will apply. Specifically for 3 of our ODIs which are measured on an on-going basis namely, temporary usage bans, interruptions to supply and our survey of developers we have exceeded our performance commitments.

For our 4 project based ODIs, biodiversity, Water Framework Directive, Carbon and RoSPA we are on or ahead of target. For carbon we buy over 95% of our electricity from a supplier which is totally renewable in nature and thus have met our commitment to increase renewables by 10% over the 5 year period.

The only ODI we cannot currently confirm performance is SIM ranking for 2017/18, given it is a relative measure compared to others in the industry. We note however that for the most important factor in the SIM calculation, our qualitative survey score, was placed 4th in the industry. We will undertake this exercise when all companies publish their ODIs in July 2018.

The full ODI report will be published on our website on 15 July 2018.

3C AIM (Abstraction Incentive Mechanism)

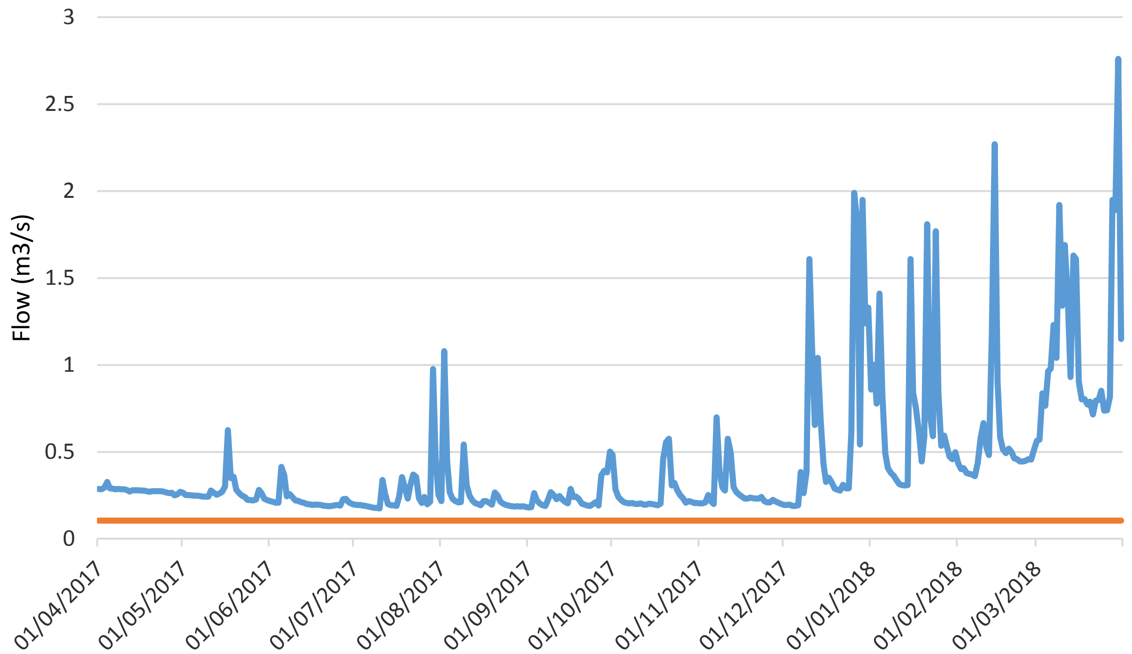
For the 12 months ended 31 March 2018

Abstraction Site	AIM Performance Ml	Normalised AIM Performance Ml	Cumulative AIM Performance 2017/18 onwards Ml	Normalised AIM performance 2017/18 onwards Ml	Contextual Information relating to AIM Performance
Northbrook	0	0	0	0	-

The abstraction incentive mechanism (AIM) has the objective of encouraging water companies to reduce the environmental impact of abstracting water at environmentally sensitive sites during defined periods of low surface water flows. The AIM aims to help to improve the resilience of water supply and ensure that it is provided in a more sustainable way (Guidelines on the abstraction incentive mechanism, Ofwat, 2016).

Northbrook is the only Portsmouth Water site remaining in the Abstraction Incentive Mechanism (AIM) as it is deemed to impact on flows on the River Hamble. In 2017/18 Portsmouth Water completed an NEP (Natural Environment Program) scheme designed to improve water quality on the River Hamble. It is possible that future enhancement schemes may take still take place for the River Hamble, although this is still subject to review.

The AIM minimum flow target for the River Hamble is 0.104 m3/second and is represented by the orange line in the figure below. This target is based on Q95 flows and recent actual abstraction from the period 2007 to 2014. During 2017/18 the low flow trigger was not passed in any day, and therefore, entries for Table 3C of the annual reporting are all zero.



3D SIM (Service Incentive Mechanism) SCORE TABLE

For the 12 months ended 31 March 2018

	Units	Decimal places	Score
Qualitative Performance			
1st Survey Score	nr	2	4.48
2nd Survey Score	nr	2	4.38
3rd Survey Score	nr	2	4.61
4th Survey Score	nr	2	4.47
Qualitative SIM Score (out of 75)	nr	2	65.34
Total Contact Score	nr	2	49.94
Quantitative Performance			
Quantitative SIM Score (out of 25)	nr	2	22.50
Total Annual SIM score (out of 100)	nr	2	87.85

3S SHADOW REPORTING OF NEW DEFINITION LEAKAGE AND SUPPLY INTERRUPTION DATA

For the 12 months ended 31 March 2018

This schedule has been published alongside the Annual Performance Report.

SECTION 4 ADDITIONAL REGULATORY INFORMATION

4A NON-FINANCIAL INFORMATION

For the 12 months ended 31 March 2018

Retail - Household	Current year	
	Unmeasured	Measured
Number of void households ('000s)	5.434	1.486
Per capita consumption (excluding supply pipe leakage) l/h/d	155	127

Wholesale	Current year Water
Wholesale Volume (Ml/d)	
Bulk supply export	2.01
Bulk supply import	0.00
Distribution input	174.4

£m	Current year Water	Cumulative 2015-2020 Water
Actual Totex	27.996	87.189
Less: Items excluded from the menu		
Pension deficit recovery costs	0.000	0.000
Third party costs	1.781	3.211
*Other 'Rule Book' adjustments	0.675	1.144
Total costs excluded from the menu	2.456	4.355
Adjusted Actual totex	25.540	82.834
Adjusted Actual totex - base year prices	22.728	76.163
Allowed totex based on final menu choice - base year prices	29.108	84.228
Variance - base year prices	6.380	8.065

* Wholesale share of FRS102 pension charges

The Cumulative column has been updated to reflect the fact that all third party costs are excluded from the Totex menu.

TOTEX MENU VARIANCE ANALYSIS

In the Final Determination, the allowed expenditure from the totex menu is £32.694m, in 2017/18 prices. This menu position gives a variance to actual totex in the year of £7.154m (£6.380m in 2012/13 prices). The following table shows this variance for each element of totex.

2017/18 Prices	**Allowed Menu Totex 2017/18**	**Actual 2017/18**	**Variance 2017/18**
Operating Expenditure	17,917	17,222	695
Renewals	5,857	4,751	1,106
Capital Expenditure	10,102	4,631	5,471
Grants and Contributions	(1,182)	(1,064)	(118)
WHOLESALE TOTEX	**32,694**	**25,540**	**7,154**

Operating Expenditure

Actual performance is favourable to the Final Determination by £0.695m. A number of net movements underpin this performance.

- Wages and salaries, including pension costs were higher by 0.7m driven by increased headcount (due to operational demands) and higher pension costs.
- Investments (engineering) costs not capitalised of £0.3m were all expected to be capitalised in the FD.
- Additional costs in relation to leakage recover activity of £0.4m.
- These were offset by lower ‘chargeable works’ activity, a range of operational savings and £0.1m of management time recharged to other group companies as a result of the transaction to sell the Group.

Renewals

The renewals expenditure for the year was less than the Business Plan by £1.106m. This was due to the following:

- Slight increase in activity in the year, with only 22.7km of pipe being renewed, compared to 22km in the Business Plan.
- Lower prices from the new contractor and new installation technology. We have achieved 80% no-dig installations, as compared to 23% in AMP5.
- Increased amount capitalised in the year.

Capital Expenditure

Capital expenditure is lower than the Business Plan by £5.471m. This is primarily driven by timing differences and the significant movements are as follows:

- Several capital schemes were brought forward to 2016/17 (from 2017/18), to comply with the DWI undertakings. These related to the new Eastergate and Westergate crypto treatment plants. Expenditure on these in the year was £0.2m, versus £3.8m in the Business Plan for 2017/18, but the schemes were completed one year earlier than planned.
- An amount of £1.4m for 2017/18 was included in the Business Plan for the Farlington Wash Water Recovery Plant. However, only £0.9m was spent in the year on this scheme and it will be completed a year earlier than planned.
- New mains expenditure was higher than the Business Plan by £0.9m.
- Optional Metering was lower than the Business Plan by £0.5m.
- Water quality contact time expenditure of £0.3m was delayed to 2018/19.
- Other schemes delayed until later in the AMP are Sources (Boreholes and springs), Water Treatment Works and the Meter Yearly Replacement Programme.
- Investments department costs not capitalised of £0.3m as noted above.

£m	Year to Date
Cumulative totex over/underspend so far in the price control period	(8.947)
RCV element of customer share of cumulative totex over/underspend	(2.213)
Adjustment for ODI rewards or penalties	0.000
*RCV determined at FD at 31 March 2018	144.210
Projected 'shadow' RCV	141.997

The Final Determination average PAYG% is 75.27%.
Therefore, the % of Totex underspend that adjusts the RCV is 24.73%.

The Ofwat template for Table 4C includes a line for the customer share of the totex over/underspend. However, in the Business Plan legacy Totex Menu Model for PR14, the cost sharing rate is not applied to the RCV. We have therefore been advised to leave this line blank.

*RCV published by Ofwat, in March 2018 prices.

For the 12 months ended 31 March 2018

£'000	Water resources		Network +				Total
	Abstraction licences	Raw water abstraction	Raw water transport	[1]Raw water storage	Water treatment	Treated water distribution	
Operating expenditure							
Power	0	923	0	3	220	1,098	2,244
Abstraction charges/ discharge consents	1,322	0	0	0	0	0	1,322
Bulk supply	0	0	0	0	0	0	0
Other operating expenditure							
- Renewals expensed in year (infrastructure)	0	0	0	0	0	2,851	2,851
- Renewals expensed in year (Non-infrastructure)	0	0	0	0	0	0	0
- Other operating expenditure excluding renewals	0	1,332	0	63	2,756	8,078	12,229
Local authority and Cumulo rates	0	453	0	11	1,107	531	2,102
Total operating expenditure excluding third party services	1,322	2,708	0	77	4,083	12,558	20,748
Third party services	0	0	0	0	0	732	732
Total operating expenditure	1,322	2,708	0	77	4,083	13,290	21,480
Capital expenditure							
Maintaining the long term capability of the assets - infra	0	0	0	0	0	1,432	1,432
Maintaining the long term capability of the assets - non-infra	0	50	0	2	261	1,230	1,543
Other capital expenditure - infra	0	0	0	0	0	1,196	1,196
Other capital expenditure - non-infra	0	8	0	0	1,146	1,167	2,321
Infrastructure network reinforcement	0	0	0	0	0	39	39
Total gross capital expenditure (excluding third party)	0	58	0	2	1,407	5,064	6,531
Third party services	0	0	0	0	0	1,049	1,049
Total gross capital expenditure	0	58	0	2	1,407	6,113	7,580
Grants and contributions						(1,064)	(1,064)
Totex	1,322	2,766	0	79	5,490	18,339	27,996
Cash expenditure							
Pension deficit recovery payments	0	0	0	0	0	0	0
Other cash items	0	0	0	0	0	0	0
Totex including cash items	1,322	2,766	0	79	5,490	18,339	27,996

Unit cost information (operating expenditure)

	Licenced volume available	Volume abstracted	Volume transported	[1]Average volume stored	Distribution input volume	Distribution input volume	
Volume (Ml)	115,705	65,724	63,667	135	63,667	63,667	
Unit cost (£/Ml)	11.43	41.20	-	570.37	64.13	208.74	
Population	725,940	725,940	725,940	725,940	725,940	725,940	
Unit cost (£/pop)	1.82	3.73	-	0.11	5.62	18.31	

[1] The Company does not have any raw water storage reservoirs, with the exception of one facility at the River Itchen, which allows for 3 days of maximum abstraction from the river.

For the 12 months ended 31 March 2018

£'000	Household Unmeasured Water only	Household Measured Water only	Total
Operating expenditure			
Customer services	1,348	615	1,963
Debt management	260	44	304
Doubtful debts	582	213	795
Meter reading	0	161	161
Other operating expenditure	978	428	1,406
Total operating expenditure	3,168	1,461	4,629
Depreciation - tangible fixed assets			
- on assets existing at 31 March 2015	71	31	102
- on assets acquired since 1 April 2015	1	1	2
Amortisation - intangible fixed assets			
- on assets existing at 31 March 2015	3	2	5
- on assets acquired since 1 April 2015	121	53	174
Total operating costs	3,364	1,548	4,912
Capital Expenditure	33	15	48

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale

Household

Demand-side water efficiency - gross expenditure	
Demand-side water efficiency - expenditure funded by wholesale	0
Demand-side water efficiency - net retail expenditure	0
Customer-side leak repairs - gross expenditure	
Customer-side leak repairs - expenditure funded by wholesale	0
Customer-side leak repairs - net retail expenditure	0

4G WHOLESALE CURRENT COST FINANCIAL PERFORMANCE
INCOME STATEMENT

For the 12 months ended 31 March 2018

£'000	Note	Water	Total
Revenue		34,235	34,235
Operating expenditure		(21,480)	(21,480)
Capital maintenance charges	1	(11,956)	(11,956)
Other operating income		(16)	(16)
Current cost operating profit		783	783
Other income		64	64
Interest income		1,187	1,187
Interest expense		(7,603)	(7,603)
Other Interest expense		0	0
Current Cost Profit before tax and fair value movements		(5,569)	(5,569)
Fair value gains/(losses) on financial instruments		0	0
Current Cost Profit before tax		(5,569)	(5,569)

1. CAPITAL MAINTENANCE CHARGES

The Capital Maintenance charges (£11,950) include the Wholesale amount of the Current Cost Depreciation £6.305m and the Infrastructure Renewals Charge £5.645m.

Current Cost Depreciation

	Operational Assets	Infrastructure Assets	Other Tangible Assets	Total
GROSS REPLACEMENT COSTS				
At 1st April 2017	252,438	1,056,778	22,596	1,331,812
Reclassification				0
RPI Adjustment	8,436	35,318	737	44,491
Disposals		(63)	(448)	(511)
Additions	1,619	4,163	1,715	7,497
At 31st March 2018	**262,493**	**1,096,196**	**24,600**	**1,383,289**
DEPRECIATION				
At 1st April 2017	120,228	-	15,768	135,996
Reclassification				0
RPI Adjustment	4,018		518	4,536
Disposals during year			(90)	(90)
Charge for year	4,638		1,773	6,411
At 31st March 2018	**128,884**	**-**	**17,969**	**146,853**
NET BOOK VALUE				
At 31st March 2018	**133,609**	**1,096,196**	**6,631**	**1,236,436**
At 1st April 2017	132,210	1,056,778	6,828	1,195,816
DEPRECIATION				
WHOLESALE	4,638	-	1,673	**6,311**
RETAIL	-	-	97	**97**
	4,638	**-**	**1,770**	**6,408**

Infrastructure Renewals Charge

<u>Estimation of Infrastructure Renewals Charge at 2017/18 prices</u>

	£'000	
Actual expenditure 16/17	4,751	
Budget 2017/18	4,855	(£5,000k at 17/18 prices)
Business Plan 2018/19 - 2031/32	5,710	
Average Cost over 15 years	**5,645**	

For the 12 months ended 31 March 2018

	Units	Metric
Net debt	£m	91.695
Regulated equity	£m	52.515
*Regulated gearing	%	63.58
Post tax return on regulated equity	%	0.00
**RORE (return on regulated equity)	%	5.37
Dividend yield	%	2.48
Retail profit margin - Household	%	-0.70
Retail profit margin - Non-Household	%	0.00
Credit rating	n/a	BBB
Return on RCV	%	4.57
Dividend cover	dec	0.02
Funds from operations (FFO)	£m	8.367
Interest cover (cash)	dec	3.10
Adjusted interest cover (cash)	dec	1.69
FFO/Debt	dec	0.09
Effective tax rate	%	98.04
Free cash flow (RCF)	£m	6.092
RCF/capex	dec	0.76

Revenue (actual)	£m	38.549
EBITDA (actual)	£m	12.440

Proportion of borrowings which are fixed rate	%	0.26
Proportion of borrowings which are floating rate	%	2.79
Proportion of borrowings which are index linked	%	96.94
Proportion of borrowings due within 1 year or less	%	2.79
Proportion of borrowings due in more than 1 year but no more than 2 years	%	0
Proportion of borrowings due in more than 2 years but no more than 5 years	%	0
Proportion of borrowings due in more than 5 years but no more than 20 years	%	96.94
Proportion of borrowings due in more than 20 years	%	0.26

* As explained in note 24 and Table 1E, year end cash balances include atypical cash of £11.037m. This has been excluded for the purpose of calculating gearing and this adjusted gearing figure has been used in other calculations to ensure consistency.

** Cumulative average ratio over 2015/16, 2016/17 and 2017/18.

RORE MOVEMENTS COMPARED TO BASE RORE SET AT PR14

RORE metrics were set at the last price review, for each of the 5 years of the AMP.

2015/16 FD RORE 5.88%
2016/17 FD RORE 5.87%
2017/18 FD RORE 5.70% (Adjusted from 5.86%, to remove non-household business)

Adjustments have been made to these metrics, to reflect the actual results in each year.

2015/16 Adjusted RORE 4.01%
2016/17 Adjusted RORE 3.97%
2017/18 Adjusted RORE 5.30% (8.14% including exceptional gain on disposal) of NHH

The average RORE for the first 3 years of the AMP is 5.37%. (Using 8.14% in 2017/18)

The adjustments are explained below, and all numbers are in 2012/13 prices.

2012/13 PRICES	2015/16	2016/17	2017/18	
NET INCOME – Final Determination	2.644	2.680	2.667	Used to calculate FD RORE %'s
Operating cost adjustments	(0.492)	(0.512)	0.348	Includes Totex, Retail and ODI variances
Gain on disposal of NHH business			1.641	Exceptional item in the year
Depreciation adjustment	0.005	0.005	0.013	Based on run-off rate of 3.8%
Interest adjustment	(0.569)	(0.578)	(0.592)	Based on real cost of debt of 3.6%
Tax on adjustments	0.211	0.217	(0.267)	Tax rate of 19%
NET INCOME - Adjusted	**1.799**	**1.812**	**3.808**	Used to calculate adjusted RORE %'s
REGULATED EQUITY	**44.930**	**45.623**	**46.757**	
Adjusted RORE	**4.01%**	**3.97%**	**8.14%**	

<u>Revenue Adjustment and Gain on Disposal</u>
Due to the sale of the Non-Household Retail business, there is no longer any associated Retail profit. This amounts to £0.072m and has been deducted from the Final Determination net income. In addition, there is an exceptional gain on disposal in 2017/18 of £1.641m. The overall impact of this transaction is £1.569m, and this equates to +2.68% on the 2017/18 RORE.

<u>Totex PAYG Adjustments</u>
These reflect favourable Wholesale totex variances, adjusted for timing differences, as follows:

2015/16 £1.093m
2016/17 £0.492m
2017/18 £0.533m

Of these amounts, 75.7% is PAYG opex and 24.3% is added to the RCV and depreciated at a run-off rate of 3.8%. There is also a cost-sharing arrangement for the Totex over-performance of 50.7%. The favourable variances relate mainly to savings in the renewals programme as a result of the appointment of a new contractor and improved technology.

<u>Retail Operating Cost Adjustments</u>
These reflect the adverse Retail operating cost variances as follows:

2015/16 (£0.613m)
2016/17 (£0.701m)
2017/18 (£0.466m)

See commentary on page 45 for an explanation of these variances.

<u>ODI Adjustments</u>
A penalty was accrued for in 2015/16 of £0.281m, relating to water quality failures. This amount was reversed in 2017/18 following accounting advice from our new auditors.

<u>Interest Cost Adjustments</u>
These reflect the higher actual cost of debt as compared to the Final Determination of 2.84%. The actual cost of debt is 3.6% and this is applied to the notional level of net debt. The difference between this and the interest allowed in the FD is used to adjust the RORE metric. These adjustments are shown in the table above.

SECTION 4 ADDITIONAL REGULATORY INFORMATION - continued

4J ATYPICAL EXPENDITURE BY BUSINESS UNIT – WHOLESALE WATER

For the 12 months ended 31 March 2018

£'000	Water resources		Network +				Total
	Abstraction licences	Raw water abstraction	Raw water transport	[1]Raw water storage	Water treatment	Treated water distribution	
Operating expenditure (exclu. atypicals)							
Power	0	923	0	3	220	1,098	2,244
Abstraction charges/ discharge consents	1,322	0	0	0	0	0	1,322
Bulk supply	0	0	0	0	0	0	0
Other operating expenditure							
- Renewals expensed in year (infrastructure)	0	0	0	0	0	2,851	2,851
- Renewals expensed in year (Non-infrastructure)	0	0	0	0	0	0	0
- Other operating expenditure excluding renewals	0	1,332	0	63	2,756	8,078	12,229
Local authority and Cumulo rates	0	453	0	11	1,107	531	2,102
Total operating expenditure excluding third party services	1,322	2,708	0	77	4,083	12,558	20,748
Third party services	0	0	0	0	0	732	732
Total operating expenditure	1,322	2,708	0	77	4,083	13,290	21,480
Capital expenditure (excl. atypicals)							
Maintaining the long term capability of the assets - infra	0	0	0	0	0	1,432	1,432
Maintaining the long term capability of the assets - non-infra	0	50	0	2	261	1,230	1,543
Other capital expenditure - infra	0	0	0	0	0	1,196	1,196
Other capital expenditure - non-infra	0	8	0	0	1,146	1,167	2,321
Infrastructure network reinforcement	0	0	0	0	0	39	39
Total gross capital expenditure (excluding third party)	0	58	0	2	1,407	5,064	6,531
Third party services	0	0	0	0	0	1,049	1,049
Total gross capital expenditure	0	58	0	2	1,407	6,113	7,580
Grants and contributions						(1,064)	(1,064)
Totex	1,322	2,766	0	79	5,490	18,339	27,996
Cash expenditure (exclu. atypicals)							
Pension deficit recovery payments	0	0	0	0	0	0	0
Other cash items	0	0	0	0	0	0	0
Totex including cash items	1,322	2,766	0	79	5,490	18,339	27,996
Atypical expenditure							
							0
							0
							0
Total atypical expenditure	0	0	0	0	0	0	0
Total expenditure	1,322	2,766	0	79	5,490	18,339	27,996

For the 12 months ended 31 March 2018

£'000	Expenditure in report year						
	Water resources		Network +				Total
	Abstraction licences	Raw water abstraction	Raw water transport	[1]Raw water storage	Water treatment	Treated water distribution	
Enhancement capital expenditure by purpose							
NEP - Making ecological improvements at abstractions (Habitats Directive, SSSI, NERC, BAPs)		4					4
NEP - Eels Regulations (measures at intakes)		4					4
Bulk supply							0
Addressing low pressure							0
Improving taste/ odour/ colour							0
Meeting lead standards							0
Supply side enhancements to the supply/demand balance (dry year critical/ peak conditions)							0
Supply side enhancements to the supply/demand balance (dry year annual average conditions)							0
Demand side enhancements to the supply/demand balance (dry year critical/ peak conditions)							0
Demand side enhancements to the supply/demand balance (dry year annual average conditions)							0
New developments						1,235	1,235
New connections element of new development (CPs, meters)							0
Investment to address raw water deterioration (THM, nitrates, Crypto, pesticides, others)					1,142		1,142
Resiliance							0
SEMD					4		4
NEP - Investigations							0
Improvements to river flows							0
Metering (excluding cost of providing metering to new service connections) - meters requested by optants						749	749
Metering (excluding cost of providing metering to new service connections) - meters introduced by companies							0
Metering (excluding cost of providing metering to new service connections) - other							0
Boundary Boxes						418	418
							0
							0
Total enhancement capital expenditure	0	8	0	0	1,146	2,402	3,556

For the 12 months ended 31 March 2018

	Cumulative expenditure on schemes completed in report year						
	Water resources		Network +				Total
£'000	Abstraction licences	Raw water abstraction	Raw water transport	[1]Raw water storage	Water treatment	Treated water distribution	
Enhancement capital expenditure by purpose							
NEP - Making ecological improvements at abstractions (Habitats Directive, SSSI, NERC, BAPs)		4					4
NEP - Eels Regulations (measures at intakes)		4					4
Bulk supply							0
Addressing low pressure							0
Improving taste/ odour/ colour							0
Meeting lead standards							0
Supply side enhancements to the supply/demand balance (dry year critical/ peak conditions)							0
Supply side enhancements to the supply/demand balance (dry year annual average conditions)							0
Demand side enhancements to the supply/demand balance (dry year critical/ peak conditions)							0
Demand side enhancements to the supply/demand balance (dry year annual average conditions)							0
New developments						1,235	1,235
New connections element of new development (CPs, meters)							0
Investment to address raw water deterioration (THM, nitrates, Crypto, pesticides, others)					1,142		1,142
Resiliance							0
SEMD					4		4
NEP - Investigations							0
Improvements to river flows							0
Metering (excluding cost of providing metering to new service connections) - meters requested by optants						749	749
Metering (excluding cost of providing metering to new service connections) - meters introduced by companies							0
Metering (excluding cost of providing metering to new service connections) - other							0
Boundary Boxes						418	418
							0
							0
Total enhancement capital expenditure	0	8	0	0	1,146	2,402	3,556

4P NON-FINANCIAL DATA FOR WR, WT AND WD – WHOLESALE WATER

For the 12 months ended 31 March 2018

Water Resources	Units	Input
Proportion of distribution input derived from impounding reservoirs	Propn 0 to 1	0
Proportion of distribution input derived from pumped storage reservoirs	Propn 0 to 1	0
Proportion of distribution input derived from river abstractions	Propn 0 to 1	0.129
Proportion of distribution input derived from groundwater works,excluding managed aquifer recharge (MAR) water supply schemes	Propn 0 to 1	0.871
Proportion of distribution input derived from artificial recharge (AR) water supply schemes	Propn 0 to 1	0
Proportion of distribution input derived from aquifer storage and recovery (ASR) water supply schemes	Propn 0 to 1	0
Number of impounding reservoirs	nr	0
Number of pumped storage reservoirs	nr	0
Number of river abstractions	nr	1
Number of groundwater works excluding managed aquifer recharge (MAR) water supply schemes	nr	20
Number of artificial recharge (AR) water supply schemes	nr	0
Number of aquifer storage and recovery (ASR) water supply schemes	nr	0
Total number of sources	nr	21
Total number of water reservoirs	nr	1
Total capacity of water reservoirs	Ml	135
Total number of intake and source pumping stations	nr	21
Total number of raw water transfer stations	nr	0
Total capacity of intake and source pumping stations	kW	6596
Total capacity of raw water transfer pumping stations	kW	0
Total length of raw water mains and conveyors	km	25.39
Average pumping head – resources	m.hd	30.69
Average pumping head – raw water transport	m.hd	0
Water Treatment		
Total water treated at all SW simple disinfection works	Ml/d	0
Total water treated at all SW1 works	Ml/d	0
Total water treated at all SW2 works	Ml/d	0
Total water treated at all SW3 works	Ml/d	0
Total water treated at all SW4 works	Ml/d	0
Total water treated at all SW5 works	Ml/d	23.16
Total water treated at all SW6 works	Ml/d	0
Total water treated at all GW simple disinfection works	Ml/d	65.19
Total water treated at all GW1 works	Ml/d	0
Total water treated at all GW2 works	Ml/d	12.10
Total water treated at all GW3 works	Ml/d	0
Total water treated at all GW4 works	Ml/d	78.46
Total water treated at all GW5 works	Ml/d	0
Total water treated at all GW6 works	Ml/d	0
Total water treated at more than one type of works	Ml/d	0
Total number of SW simple disinfection works	nr	0
Total number of SW1 works	nr	0
Total number of SW2 works	nr	0
Total number of SW3 works	nr	0
Total number of SW4 works	nr	0
Total number of SW5 works	nr	1
Total number of SW6 works	nr	0
Total number of GW simple disinfection works	nr	13
Total number of GW1 works	nr	0
Total number of GW2 works	nr	1
Total number of GW3 works	nr	0
Total number of GW4 works	nr	6
Total number of GW5 works	nr	0
Total number of GW6 works	nr	0
Number of treatment works requiring remedial action because of raw water deterioration	nr	2
Zonal population receiving water treated with orthophosphate	000's	638.904
Average pumping head – treatment	m.hd	2.21

For the 12 months ended 31 March 2018

Water Distribution	Units	Input
Total length of potable mains as at 31 March	km	3336.6
Total length of mains relined	km	0
Total length of mains renewed	km	21.9
Total length of new mains	km	10.5
Potable water mains (<320mm)	km	2981
Potable water mains 320mm - 450mm	km	185.7
Potable water mains 450mm - 610mm	km	111.7
Potable water mains > 610mm	km	58.1
Total length of non-potable and partially treated main for supplying customers	km	0
Total length of non-potable and partially treated main for treatment	km	0
Capacity of booster pumping stations	kW	2982
Capacity of service reservoirs	Ml	484
Capacity of water towers	Ml	0
Distribution input	Ml/d	174.43
Water delivered (non-potable)	Ml/d	0
Water delivered (potable)	Ml/d	146.97
Water delivered (billed measured residential)	Ml/d	24.71
Water delivered (billed measured business)	Ml/d	88.25
Total Leakage	Ml/d	32.87
Distribution losses	Ml/d	24.37
Water taken unbilled	Ml/d	2.58
Number of lead communication pipes	nr	81727
Number of galvanised iron communication pipes	nr	18162
Number of other communication pipes	nr	207394
Number of booster pumping stations	nr	26
Total number of service reservoirs	nr	30
Number of water towers	nr	0
Total length of mains laid or structurally refurbished pre-1880	km	52.9
Total length of mains laid or structurally refurbished between 1881 and 1900	km	60.7
Total length of mains laid or structurally refurbished between 1901 and 1920	km	174.4
Total length of mains laid or structurally refurbished between 1921 and 1940	km	437.8
Total length of mains laid or structurally refurbished between 1941 and 1960	km	424.2
Total length of mains laid or structurally refurbished between 1961 and 1980	km	848.8
Total length of mains laid or structurally refurbished between 1981 and 2000	km	863.5
Total length of mains laid or structurally refurbished post 2001	km	474.2
Average pumping head – distribution	m.hd	36.36
Band Disclosure (nr)		
WTW's in size band 1	nr	6
WTW's in size band 2	nr	0
WTW's in size band 3	nr	9
WTW's in size band 4	nr	3
WTW's in size band 5	nr	2
WTW's in size band 6	nr	1
Band Disclosure (%)		
Proportion of Total DI band 1	%	1
Proportion of Total DI band 2	%	0
Proportion of Total DI band 3	%	26
Proportion of Total DI band 4	%	21
Proportion of Total DI band 5	%	24
Proportion of Total DI band 6	%	28

For the 12 months ended 31 March 2018

Properties and Population	Units	Input
Residential properties billed for measured water (external meter)	000s	66.712
Residential properties billed for measured water (not external meter)	000s	22.578
Business properties billed measured water	000s	13.816
Residential properties billed for unmeasured water	000s	204.159
Business properties billed unmeasured water	000s	1.806
Total business connected properties at year end	000s	18.321
Total residential connected properties at year end	000s	301.485
Total connected properties at year end	000s	319.806
Number of residential meters renewed	000s	2.291
Number of business meters renewed	000s	0.164
Number of meters installed at request of optants	000s	2.470
Number of selective meters installed	000s	0
Total number of new business connections	000s	0.142
Total number of new residential connections	000s	1.982
Total population served	000s	725.940
Number of business meters (billed properties)	000s	17.050
Number of residential meters (billed properties)	000s	90.805
Company area	km^2	868
Other		
Number of lead communication pipes replaced for water quality	nr	11
Total supply side enhancements to the supply demand balance (dry year critical/ peak conditions)	Ml/d	0
Total supply side enhancements to the supply demand balance (dry year annual average conditions)	Ml/d	0
Total demand side enhancements to the supply demand balance (dry year critical/ peak conditions)	Ml/d	0
Total demand side enhancements to the supply demand balance (dry year annual average conditions)	Ml/d	0
Energy consumption - network plus	kWh	14
Energy consumption - water resources	kWh	10
Energy consumption - wholesale	kWh	24
Peak factor	%	120.36%
Mean zonal compliance	%	99.93%
*Volume of leakage above or below the substainable economic level	Ml/d	1.53

*ELL=31.4 Ml/d

4V OPERATING COST ANALYSIS – WATER RESOURCES

For the 12 months ended 31 March 2018

£'000	Impounding Reservoir	Pumped Storage	River Abstractions	Groundwater, exclu. MAR water supply schemes	Artificial Recharge (AR) water supply schemes	Aquifer Storage and Recovery (ASR) water supply schemes	Total
Operating expenditure (exclu. atypicals)							
Power	0	0	68	855	0	0	923
Local authority and Cumulo rates	0	0	0	453	0	0	453
Bulk supply	0	0	0	0	0	0	0
Other direct operating expenditure				1,390			1,390
Other indirect operating expenditure	0	0	0	1,264	0	0	1,264
Total operating expenditure excluding 3rd party	0	0	68	3,962	0	0	4,030
Depreciation	0	0	0	291	0	0	291
Total operating costs excluding 3rd party	0	0	68	4,253	0	0	4,321

OTHER EXPENDITURE – WHOLESALE WATER

For the 12 months ended 31 March 2018

£'000	Water Resources	Raw Water Distribution	Water Treatment	Treated Water Distribution	Total
Other Expenditure					
Employment costs - directly allocated	17	6	669	2,826	3,518
Employment costs - indirectly allocated	539	180	1,378	2,158	4,255
Number FTEs consistent with 4V.9 above	1	0	16	67	84
Number FTEs consistent with 4V.10 above	9	3	23	36	71
Costs asscociated with Traffic Management Act	0	0	0	98	98
Service Charges					
Canal & River Trust abstraction charges/ discharge consents	0	0	0	0	0
Environment Agency abstraction charges/ discharge consents	1,322	0	0	0	1,322
Other abstraction charges/ discharge consents	0	0	0	0	0
Statutory water softening	0	0	0	0	0

DISCLOSURE OF TRANSACTIONS WITH ASSOCIATES

The transactions required to be disclosed under Condition F of the Company's Instrument of Appointment are set out below:

Borrowings or Sums Lent

There is a loan outstanding made to a Group Company, South Downs Limited, in June 2002. The balance of the loan, consisting of the principal amount and accrued interest to date, amounts to £55.484m. A repayment of £nil (2017 £0.500m) was made by South Downs Limited in the year. This loan was made as a part of the refinancing package which was carried out in the financial year 2002/03. The interest rate for the loan is based on LIBOR plus a margin.

Interest Received

A receipt of interest amounting to £831,643 in respect of the inter-company loan made to South Downs Limited in 2002 (as covered above) was received from South Downs Limited.

Dividends paid to Associated Undertakings

The dividends paid to the holding company, Portsmouth Water Holdings Limited, are shown in note 9 on page 26 of this Annual Performance Report. The dividend policy is also covered within this note.

Payments for Tax Losses

During the year Portsmouth Water made no payments to group companies relating to the surrender of tax losses to Portsmouth Water.

Supply of Services

Details of services supplied to the Appointee by associates during the year are disclosed below.

Service	Associate Company	Turnover of Associate (£000's)	Terms of Supply	Value (£000's)
Rent of operational sites Solar power income	Brockhampton Holdings Limited	322*	Market Tested Market Tested	85 19

*Brockhampton Holdings Limited accounts do not include any amounts classified as turnover. Amounts relating to rent and solar power income are included within other operating income which totals £322k of which £182k relates to total rental income and £140k relates to total income from solar power.

Directors Remuneration

There is a recharge of Directors salaries amounting to £65,217 paid to Portsmouth Water Limited by Brockhampton Holdings Limited, which represents the time spent by Portsmouth Water Executive Directors on Group matters. There are also 2 recharges to South Downs Ltd, relating to the sale of the Company. One is for £101,839, relating to time spent by N Smith, H Orton and C Hardyman and the other is for £106,779, relating to EBT Directors' fees.

Statement by Board of Directors

To the best of their knowledge, the Directors of the Company declare that all appropriate transactions with associated companies have been disclosed.

Price Control Units

Portsmouth Water has closely followed the Ofwat guidance for the allocation of costs and assets between price control units and therefore believes that there is no cross subsidy between them. Therefore, no market testing has been undertaken in 2017/18.

REPORT OF THE INDEPENDENT AUDITOR

Independent Auditor's report to the Water Services Regulation Authority (the WSRA) and Portsmouth Water Limited

Opinion

We have audited the tables within Portsmouth Water's Annual Performance Report for the year ended 31 March 2018 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D) and the net debt analysis (table 1E) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J) and the related notes.

We have not audited the Outcome performance table (tables 3A to 3S) and the additional regulatory information in tables 4A to 4W.

In our opinion, Portsmouth Water's Regulatory Accounting Statements within the Annual Performance Report:

- have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.10, RAG 4.07 and RAG 5.07) and the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.10, appendix 2), set out on pages 24 to 41.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Regulatory accounting statements within the Annual Performance Report below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to
Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory accounting statements within the Annual Performance Report section of our report. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements under the FRC Ethical Standard. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory accounting statements within the Annual Performance Report have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.10, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. The Annual Performance Report is separate from the statutory financial statements of the Company and has not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP").

Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006. The Regulatory Accounting

Statements on pages 17 to 21 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from UK GAAP. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

The Regulatory Accounting Statements are prepared in accordance with a special purpose framework for the specific purpose as described in the Responsibilities for the Annual Performance Statement and the audit section below. As a result, the Regulatory Accounting Statements may not be suitable for another purpose.

Our opinion is not modified in this respect.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is not appropriate; or
- the directors have not disclosed in the Regulatory Accounting Statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Regulatory Accounting Statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements within the Annual Performance Report and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements within the Annual Performance Report or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement or inconsistency of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Responsibilities of the Directors for the Annual Performance Report

As explained more fully in the Statement of Directors' Responsibilities set out on pages 15 to 16, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement, as defined in RAG
3.10, appendix 2). The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

In preparing the Annual Performance Report, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the Audit of the Regulatory accounting statements within the Annual Performance Report

Our objectives are to obtain reasonable assurance about whether the Regulatory accounting statements within the Annual Performance Report are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this Annual Performance Report.

As part of an audit in accordance with ISAs (UK), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the company's Annual Performance Report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.

  Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the company to cease to continue as a going concern.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the company to cease to continue as a going concern.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during the audit.
- Assess the reasonableness of significant accounting estimates and related disclosures made by the directors.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the company.

The Company has presented the allocation of operating costs and assets in accordance with the accounting policy for price control segments set out in note 1(k) and its accounting methodology statement published on the Company's website on 15 July 2018. We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK).

Opinion on other matters prescribed by Condition F Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements within the Annual Performance Report is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2018 on which we reported on 25 May 2018, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

James Ledward (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
Gateway House
Tollgate
Chandlers Ford
SO53 3TG

June 2018