Half-Year Report

2019 | Unaudited interim results for the six months ended 30 September 2019

Chairman's Statement

Mike Kirk
Chairman
28 November 2019

I am pleased to report a continued strong operating performance as we reach the mid point of the final year of the 5 year regulatory period.

The year to date continues to be busy, with the senior leadership team committing significant resource to the PR19 Business Plan and in continuing activity in preparation for the development of Havant Thicket Winter Storage Reservoir. This is a significant project for the Company and the region, with the reservoir enabling additional significant bulk water supplies to Southern Water by 2029.

The Company was confirmed as having the second highest SIM score for 2018/19 and highest overall for the regulatory period. We received the highest SIM out-performance payment in the Ofwat Draft Determination, confirming our SIM performance for the 4 years of this AMP period is industry leading. Our performance in this trial year for C-MeX shows similar good performance.

We are delighted that additional investment, together with significant innovation has allowed us to make further reductions in leakage. With leakage currently at 24.2 Ml/d we are confident that the Company will meet the 5 year average target of 29.9 Ml/d.

In parallel, our performance on interruptions to supply and water quality contacts for 2018/19 were confirmed as industry leading by Ofwat. Our performance as at the end of September 2019 is good for both of these metrics and we remain confident we will outperform our 2019/20 targets for both measures. Our performance on both metrics in AMP6 has been used by Ofwat to set industry standards for the AMP7 period (2020-25).

CEO's Statement

Bob Taylor
Chief Executive Officer
28 November 2019

Operating Results

I am pleased to present an overview of our business performance for the 6 months ended 30 September 2019.

PR14 Business Plan

The Company established 13 Outcome Delivery Incentives (ODIs) in the AMP6 period, 2015-20. We are now in the last year of the period and many of the commitments have been completed and achieved. In total we expect to achieve 11 ODIs with improvement needed in two or possibly three areas.

We have made significant progress in recent years, and maintained performance in 2019/20 H1, on water quality contacts and leakage in particular. Our water quality contacts target was not set correctly by the Company at PR14 and we will incur a penalty as a result. We have, however, made significant steps to improve performance and have industry leading performance at PR19.

In 2019 we have had 7 water quality failures at customer taps affecting our Mean Zonal Compliance performance. All failures were investigated and confirmed to relate to issues at the property, and no concern for wider water quality compliance issues arose. However, we will fail to meet our commitment for 2019. It is likely that our assessment of how much water our domestic customers use will not meet our target of 144 l/h/d. This measure is very weather dependent. 2019 was a record breaking hot / dry summer and adversely impacted this target.

ODIs	2019/20 H1	2019/20 full year forecast	Target (2019/20)	Rewards/penalty in 2019/20
Bursts	133	**342**	342 over AMP6	In deadband with neither penalty or reward applying
Mean Zonal Compliance* (%)	99.91	**99.93**	> 99.95%	Penalty is £320k for 2019
Water quality contacts* (# per 10,000 population)	0.309	**0.413**	0.421 over AMP6	AMP6 penalty reflecting prior years performance despite good performance in 2019
Temporary Usage Bans	0	**0**	0	Reputational - no penalties / rewards
Leakage (Ml/d)	24.2	**25.3**	29.9 Ml/d	Small reward likely to accrue as a result of 2019/20 performance.
Interruptions to supply (mins per property)	1 min 59 secs	**5 Minutes**	5 minutes	AMP6 reward based on prior years performance
Biodiversity Action Plan	Progress as planned	**Progress as planned**	Signed off by CCG in year 5	Penalty negated
Water Framework Directive	Completed and signed off by EA	**Completed and signed off by EA**	Completed March 2018	Penalty Negated
Carbon (increase use of renewables)	Over 95% of electricity from renewable sources	**Over 95% of electricity from renewable sources**	Actioned in 2015/16	Reputational
RoSPA Accreditation*	Awarded	**Awarded**	Awarded	Reputational
Service Incentive Mechanism	n/a	**n/a**	No target as no survey in 2019/20	Ofwat have allocated reward of £1.3m for SIM performance in AMP6.
Reducing per capita consumption (l/h/d)	n/a	**146**	144	Penalty £81k per l/h/d likely in 2019/20
Survey of developers (%)	n/a	**n/a**	70%	Survey in March 2020 - Reputational

PR19 Business Plan

In July Ofwat published its Draft Determination (DD) which will determine the revenue the Company can recover in the period 2020-25. This is the penultimate stage of the three year Price Review process.

- The DD has a number of significant financial changes relative to our revised Business Plan (1 April 2019).
- The industry Cost of Capital has been reduced relative to our revised Business Plan, by 0.21% to 3.19% on a CPIH basis.
- However, the Company Specific Premium, relating to our cost of procuring debt, remains at 0.30% on the debt element only, giving an appointed WACC of 3.36%.
- The DD proposes that Havant Thicket is subject to a separate price control for the construction period of 10 years, with a lower cost of capital at 2.72%.
- The efficiency assessment concludes that the wholesale Totex, in our revised plan, was lower than the value Ofwat believe we need to fund our business. This means that 62% of any outperformance on Totex is retained by the business.
- The ODI incentive rates have been increased for almost all of the common ODIs resulting in a significant skew towards penalties.
- The only significant change on ODI targets is that of per capita consumption, where our proposed target of 135 l/h/d by 2024/25 has been stretched further to 133 l/h/d.
- A SIM reward for 2015-20 of £1.4m was included in the determination.
- We have responded to Ofwat's challenge on leakage and have increased the AMP7 reduction from 15% to 20%

The Company submitted its Representation to Ofwat on the Draft Determination on 31 August 2019 and met with them on 10 October highlighting our increasingly difficult position on finaceability in particular.

The Board is very concerned that the reduction in the cost of capital, or material changes to other key assumptions made in our representation, result in us being barely financeable and any further reduction in the cost of capital will mean we cannot assure we are financeable in the AMP7 period.

We have engaged positively with Ofwat on their approach to Havant Thicket and believe we are able to agree a framework that addresses regulatory concerns whilst providing sufficient certainty and incentive of how the regulatory framework will apply to the Company.

The Final Determination will be published on 16 December 2019 and we expect to see the details of the Havant Thicket regulatory framework included which reflect our discussions with Ofwat.

Customer Service

The Company has achieved the highest SIM performance in the current AMP period, earning the highest reward, totalling 6% of retail revenue. There is no SIM in 2019/20 as it is a trial year for C-MeX, a new customer service measure that will be used from 2020. In the first quarter of this trial year we were 2nd in the industry for C-MeX, with a score of 81.58.

We have also been ranked 2nd in the written complaints report from CCWater for 2018/19. Our performance per 10,000 connected properties was 10.3, compared to the industry average of 24.6. In the six months to 30th September 2019, the number of written complaints was identical to the same period in the previous year.

Havant Thicket Winter Storage Reservoir

In its Draft Determination, Ofwat has indicated support for Havant Thicket and set out its proposals for a separate price control for the project. We have responded to Ofwat in a number of areas including financeability and the regulatory framework for the price control. Ofwat has since published its emerging thinking in relation to the separate price control within the license modification consultation.

The Company focus is on developing the project design to a greater maturity where project costs, risks and programme are sufficiently detailed to support submission of a planning application by September 2020. This information will also inform stages of the proposed separate price control. The Principal Designer (Atkins) commenced work on the project in July 2019. The reservoir is planned to be complete and commissioned by March 2029 to meet Southern Water's needs.

Work continues in partnership with Southern Water to develop the long-term commercial arrangements, and establish appropriate joint governance for the project during design, planning, construction and commissioning phases, with Portsmouth Water initially taking the project risk, in order to maintain momentum. Southern Water has agreed to underwrite the next tranche of project development costs until March 2020, by which time we expect to finalise the long term bulk supply agreement.

Biodiversity Management

We continue to actively manage the biodiversity on our own sites, through a combination of sensitive maintenance regimes and enhancement projects. One recent example of enhancement saw us fitting bat boxes inside a decommissioned service reservoir.

Working with others in our catchments

We continue to engage with land users in our catchments to encourage groundwater sensitive agricultural practices. In the last quarter we have delivered two equine-facing events and produced a dedicated equine leaflet. New Forest Catchment Partnership plan to use the leaflet themselves.

We have attended the East Hants, Meon Valley and Arun & Western Streams Catchment Partnership meetings and are providing ongoing updates and support to these and other groups with a similar interest.

We have continued our programme of farm visits, particularly in the Aldingbourne, Eastergate and Westergate Catchments. These include Tinwood Vineyard where 10 hectares of arable land has been changed to grow cover crops, and Eartham Partnership, where we are looking to support cover crop planting and other precision farming methods from 2020 onwards.

Capital programme

New Mains activity has been above average in the first 6 months of the year with 7,450m of mains renewals being laid to date. This is slightly ahead of the 7,150 target. Expenditure has been higher than targeted at £2.54m. This is mostly as a result of the significant amounts of main laying undertaken in heavily populated areas, which is, on average, more costly than rural areas.

Major capital schemes

Gross capital investment in the half year was £7.3m (30 September 2018 - £5.0m). Amounts totalling £1.4m relating to the development of Havant Thicket reservoir were included in this balance.

We are undertaking a number of schemes associated with ensuring adequate disinfectant contact time. This work includes the construction of a new booster station between Farlington and Racton, and the rebuilding of Lavant WTW with UV treatment. Work is also progressing on the River Itchen WTW Eel screen replacement. This £2.2m scheme will see the replacement and upgrading of the intake screens to stop eels being drawn into the works. As part of the same scheme, we will be installing a second pipe crossing at the River Wallington. This will significantly improve our resilience at this critical crossing point on the Hoads Hill to Nelson transfer main.

Leakage

The Company has made significant improvements in the first half of 2019/20. Since April, we have reduced the amount of water lost through our network by 25%, from 28 Ml/d to 21 Ml/d. This level of leakage equates to 64 litres per property per day, lower than 2018/19 leakage figures for all water companies in the UK.

Our leakage programme has benefited from the use of innovative leak detection technologies, including fixed and mobile noise loggers. This technology has not only made us quicker at detecting and repairing leaks, but also increased the number of leaks that we are able to find. Our current leak detection levels have increased by 145% on the previous year for the same available resource.

Leakage is a very high profile issue with customers, and there are wide ranging views from customers and stakeholders. We understand the critical role lowering leakage has on reducing abstraction, encouraging water efficiency and increasing resilience. We are therefore proud that our current leakage level is a historic low for the Company and puts us in a strong position to meet the challenges of PR19.

Health & Safety

The first half of the year has provided opportunities for us to continue our culture of outstanding Health and Safety practices, in accordance with our RoSPA accreditations.

A company-wide conference, specifically aimed at our behavioural Health and Safety culture, was held at our Head Office site and was attended by all employees. This continued our theme of – "Stay alert, don't get hurt". We also conducted a 'tyre and wiper blade' inspection initiative on all Company and private staff vehicles. In addition, courses were held regarding the best practices for cleaning service reservoirs.

We continue our focus on mental health and wellbeing, with the introduction of our Mental Wellness ambassadors and held activities during World Mental Health Day. During the first six months an unfortunate RIDDOR incident occurred. This was effectively dealt with and we have taken immediate action to reassess any further risks.

Investing in our People - a highly skilled and motivated workforce delivering for our customers

We work hard to ensure that our staff continually demonstrate behaviours which align with our core values - Excellence, Respect and Integrity. We believe this work is key to successfully achieving our vision of "delivering excellence". We continue to invest heavily in our people and have utilised over £170K from the Apprenticeship Levy - this has largely been allocated to our front line operations staff. This helps ensure that we have the best trained staff delivering the best service to our Customers. In a recent employee survey 96% of staff said they are "Proud to work for Portsmouth Water" which is a remarkable result in the current economic climate. We have also been pleased to launch the Company's 'Young People's Board'.

Brexit

The Company has carried out significant preparatory work since Autumn 2018 in connection with Brexit where the main risk has been identified as a loss of continuity of chemical supplies and other consumables in the event of a 'hard Brexit'. We consider that we are well placed to continue to provide our high standard of customer service and maintain supplies in the event of a 'no deal' Brexit scenario.

Throughout the summer period, we maintained winter stock levels of fittings, and have put in place real time monitoring to help us manage essential water treatment chemicals. We have taken a conservative approach to chemical stock levels and have, in all cases, exceeded the agreed industry standard of 2 weeks supply.

In addition, we have jointly accumulated 46,000 litres of diesel with our partner, Cappagh. The fuel will be used in the event of a Brexit related fuel shortage and will help both Companies maintain essential services.

We have taken action to help mitigate the anticipated traffic disruption at Portsmouth International Port (PIP) during Brexit. Working closely with Portsmouth City Council, we have relocated stores of essential equipment on the island of Portsmouth.

We also produce reporting for the entire industry and to Defra on a daily basis and are actively involved in the Water UK Brexit Incident Management Groups.

Development of Non-Appointed Business

Non-appointed revenue streams have received additional focus this year, with the appointment of a new Commercial Director. Existing activity is being reviewed and where appropriate new agreements and corresponding rates are being negotiated. In addition, a number of new initiatives are being investigated with the expectation of an increase in non-appointed revenues from 2020 onwards.

Financial Results

Helen Orton
Finance and Regulation Director
28 November 2019

The results for the period have been prepared in compliance with UK Accounting Standards and reflect the provisions of Financial Reporting Standard 102 (FRS102) and on a Going Concern basis. A summary of the financial performance for the 6 months to 30 September 2019 is set out below.

	6 months to 30 September 2019 £m	6 months to 30 September 2018 £m
Turnover	21.4	20.9
Operating costs (excluding depreciation)	(15.0)	(14.0)
Depreciation and amortisation	(3.1)	(2.9)
Profit before exceptional items	3.3	4.0
Loss on disposal of Fixed Asset	0.1	(0.2)
Profit before interest and tax	3.4	3.8

Revenue

An increase of £0.5m in revenue is attributable to an increase in Measured Supplies and Bulk Supply offset by a fall in Chargeable Work revenue. The Measured Supplies revenue (increase of £0.441m) is driven by a modest tariff increase and new properties and optants, increased Bulk Supply to Southern Water (£0.209m) represents additional amounts of water transferred and this has been offset by a (£0.374m) reduction in Chargeable Work revenue (timing of activity undertaken).

Operating Profit

Operating profit at £3.3m shows a reduction of £0.7m on the prior period of £4.0m. This was primarily driven by additional costs as discussed further below.

Operating Costs

The six month period to 30th September 2019 has seen a small overall decrease in net operating expenses which has been offset by an increase in cost of sales, the most significant of which is below.

Description	£000
Head count	469
Network contractors - (including reinstatement and backfill)	306
Contractor maintenance at operational sites	264
Depreciation	205
Leakage	185
General contractors	72
Trade effluent	55
Mains renewals	(250)
Periodic Review Costs - PR19	(352)

Cash and Cash Flow

Operating cash flow in the half year of £4.8m outflow, is higher than in the prior half year period (2018 cash outflow - £3.3m) due to a higher level of capex cash spend.

During the period, £7m was repaid under the revolving capital facility and an amount of £10m was drawn down at the half year end. This is largely to offset the high level of capital spend, relating to the profile of our capital programme and also Havant Thicket spend.

Capital contributions

The Company receives capital contributions, primarily in connection with new mains for housing developments. In accordance with the requirements of FRS102 these contributions are deferred and amortised to the Income Statement. Amounts received in the half year were £0.6m (September 2018 £0.7m) with £0.3m (September 2018 £0.3m) released within the year to turnover.

The period-end cash balance was £18.3m (2018 - £17.1m).

Interest and other finance income

Interest payable between the two periods is consistent and in line with RPI expectations. Other finance income remains constant for the two periods at £100k.

Financing

The Company has a £15m working capital facility and a £0.5m overdraft facility. The working capital facility was renewed for a further five years in August 2017. At 30 September the utilised working capital facility was £10m (30 September 2018 - £2.5m utilised).

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

Ratios

Gearing

Net debt to regulatory capital value is a key covenant defined by the Company's index linked loan documents. Gearing at 67.7% (30 September 2018 - 64.5%) has remained broadly consistent from the prior year. Gearing remained comfortably within the 86% ceiling imposed by the bond covenants.

Artesian Interest cover

The interest cover ratio, of 1.61 times (September 2018 - 1.43 times) remains above the 1.4 times covenant required.

Pensions

The Company is the principal employer of the Brockhampton Pension Scheme, a defined benefit scheme. The latest valuation as at 31 March 2019 based on FRS102 assumptions and market movements was calculated and estimates a net pension asset (after deferred tax) of £23.782m (March 2018 value after deferred tax £24.794m). A full FRS102 actuarial valuation will be undertaken at the year end in line with UK GAAP requirements.

Credit Rating

The Company has a credit rating with both Standards and Poor's (S & P) and Moody's. The rating with S & P remained unchanged at BBB and Moody's remained at Baa1. Moody's moved to negative watch in October 2017 and stated "The outlook change to negative reflects Portsmouth Water's exposure to the likely cut in allowed returns from 2020, as guided by the regulator in its final PR19 methodology".

Outlook

As we progress through the second half of the final year of the regulatory price review, the business will be focused on continuing to deliver exceptional customer service, alongside the challenges of delivering against our ODI performance targets particularly in relation to water quality contacts and per capita consumption. In addition, the activity in relation to progressing planning for the Havant Thicket Winter Storage Reservoir project, will materially increase during this period as we move into the next stage of the project.

We will continue to see a focus on cost reduction and efficiency savings to offset other cost pressures seen in the business.

The Ofwat Final Determination is due to be received on the 16th December 2019.

Income Statement

Unaudited interim results for the six months ended 30 September 2019

	6 months ended 30 September 2019 £000	6 months ended 30 September 2018 £000	12 months ended 31 March 2019 £000
Turnover	**21,339**	20,940	42,161
Cost of sales	**(12,621)**	(11,352)	(23,111)
Gross profit	**8,718**	9,588	19,050
Net operating expenses	**(5,446)**	(5,623)	(11,124)
Operating profit before loss on disposal of fixed assets and exceptional items	**3,272**	3,965	7,926
Gain/(loss) on sale of fixed assets	**106**	(189)	(494)
Exceptional staff costs relating to sale of business	**-**	-	(2,422)
Profit on ordinary activities before interest	**3,378**	3,776	5,010
Investment income	**515**	506	957
Other finance income	**100**	100	762
	3,993	4,382	6,729
Finance costs	**(3,571)**	(3,701)	(7,444)
Profit/(loss) on ordinary activities before taxation	**422**	681	(715)
Taxation of profit /(loss) on ordinary shares	**-**	89	(7)
Profit/(loss) for the financial period	**422**	770	(722)
Statement of other comprehensive income			
Profit/(loss) for the financial period	**422**	770	(722)
Remeasurement of net defined benefit asset	**-**	-	(1,170)
Movement in deferred tax relating to pension asset	**-**	-	199
Total comprehensive income for the period	**422**	770	1,693

Statement of Other Comprehensive Income

As at 30 September 2019

	As at 30 September 2019 £000	As at 30 September 2018 £000	As at 31 March 2019 £000
Profit/(loss) for the financial period	**422**	770	(722)
Remeasurement of net defined benefit asset	**-**	-	(1,170)
Movement in deferred tax relating to pension asset	**-**	-	199
Total comprehensive income for the period	**422**	770	1,693

Summarised Statement of Financial Position

As at 30 September 2019

	As at 30 September 2019 £000	As at 30 September 2018 £000	As at 31 March 2019 £000
Non current assets	**197,391**	186,768	193,061
Current assets	**26,087**	26,531	36,564
Creditors: Amounts falling due within one year	**(28,260)**	(23,312)	(36,773)
Net current (liability)/assets	**(2,174)**	3,219	(209)
Total assets less current liabilities	**195,217**	189,987	192,852
Creditors: Amounts falling due after more than one year	**(135,640)**	(130,887)	(133,847)
Provisions for liabilities	**(6,919)**	(6,676)	(6,919)
Net assets excluding pension asset	**52,658**	52,424	52,086
Pension asset	**23,632**	24,794	23,782
Net assets including pension asset	**76,290**	77,218	75,868
Capital and reserves			
Called up share capital	**1,078**	1,078	1,078
Reserves	**75,212**	76,140	74,790
Shareholders' funds	**76,290**	77,218	75,868

Summarised Statement of Changes in Equity

As at 30 September 2019

	6 months ended 30 September 2019 £000	6 months ended 30 September 2018 £000	12 months ended 31 March 2019 £000
Called up share capital	**1,078**	1,078	1,078
Share premium account	**4,527**	4,527	4,527
Capital redemption reserve	**3,250**	3,250	3,250
Retained earnings brought forwards	**64,591**	69,360	69,360
Balance	**73,446**	78,215	78,215
Profit/(loss) for the period	**422**	770	(722)
New share capital/premium issued	**2,422**	-	2,422
Remeasurement of defined benefit asset	**-**	-	(1,170)
Movement of deferred tax relating to pension scheme	**-**	-	199
Effect of change in corporation tax rate on pension asset	**-**	-	-
Total comprehensive income for the period	**76,290**	78,985	78,944
Dividends	**-**	(1,767)	(3,076)
Closing balance	**76,290**	77,218	75,868

Summarised Statement of Cash Flows

For the six months ended 30 September 2019

	6 months ended 30 September 2019 £000	6 months ended 30 September 2018 £000	12 months ended 31 March 2019 £000
Cash (used)/generated from operations	**(4,611)**	(3,265)	9,797
Investing Activities			
Sale of tangible fixed assets	**160**	9	-
Purchase of tangible fixed assets	**(6,048)**	(5,050)	(13,896)
Purchase of intangible fixed assets	**-**	-	(112)
Capital contributions and infrastructure charges received	**605**	710	1,404
Interest received	**-**	381	957
Net cash used in investing activities	**(5,283)**	(3,950)	(11,647)
Cash flows from financing activities			
Net (Repayment) working capital facility	**3,000**	(500)	7,000
Inter-company loan	**-**	1,800	-
Interest on index linked loan	**(2,013)**	(1,953)	(3,867)
Interest on other loan facilities	**-**	(40)	(163)
Dividend payments	**-**	(1,767)	(3,076)
Equity payment received	**-**	-	2,422
Net cash generated/(used in) financing activities	**987**	(2,460)	2,316
Net (decrease)/ increase in cash and cash equivalents	**(8,907)**	(9,675)	466
Cash at beginning of year	**27,210**	26,744	26,744
Cash and equivalents at end of year	**18,303**	17,069	27,210
Comprising			
Debt Service Account	**2,013**	1,953	1,968
Other Cash accounts	**16,290**	15,116	25,242
Cash and equivalents at end of year	**18,303**	17,069	27,210

Notes

1. The interim results for the six months to 30 September 2019 have been prepared under FRS102 and on the basis of accounting policies consistent with those adopted for the year ended 31 March 2019.

   The interim financial information is unaudited and does not constitute statutory accounts as defined in s.434 of the Companies Act 2006. The results for the year to 31 March 2019 have been extracted from the latest published accounts, which have been filed with the Registrar of Companies and on which the report of the auditors was unqualified.

2. The tax charge is based on the estimated effective rate of tax, including deferred tax, for the full year to 31 March 2019.

3. Copies of the interim report are available to the public from the Company's Registered Office, P O Box 8, West Street, Havant, Hants PO9 1LG or from our website www.portsmouthwater.co.uk/news/publications/accounts.

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Portsmouth
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